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Hawtrey, Austerity, and the 'Treasury View,' 1918-25

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In Great Britain the seven years following WWI were marked by rigorous austerity policies. From 1918 to 1925 the main objectives were budget cuts and monetary deflation. Certainly, being the central department for financial policies, the British Treasury had decisive authority in setting such economic agenda. In particular, the official who had the greatest weight with chancellors of the Exchequer was the Controller of Finance, Basil P. Blackett (1917-1922), followed by Sir Otto Niemeyer (1922-1927). Their papers in the Treasury files reveal that the economist Ralph Hawtrey was the primary source of economic knowledge for Blackett and especially for Niemeyer. This work proves that Hawtrey's original economic theory provided solid theoretical justifications for the austerity policies. Hawtrian economics refined and strengthened the economic stance of the senior officials of the British Treasury. This study draws on Hawtrey's most important scientific works together with his press articles and copious Treasury papers to unravel the conceptual building blocks of Hawtrey's austerity doctrine. It emerges that his policy prescriptions ensued directly from his economic model. Hawtrey advocated monetary stabilization through the management of the bank rate, budgetary rigor, and rejection of public investment, all of which became widely established goals among other orthodox economic institutions, from the Bank of England to the League of Nations. This paper reveals that, in the early post WWI years, economic theory had clear operative force on policymaking.

Keywords: Ralph Hawtrey, Austerity, Treasury View, Interwar Years, Deflation, Savings.

JEL categories: N 44, N 14, B 13, B 41

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INTRODUCTION

In Great Britain the seven years following WWI were marked by rigorous austerity policies.[2] From 1918 to 1925 the main objectives were budget cuts and monetary deflation. Certainly, being the central department for financial policies, the British Treasury had decisive authority in setting such economic agenda. In particular, the official who had the greatest weight with chancellors of the Exchequer was the Controller of Finance, Basil P. Blackett (1917-1922), followed by Sir Otto Niemeyer (1922-1927). Their papers in the Treasury files are virtually the only direct source of information we have about their economic outlook and policies. The papers reveal that the economist Ralph Hawtrey was the primary source of economic knowledge for Blackett and especially for Niemeyer. Hawtrey's memoranda were often underlined, studied, exchanged, and discussed, not only among the Treasury officials but also with Montagu Norman, the powerful Governor of the Bank of England. Such archival evidence is a basis for challenging the conventional account of Hawtrey as a man of the backwaters, the "unworldly" intellectual who was excluded from British post-war policymaking. This interpretation has been long-lived, since Black wrote Hawtrey's famous obituary (Black 1977). The studies of Howson (1985) and Gaukroger (2008) show how, up to 1925, Hawtrey" was able on occasion to use his position in the Treasury to exert some influence on the attitudes of policymakers, if not on the policies actually adopted" (Howson 1985, 143). Indeed, they stress that "Hawtrey had been influential in the early 1920s when other economists were not" (Howson 1985, 177).

This paper takes a different angle. Rather than focus on the episodes in which Hawtrey had an active say in policymaking, I will evaluate Hawtrey's economic ideas in relation to the austerity policies that the Treasury supported. How did Hawtrey's economic arguments engage with policy? Did Hawtrey support post-war austerity? If so, what were his theoretical reasons?

These research questions have a meaning that goes beyond a mere biographical study of Ralph Hawtrey. They serve as an approach to a better understanding of the nature of the so-called "Treasury view," that spending on public works crowds out private investment. Was the Treasury view the upshot of economic theory or rather of practical knowledge?[3] If one found that Hawtrey did not support the austerity agenda, it would help confirm the weakness of economic theory compared to the institutionalized orthodoxy in the thinking of the senior Treasury officials Niemeyer and Blackett, who best personified the Treasury view. This would be in line with Tomlinson (1981) and Middleton (1985, 1987), who have described the Treasury view as a pragmatic stance that took into consideration principally, if not solely, the political and administrative constraints of the time—factors that a Treasury official could not ignore. In their view, the

[2] In this paper I adopt the common definition of austerity. The formulation by Blyth (2013) is the clearest: "Austerity is a form of voluntary deflation in which the economy adjusts through the reduction of wages, prices, and public spending to restore competitiveness, which is (supposedly) best achieved by cutting the State's budget, debts and deficits" (2).

[3] This debate also entails a different interpretation of the successive evolution of the Treasury view in the thirties: was the Treasury's difficulty in accepting the Keynesian insights a matter of theoretical convictions or rather of administrative constraints? See Middleton (1985, 1987) and Howson and Winch (1977).

influence of economists and economic ideas were considered secondary or even irrelevant to practical concerns that shaped the thinking of Treasury officials.

In contrast, this work will prove that Hawtrey's original economic theory provided solid theoretical justifications for the austerity policies. Hawtrey's theory differed from classical economics and was the one which Niemeyer and Blackett were well acquainted with and, for the most part, agreed with. In fact, there are good reasons to suppose that Hawtrian economics refined and strengthened the economic stance of the senior officials of the British Treasury. This finding bolsters the positions of Howson and Winch (1977),[4] Clarke (1988), and Peden (1983a, 1984, 1996, 2000, 2004),[5] who, in varying degrees, recognized the importance of economic ideas, particularly of Hawtrian economic theory, for the constitution of the Treasury view. It was Hawtrey himself who, in a 1966 interview with Sir Alec Cairncross, asserted that Keynes attacked the Treasury view "because it was his view" (HTRY 13/5). Here Hawtrey was referring specifically to the renowned crowding-out argument. Nonetheless, an in-depth analysis of his published and unpublished works reveals that his economic theory informed the Treasury view in a much deeper sense. To be sure, my work does not disregard the moral, political, and practical aspects that were unavoidable components of the Treasury view.[6] Yet here the focus is on the importance of theoretical beliefs, chiefly of Hawtrey's economic doctrine, in justifying the economic policies of austerity. Hitherto no scholar has systematically investigated the basis of Hawtrey's support for such policies.

This study draws on Hawtrey's most important scientific works together with his press articles and copious Treasury papers. The exposition is thematic. Rather than give a general account of Hawtrey's theory, I focus on certain conceptual building blocks that are crucial to grasp the theoretical basis of his policy prescriptions in favor of austerity. [7] The first section provides the relevant historical background. I show that from 1918-1925 Britain experienced severe austerity measures, and demonstrate Hawtrey's influence on the Treasury and the Court of the Bank of England, the two most influential decision making bodies. Section II examines Hawtrey's archival documentation in order to unravel his main policy prescriptions up to 1925, which I prove to be an austerity agenda. Section III constitutes the main body of the article, in which I explore the Hawtrian economic beliefs, which were the source of his practical advice. Through these three sections I delineate how Hawtrey's austerity followed logically from his economic theory.[8]

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[4] The authors pointed out that Ralph Hawtrey, the "in-house economist" of the Treasury, provided the main theoretical justifications of the Treasury policies in the 1920s.

[5] Peden's words: "The Treasury view was as much a product of policy and public administration as of economics," and again, "The Treasury view of 1929 was as much a product of public finance and of the City as of Hawtrey's economic theory."

[6] In C.E. Mattei (2015) I have argued that the Treasury view extended beyond a belief in crowding out, and included moral and political, as well as economic, elements. The latter were strongly derived from Hawtrian economic analysis.

[7] For a general overview of Hawtrey's economic theory, see: Gaukroger (2008), Black (1978), Davis (1981), Deutscher (1992), Laidler (1993), and Howson (1985).

[8] The direct connection between Hawtrey's monetary theory and his policy advice in general has also been stressed by Black (1978), Howson (1985), and Alan (2008).

I. AUSTERITY AND HAWTREY'S ROLE

A widespread anti-waste campaign[9] and the "Geddes Axe" of 1922[10] marked the end of the expansionary phase of postwar social reform and the beginning of the austerity drive that characterized British economic policy throughout the 1920s.[11] From that moment onward, the objectives of British financial policy were clear: 1) to balance the budget; 2) to reduce the debt; and 3) to decrease public expenditures and, in consequence, to remit taxation (Clarke 1988, 31). The results were tangible. Expenditure on health insurance fell from £9.2 million in 1921/22 to 1922/23 to £5.8 million. Defense expenditure was also cut.[12] In that same financial years housing expenditure fell from £9.1 to £8.0 million. (Mallet and George 1933, 556-59). Central Government expenditure was 26% of real GDP[13] in 1921, it fell to 22% in 1922 and again to 21% in 1923, remaining slightly below this level for the whole decade.[14]

Financial austerity went hand in hand with monetary austerity. Moggridge (1972) and Howson (1975) extensively document the policies of dear money during all the steps toward a return to the gold standard at the prewar parity (4.86 dollars to the pound) achieved in 1925. The prewar parity overvalued the pound by about 10% at the price level that prevailed in 1925 at the time of resumption (Friedman 1963). As early as March 1920, a 7% bank rate was imposed; it exemplified the commitment to a deflationist policy,

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[9] The Geddes Committee was called for by Lloyd George in order to "take the sting out of the anti-waste agitation" (*The Times*, 4 August 1921, 8). The anti-waste agitation began in 1919 with the Northcliffe and Rothermere press (*Daily Mirror*, *Daily Press* and *The Times*) and had a large constituency in England. "This campaign, the most vigorously prosecuted and most sustained of its kind since the inception of the mass popular press of the 1890s, employed tactics which were well attuned to the communications of certain basic ideas to the mass electorate" and again, "few contemporaries seem to have questioned the popularity of the anti-waste campaign...the relentless press attention elevated public economy until it became the common language of all politicians" (McDonald 1989, 646). The objective of the campaign was to denounce the evils of growth of state bureaucracy and high taxation. Values of prudence and thrift were constantly invoked. Enhanced Treasury control of expenditure was also called for. Various anti-socialist and anti-waste coalitions achieved considerable success in local elections in 1922-1923. Public opinion surely facilitated the Treasury's economy policy. However, as Mc Donald tells us, the Treasury officials were not the natural allies of this campaign, as they deemed it simplistic and "political."

[10] The term "Geddes Axe" comes from the Committee of National Expenditure known as the "Geddes Committee," from the Chairman Eric Geddes. The committee of businessmen was appointed by Prime Minister Lloyd George and Chancellor Robert Horne. The committee was supplied and guided by Treasury briefs. It recommended severe measures of economy: £ 87 million in cuts of which £ 52 million were put into place. See Interim Report (Cmd, 1581), Second Interim Report (Cmd, 1582), and Third Report of the Committee on National Expenditure (Cmd, 1589). Also see Cobin (2009); Cline (1974); McDonald (1989).

[11] The post-war decade opened with the most violent economic fluctuation in British history. A short-lived boom was followed by the severe slump of Spring 1920-1921. The rest of the decade was characterized by heavy unemployment, stagnation in industry falling prices, and slow rates of growth of income and output. Most scholars agree with Pigou's diagnosis: "The Slump...did not so much end as peter out...The ending of the slump was the beginning of the Doldrums. In these we might say the country remained more or less—not of course completely—becalmed until the Wall Street crash in 1929 heralded a second and greater slump" (Pigou 1926).

[12] See figures in Peden (1985, 76).

[13] Measured at 1900 prices. Central government expenditure adjusted for the calendar year

[14] From figures of £1,188 million in 1919/1920 and £1,070 million in 1920/1921, central government expenditure fell to £812 million (1921/1922); £749 million (1922/1923) and remained in the £700 million range throughout the whole century (Mitchell 1992, 801).

pursued from the slump of 1920-21[15] until the end of the decade. Wholesale prices fell drastically in 1926 as compared to 1920 (Mitchell 1988, 957). Also, money wages in industry in 1922 diminished by one third from the 1920 level (Mitchell 1988, 198).

In that period, progressive social action was sought. For example, in the public housing sector, the 1919 Addison Housing Act proposed an ambitious popular housing program (Bowley 1945; Malpass 2005). Nonetheless, with austerity in action, they were "consigned to the waste paper basket" (Tooze 2014, 359).[16] The question to ask is: what role did the Treasury play in such policy turnover?

During the interwar period, the Treasury was considered the central department of government (Peden 1983a), the Cabinet Office being less important than it is today. The Treasury's crucial role in British administration has a long historical tradition.[17] After the First World War, the Treasury gained ever-greater political strength.[18] It represented a reaction to the loss of Treasury control during the war and the subsequent extension of public expenditure and inflationary government borrowing.[19]

From 1919, the Treasury was divided into three departments,[20] of which the financial department was by far the most important:

> The Chancellor's annual budget was prepared by the Treasury's Finance Department, headed from 1919 to 1922 by Basil Blackett. The Finance Department was responsible, in conjunction with the Boards of Inland Revenue and Customs and Excise, for estimating revenue in the coming financial year, and therefore for the level of central government expenditure that could be afforded within a balanced budget at given rates of taxation...The

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[15] Together with deflationary budgetary policy, and a collapse of exports, scholars see dear money policy as one of the main factors that made the post-war slump so severe. See Howson (1975, 25). Tooze (2014) holds a stronger view: the deflationary policy was the primary source of the British post-war slump; through the effect of soaring unemployment, deflation especially caused a subversion of the power relations among classes, to the detriment of the workers.

[16] Secondary school for all was not fulfilled (Andrews 1976); no major development for health services happened. (See Gilbert 1970, 77, 151-2, 158-9). Between 1918 and 1923 the number of houses was only about half the figure the government had promised to build in three years. Central government expenditures on education and health remained far below the 1921-22 levels for the rest of the decade. See Peden (1985, 45-52); Mallet and George (1933, 556-59).

[17] Since the 1860s, the annual estimates of all central government had to be submitted to the Treasury for approval before being presented to Parliament. Moreover, the Chancellor of the Exchequer, in his budget, was required to make a statement of account to Parliament that the funds had been spent on the purposes for which Parliament had voted them (Daunton 2002, 18-19).

[18] In August 1919 the Cabinet agreed not to discuss proposals from departments involving expenditure until the Treasury had had the chance to study and criticize them. If the Treasury opposed a proposal, the spending department concerned had to notify the Treasury that an appeal to the Cabinet was pending.

[19] Peden (1983a, 374) specified: "According to the Haldane Committee in 1918 the Treasury was responsible for 'supervising and controlling' all the operations of central government in so far as these affected the financial position, as well as for carrying out financial policy. The Committee (which included a former Treasury Financial Secretary and a former Permanent Secretary of the Treasury) concluded that 'on the whole, experience seems to show that the interests of the taxpayer cannot be left to the spending departments' and 'that those interests require careful consideration of each item of public expenditure in relation to other items and to the available resources of the State'" (Ministry of Reconstruction l918, 17-19). See also Kathleen Burk (1982).

[20] The other departments dealt with control of public expenditure and control of the civil service.

> Finance Department was also responsible for the management of the National Debt and for banking and currency, but relied heavily on the technical skills of the Bank of England in carrying out these responsibilities. Collectively the Treasury and the Bank of England were known as the "monetary authorities." (Peden 1993, 226)

In sum, financial authority was a prerogative of the Treasury. Daunton (2002) specified that the Treasury had enormous fiscal power even compared to other nations. In comparison to the USA, for example, no external intrusion from lobbies occurred, as "the annual budget is drawn up in conditions of secrecy by the leading officials of the Treasury and revenue departments, in consultation with the chancellor of the Exchequer and his junior ministers. British officials have immense authority compared with their American counterparts who lack such a high level of continuity both in terms of personal career and identity with a departmental ethos which went back to the creation of the Gladstonian fiscal constitution" (18). The Treasury also had monetary authority, which it shared with the Bank of England (Peden 2004, 6). In fact, until 1921 the Treasury controlled the bank rate.[21]

Clearly, the actual policy impact was the outcome of political debates and bargaining between the Treasury and other Whitehall departments. Nonetheless, many case studies of the 1920s show how the Treasury *did* have enormous impact on the overall line of financial and monetary policy, especially with regard to constraints on social reform (housing and education) and unemployment works.[22]

The voices of the Treasury's doctrine were embodied in the words of the "select group of senior officials" (Clarke 1988, 29) who were the official advisors of the Chancellor of the Exchequer (Peden 2000, 17). The Controller of Finance in particular held a crucial post for advising the Chancellor on all financial matters.

Sir Basil Blackett and Sir Otto Niemeyer had a forceful influence on policy. Until 1925, they were much more influential than the Chancellor himself, who was usually in office for a very short period and was rarely a financial expert (Peden 2000, 137). What was Hawtrey's role in policymaking? Most importantly, what was his relationship with the powerful Niemeyer and Blackett?

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[21] Until March 1921, the Bank of England was still dependent on the Treasury's cooperation for raising the bank rate. Howson specified, "During the period of cheap money the important rate of interest in the money market was the Treasury bill tap rate. During the war and until April 1921 Treasury bills were on sale only on tap. Bank rate was ineffective, because if the Bank tried to raise market rates above the Treasury bill rate by open-market sales of securities, the banks could run off their large Treasury bill holdings, forcing the government to borrow on Ways and Means from the Bank" (Howson 1975, 10).

[22] An especially important case study is Peden (1993), in which the author showed how there were important alternative strategies to austerity (discussed at Gairloch with Lloyd George) that were drastically blocked by the Treasury advices. On the Treasury's strong impact on monetary policy, see Howson (1974). Peden (1983a, 380-82) also spoke of the Treasury's "encroachment on the preserves of hitherto fiercely independent departments," such as the Ministry of Labour, in which investigators were limited. See Lowe (1974).

After reading Mathematics at Cambridge, Hawtrey undertook a career as Civil Servant. In 1919 he was appointed Director of Financial Enquiries,[23] and was finally "sufficiently high placed in the Treasury to be party to the inner process of policymaking" (Black 1977, 378). Not high enough to speak directly to the Chancellor on his own initiative, however: Hawtrey had to communicate his ideas through Blackett or Niemeyer. Noteworthy episodes of Hawtrey's direct impact on policymaking are renowned (Howson 1985, Gaukroger 2008, Black 1977). First and foremost, Hawtrey's prescriptions were literally incorporated into the resolutions of the 1922 international financial Genoa Conference. His proposals had been approved by Blackett and the Bank of England. Hawtrey went to Genoa as part of the UK delegation to engage in a meticulous process of persuading other delegates and officials.[24] It is also worth remembering that Hawtrey was among the select officials who wrote advice to Chancellor Churchill during his troubled decision to declare the return to the Gold Standard (Peden 2004). My primary focus is Hawtrey's influence on the most powerful minds of the Treasury. More than the single episodes recalled above, his impact on their ideas became deeply ingrained and thus long-lived.[25]

Throughout the interwar period Hawtrey was the sole Treasury official to be an economist of international standing. His academic achievements were striking. In 1919 he produced *Currency and Credit,* which, for over a decade, became a standard text for Harvard graduates in Economics. In 1928-29 he was a visiting professor at Harvard. Hawtrey became fellow of the British Academy in 1935, and in 1959 he was elected to an honorary fellowship at Trinity College, Cambridge.

The files of the Controller of Finances reveal that Niemeyer and Blackett regularly wrote notes to Hawtrey to ask for advice on economic matters, from the most technical and statistical to precise policy suggestions.[26] It appears that Hawtrey was extremely prolific in drafting reports and memoranda to instruct his colleagues on fiscal, especially monetary, principles. Many documents prove not only how Blackett and

[23] In 1915 the Financial Enquiries Branch had been established as a special branch of the Treasury "to collect information upon all subjects of general financial interest and to prepare reports from time to time both on its own initiative and also upon any question that could be specifically referred to it by the Chancellor of the Exchequer" (Black 1978, 367).

[24] Hawtrey spoke of "regular meetings with the delegates and other officials, every evening after the day's proceedings." Hawtrey's proposal ended up appearing as "an integral part of the proposals of the conference" (Howson, 1985, 156).

[25] This is in line with Clarke's idea that Hawtrey's theory might have had a "more insidious influence" on Treasury officials throughout the thirties by keeping alive the Treasury view with its crowding out rationale (Clarke 1988, 319).

[26] The cases are too many to be cited; a couple of examples will suffice. In T 208/27, we have a note dated 4/3/19 in which Blackett asks Hawtrey for advice regarding fiscal issues. In reply, Hawtrey sends a note to Blackett with his memo on taxation (T.208/27). Concerning Niemeyer, his Treasury papers (T 176) are full of Hawtrey's memoranda.

Niemeyer read and underlined Hawtrey's works, but also that they actively used them for their policy advice, which was imbued with Hawtrian economic theory.[27]

To gain full awareness of Hawtrey's ideological impact, one ought also to highlight Hawtrey's personal and frequent exchanges with the Bank of England, and in particular with its head, the Governor Montagu Norman.[28] Archival material discloses numerous correspondences between the two, especially in the years 1919-1924.[29] Norman often asked Hawtrey for advice regarding the monetary policy to be conducted, and the two were often in fundamental agreement.[30] Norman thought very highly of the Treasury's economist, having studied many of his economic works. The Hawtrian literature was diffused throughout the whole Court of the Bank. In 1923 Norman writes, "Dear Mr. Hawtrey, it was very good of you to send me a copy of your new volume of Essays. Your papers are always read here with great interest, and although we have studied one or two of the present series before, we should not value the book the less on that account. Yours very Truly, Norman."

In sum, Hawtrey's theories and prescriptions were widely circulated not only among Treasury officials but also throughout the Bank of England. The British establishment that conducted the austerity policies in the 1920s was well educated by Hawtrian economics. What type of economic knowledge did Hawtrey impart? I will answer this in several steps. A summary of his concrete policy prescriptions will lead to a more theoretical discussion that will serve to rationalize the reasoning behind his policy prescriptions.

[27] The episodes are numerous, especially concerning Niemeyer. The Files T176/5 on monetary policy are for the most part composed of Hawtrey's memoranda. One example of how Niemeyer actively deployed Hawtrian ideas is his correspondence with the International Labour Office (ILO) official Sir Llewellyn Smith in T 208/ 95. In order to formulate his replies, Niemeyer wrote Hawtrey for advice on the relation between monetary policy and unemployment. The letters to Smith show that Niemeyer fully used Hawtry's memo: the Hawtrian concept of credit stabilization as the ultimate solution to unemployment is the main theme. Also, in 1923, Niemeyer agreed with Hawtrey's concerns regarding the risk of raising bank rate for unemployment. They both met with the Governor of the Bank of England to persuade him not to raise interest rates (Sayers 1976, 128-129 and Gaukroger, 2008, 145). T 208/49 reveals that Blackett deployed Hawtrey's memorandum "Debt after the war" in order to write letters and notes discussing the matter of inter-allied debt. An extensive study of Niemeyer's and Blackett's reception of Hawtrey's theory goes well beyond the scope of my paper, and will be the subject of future works.

[28] Charles Addis of the bank of England was a frequent correspondent to Hawtrey. Furthermore, Mr. Bellerby from ILO explicitly wrote it was thanks to Hawtrey that he was introduced to the "autocracy of the court of the Bank of England" (HTRY 1/28).

[29] See T 208/ 44; T 208/45; HTRY 10/11.

[30] In 1920 Norman wrote to Hawtrey: "Dear Mr Hawtrey, I am of course much in agreement with respect to the memorandum you have kindly sent me: especially as regard the Treasury minutes having been taken seriously so far and the consequent effectiveness of the 7% bank rate." The concluding remarks of the letter are, "I would like you to consider this note—might not we (of the dear money school) be taxed with bad faith if the rate were put up now? Yours sincerely M Norman." Clearly, Hawtrey is part of the "we" of the dear money school. Again, on October 12, 1922, Norman writes "Dear Hawtrey, thank you for sending me your paper on the Genoa resolutions. I have read it with the appreciation of the lucidity of your argument and the compression of your thought and I would that the central banks could in practice attain to the ideal that is set before them! Sincerely yours, Norman." In the years to come, Norman did not fully follow Hawtrey's ideas on the need to revert to cheap money. However, Hawtry's proposals, including the ones on sending gold to America, were taken seriously into consideration (T 176/5 note from Norman to Niemeyer, 21 November 1923).

II. HAWTREY'S ECONOMIC PRESCRIPTIONS

This section considers the nature of Hawtrey's main policy prescriptions during the period 1918-1925. Given the bulk of pertinent Hawtrian Treasury memoranda, a concise review of this topic is not a simple task. Hawtrey's draft of the Genoa resolutions will be the *fil rouge* to tackle the topic. The reasons for this choice are significant. In drafting them, Hawtrey's aim was to provide a comprehensive scheme of economic policies; most importantly, Hawtrey never had second thoughts about them. Additionally, before these resolutions were sent to the London Conference of the allied experts (March 1922), Hawtrey had discussed them at length with Blackett and Norman. Hence, the Hawtrian resolutions were in line with the economic orthodoxy of the British establishment, embodying the consensus of the Treasury and the Bank of England. In a Treasury memorandum of April 2, 1922, Hawtrey well pinpointed the essence of this consensus: "the principle of the resolutions is the reconciliation of the two aims sought by nearly all currency reformers and experts, that is to say, the reestablishment of the gold standard and the stabilization of prices." I will proceed thematically, addressing monetary policy first.

II.I MONETARY POLICY

II.I.I Cheap or Dear Money

The draft resolutions are clear: "The only way to remedy the conditions of foreign exchange is to establish a sound currency. Tampering with the exchange market is, as the Brussels conference said, 'futile and mischievous'" (T 208/28, fol 2). Hawtrey advocated "a return to sound currency" as the absolute aim of British and international economic policy after World War I. During the inflationary years of 1918-1920, this consisted of promoting drastic dear money. The first Hawtrian objective was price deflation.

In his influential memo "Cheap or dear Money" (4 February 1920), Hawtrey emphatically defended the "orthodox monetary theory" that "prescribes high money rates as the remedy for adverse exchanges and for the other symptoms of a too great expansion of credit" (T 176/5, fol 71). To Hawtrey, the evils of post-war inflation were catastrophic and could be defeated only by putting the "simple remedy" of dear money into practice. "Inflation is caused by too much borrowing. Borrowing can be checked by raising the price to the borrower" (T 176/5, fol 71).

To refute the critics of dear money, Hawtrey put forth two arguments. Both were deployed verbatim by Blackett and Niemeyer, who were in possession of a copy of this memo. First of all, he stated, high interest rates *are* effective in the curtailing of borrowing, since "the mere prospect of high rates...is likely to stop the expectation of a further general rise of prices." Hawtrey continues, "Undoubtedly rates ought to be high if they are to be deterrent, but not necessarily higher that 9 or 10 percent" (T 176.5, fol 72).

Secondly, not only was deflation necessary for lowering prices and bettering exchanges, but also for funding the floating debt. Indeed, the post war inflationary conditions tended to curtail the supply of investible savings, which were necessary for a genuine funding operation. This was for two reasons: 1) At a time of expanding credit and rising prices, traders tended to borrow, or else, if they had cash in their hands, to invest all they could in their business and not in gilt-edged securities. 2) A new issue of gilt-edged securities had to compete with industrial issues, as "Rising prices swell the dividends of industrial shares and make them more attractive in comparison to fixed-interest bearing investments" (T 176.5, fol 73).[31]

These Hawtrian recommendations were perfectly in harmony with the ones of the 1918 Cunliffe Committee, the Committee on Currency and Foreign Exchange, that firmly set the agenda of British post-war austerity. Hawtrey was well aware of the possible depressive effects of high interest rates. However, he believed that the circumstances after the war were such that drastic and rapid rises would not cause economic distress. "Falling prices spell trade depression. At the present moment, wages have not kept up with the price movements of the last few months, and trade indebtedness is not for the most part based on the recent inflated values. Stocks of commodities are very short; traders have accumulated large liquid reserves. Under such conditions the community can stand a considerable degree of credit contraction without suffering the unemployment, the falling wages, and the bankruptcies which usually mark the process" (T 176/5, fol 75).

Furthermore, the burden on the Exchequer would be fully compensated by the long-term advantages of currency stabilization and would not have to last long, since once short-term debt is redeemed, "the Bank of England will gain control of the market, and more moderate rates will be sufficient to start deflation than when the government is borrowing. Moreover a limitation of the currency notes will facilitate action, in that it will make borrowers take a rise in rates seriously" (T 176.5, fol 76).

In August 1920, Hawtrey was advocating dearer money. Prices had fallen, but not enough. "What we need to do is to raise the value of pound sterling in relation to commodities till its purchasing power is equal to that of a sovereign. To raise the value of the Sterling is, under another name, to reduce prices. The problem before the country is to reduce prices by something between 20 and 25%" (HTRY 1/13).[32]

A year later, Hawtrey proudly affirmed that the deflationary policy was finally effective. He wrote, "What actually happened in this country was a combination of high bank rate, budget surplus and an agreed restriction of credit by the banks" ('Bank Rate,' July 1921, T 208/38). Hawtrey specified that without a rise in the bank rate, the other two elements would have been ineffective:

> In the early months of 1920 the malady from which business was everywhere suffering was inflation. The remedy universally demanded was deflation, that is a contraction of credit and a reduction of prices. After much controversy, the means for applying the remedy was found in

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[31] Hawtrey stressed that post-war inflation also had a disturbing effect on exports and on the balance of payments: "Inflationary finance itself tends to diminish exports, it artificially enhances the nominal purchasing power of the people and the increased purchasing power is applied to deplete stocks of commodities. Traders endeavor to make good stocks partly from home production and partly form imports and there is less left available for exports" (T 208/ 47, fol 16-17).

[32] A sovereign was a gold pound coin.

> the increase of the bank rate by 7% on the 15th April 1920. The success of this measure has been decisive. Wholesale prices have fallen by 40%. If the dollar exchange remains where it was, that is only because similar measures in America had had the similar results. ('Bank Rate,' T 208/38, fol. 1)

In this memorandum, Hawtrey implicitly denied his optimism of a year before. He confirmed that the negative effects of a rise in bank rate were beginning to be felt. However, he remained of the idea that deflation was legitimate as the only remedy against the much greater evil of inflation.

> It is well recognized that deflation, in particular, a fall of prices, depresses business...but the defense for deflation has been that it is the only way of escape from the greater evil of continuous and progressive inflation. Such an inflationary movement as existed at the beginning of 1920, could only be checked by measures drastic enough to start a contrary movement almost equally violent. Consequently we had no alternative but to face a severe contraction of credit, with its accompanying tribulations. About six months ago at the new year it might fairly be claimed that both England and America had passed through the ordeal. Dear money had accomplished its purpose. An enormous reduction of prices had been effected, and every trace of an inflationary tendency had evaporated. (ibid.)

Because the ordeal of deflation was undertaken, the policy of dear money should stop, as, "business stagnation, vanishing profits, unemployment, wage reduction, labor disputes, falling revenue, are precisely the consequences which theory and experience alike show that must follow from credit contraction...they have been and still are quite unnecessarily intensified."[33] Yet, the Hawtrian decisive argument against persistent dear money was a monetary one: deflation had already depressed prices below the levels at which they could be stabilized.[34] Sooner or later inflation, and thus price instability, would unavoidably ensue.

From 1922 onwards, Hawtrey advised, with the economy in a recessionary phase, the potent instrument of the bank rate should be used to stop the fall of prices. But "should signs appear of an undesirable rise of prices beginning, there should be no difficulty in checking it by raising the bank rate

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[33] At this point, Hawtrey used a rhetorical device constantly present in his memoranda. Persistent deflation was not primarily due to wrong British domestic policy but rather to excessive rigidity of the American economic practices: "The fault lies much more in America than here. As the purchasing power of the dollar is forced up by the credit restriction in America, the sterling exchange is forced down in proportion, and can only be maintained if we follow America's example and restrict credit here."

[34] For Hawtrey this was true for two reasons: 1) In USA prices would have to go up since the surplus gold reserve was nearly 1,000,000,000 and the stock of currency in the hands of the general public (outside banks) was double with respect to the pre-war period. For this reason prices could not stabilizes at the current 50 percent below pre-war level. 2) British capacity to bear the burden of national debt depended on the value of the pound sterling in which it was calculated. The national revenue fell in proportion to the reduction of prices of commodities. Hence, the budget deficit was unsustainable. "If we try to raise the purchasing power of sterling to parity with the present purchasing power of the dollar, we should be faced with such a shrinkage of revenue as will cause a heavy budget deficit" (T 208/38, fol 5).

again." Indeed, for Hawtrey, "prompt action is the essence of credit control" and the key to a successfully managed currency in order to attain the ultimate goal of price stabilization. He wrote, "If we are to have stability in the purchasing power of our money, we must revert to the pre-war practice of making frequent changes in the bank rate (say half a dozen in a year) in order to check any incipient movement upwards or downwards" ('Bank Rate,' T 208/38, fol 7). Timely action could avoid large variations in the interest rate.

The study of the Treasury papers reveals that the economic prescription of active monetary management from the part of the central bank in favor of price stabilization became a common concern among the orthodox economic institutions that were no longer thinking in terms of monetary laissez-faire. Indeed, Hawtrey's principle of monetary management gained consensus among the senior Treasury officials, including Niemeyer and Blackett, the court of the Bank of England, and also the League of Nations—especially the ILO, which considered it the remedy for unemployment. It was exactly this policy recommendation that was at the core of the official Genoa resolutions. The bottom line was that the inflationary tendency of credit could be perfectly controlled thanks to the prompt and cooperative actions of the "great Central Banks of the world," who altered the bank rate in response to the price index[35] and regulated credit "with a view of preventing undue fluctuations in the purchasing power of gold."

II.I.II The Gold Standard

Monetary management alone was not enough. The other fundamental pillar of Hawtrian monetary policy was the attainment of a gold standard. The first of the Genoa draft resolutions clearly stated that, internationally, "an effective gold standard should be aimed at." All throughout 1918-1925, Hawtrey felt strongly about his support of the gold standard. On April 21, 1924, he made one of his rare interventions in the press with a note to the editor clarifying his position:

> Sir, in one of your city-notes of the Times of today, you give what I fear is a misleading impression of the views I advocated for at the meeting of the Royal Economic Society yesterday. It is not the case that I urged the benefits of the monetary reform as elaborated in Mr Keynes' recent book. Much as I admire that very remarkable work, I did not support Mr Keynes in his proposal for abandoning the gold standard, but argued for the policy of currency stabilization with a gold standard, which is embodied in the resolutions of the Genoa conference." (T 208/80)[36]

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[35] In this respect, Hawtrey insisted on the progress of the Genoa suggestions with respect to the pre-war gold standard. Banks would not rely solely on the level of the gold reserve but rather the world price index, allowing for more punctual action in favor of price stabilization (see T 208/54).

[36] To prove that his view was a common one among the orthodoxy, he cited Charles Addis, his acquaintance from the bank of England: "As I said at the time I was expressing only my own personal views: but may I remind you that Sir Charles Addis, in the address he delivered to the Institute of Bankers on December 10 last, stated that 'it is part of our official currency policy, in cooperation with the Central Banks of Europe, and it is hoped with the Federal

A year later Chancellor Winston Churchill asked Hawtrey for advice on the policy to be adopted. Should the gold standard be restored? Hawtrey replied with two compelling interrelated arguments. First, when stability of internal prices requires deflation, a managed currency may not suffice. Since the automatic check to inflation of the loss of gold reserve would not occur, it was not certain that the Bank of England would have sufficient power to increase the bank rate. This was ever more the case for the external stability of prices, where "exchange stability cannot be obtained by any other method than the gold standard" ('The Gold Standard,' T 208/54, reprinted in Peden 2004, 33).

Secondly, "the injurious effect of unstable foreign exchange on trade" was particularly valid for countries like Great Britain that were great financial centers—that is, that acquired "the special force of financial strength" by being short-term lenders to their neighbors. Since stability of exchanges was attainable only with gold, England's financial prosperity could be restored only through the gold standard.[37]

In all of his Treasury memoranda up to the end of 1925, Hawtrey expressed the conviction that Sterling Gold par could be reached without the need for a rise in the interest rate in order to maintain the exchange rate. The reasons he gave were fundamentally three: 1) The United States would react positively to a return of Sterling to par by furthering their expansionary fiscal policy. 2) In the unlikely case of the USA operating restriction of credit before the British economy had revived, there was the possibility of exporting gold, which acted directly on the British balance of payments and had an inflationary effect in America.[38] 3) The cooperation of central banks, especially the Federal Reserve and the Bank of England, would avoid any monetary strain due to the competition of gold reserves.[39] Thanks to the Genoa scheme, no credit contraction would be needed in order to attain parity.

Reserve Board of the United States, to give a world extension to this faculty of price control, with the object of preventing undue fluctuations in the purchasing power of gold'?" (T 208/80, *The Times*, 21 April 1924).

[37] The Hawtrey faith in the gold standard was fully expressed in the memorandum 'The Gold Standard and the Balance of Payments': "Before the war, it was the special function of London and the special source of its financial strength, that not only imports to England, but imports to all other countries all over the world, were financed by bills drawn on London, which were sold in the London discount market. That business has shrunk very seriously and the reason is that foreign traders cannot assume sterling liabilities without running an exchange risk...the prewar system cannot revive unless the exchange risk is eliminated by a stabilization of the exchanges" (T 208/54, 3 February 1925).

[38] The remedy of exporting gold to America, even in very large quantities, and by suspending the fiduciary limit of the Bank of England for the purpose, was repeated in many other memos of those years, starting from the memos "Export of Gold to America" of March 1923 (T 208/54, fol 10-14) and 'Sterling and Gold' (T 208/54, fol 24-31).

[39] "The real safeguard against all these dangers is to be found in the regulation of credit here and in America *by agreement*...With a gold standard common to England and America and with the Bank of England and the Federal Reserve banks cooperating in the control of credit, it will be easier to preserve the stability of the currency than when each country is monetarily independent of the other...that is the purpose of the Genoa resolutions. The Genoa resolutions provide for cooperation among the Central Banks with the view to maintaining the gold standard and also to keeping the purchasing power of the gold itself stable" ('The Gold Standard', T 208/54, reprinted in Peden 2014, 38).

Indeed, none of the three points were actually verified. In March and April, prices in the USA kept rising and the British bank rate was not lowered. After the return to gold, in July 1925, Hawtrey wrote:

> The country is now deeply committed to the gold standard but the depression of trade still remains very severe. Its continuance here at a time when other countries have escaped from it, may be attributed to our efforts to return to the gold standard by raising the value of sterling. We have not resorted since 1921 to any spectacular contraction of credit, but we have had the steadily growing pressure of a bank rate rising from 3 to 4 to 5 percent. It cannot be denied that if the gold standard necessitates a further contraction of credit, that will be a very serious thing for the country. There are very good reasons for supposing that nothing of this kind will be necessary. ('Gold and Bank Rate,' 208/54)

It is clear that Hawtrey persisted in his optimism even though the expected revival of credit he had forecast did not occur. The Treasury's economist was well aware that the critics of orthodox monetary policy vividly saw the connection between the gold standard and the depressive effect of a rise in the bank rate, whether the rise was in order to return to the gold standard or to prevent excessive exports of gold when the gold standard was re-established. Hawtrey denied the necessity for such a direct link, insisting that the gold standard could be maintained with lower bank rates.

Yet in the hypothetical trade-off between gold-based monetary stability and a reduction of the bank rate, Hawtrey surely preferred the former: "In view of the very urgent consequences of a high bank to trade, it is of urgent importance that it should be reduced as soon as circumstances allow. It is obvious that if a reduction of the bank rate meant an abandonment of the gold standard, it could not be contemplated" (T 208/54). After the war the gold standard was the sole practical way in which trust in the monetary unit could be restored and maintained.

The absolute priority of orthodox monetary theory over slump and unemployment was founded on the profound conviction that the gold standard was a vital prerequisite for putting into practice the spirit of the Genoa resolutions: "As soon as sterling reaches par, the Genoa principle of stabilization of prices through the control of credit will come into action" ('The Gold Standard and the Balance of Payments,' 3 February

1925, T 208/54).[40] The success of this objective certainly required the anchoring to gold parity of all other Western countries, which would individually benefit from international monetary stability.[41]

Throughout the 1920s, Hawtrey stood as a fervent supporter of the Gold Standard. On September 2, 1925, an article appeared in the *Times* called "The Gold Standard." Hawtrey's propositions were deployed to defend the gold standard against its critics. Thanks to gold, not only would British trade be revived, London would also establish its world financial hegemony.[42] Hawtrey repeatedly denied the possibility that, with the gold standard, New York would supplant Britain in its predominant position on currency policy.

This excursus on Hawtrey's monetary policy discloses that during the immediate post-war years Hawtrey was a fervent advocate for monetary rigor: to be effective, the rise of bank rate had to cause a contraction of credit and a depression of trade. After 1922, he fully saw the dangers of bank rate increases in a time of economic downturn. While dear money was innocuous and beneficial in a time of credit expansion, this was not the case in a time of depression. Yet, in order to achieve the Genoa principle of monetary stabilization, the gold standard was a crucial prerequisite. Despite Hawtrey's optimism, the goal of anchoring sterling to par prevented any kind of expansionary British monetary policy. It is true that Hawtrey's policy prescriptions distinguished the objective of reaching gold from the strategy of high bank rates, endorsing the former but not the latter. Nonetheless, the reality of British monetary policy showed that the two were indissoluble. By giving priority to the gold objective, one can affirm that, *de facto*, Hawtrey complied with British monetary deflation. While there might still be room for discussion over the extent to which Hawtrey's monetary policy could be considered an austerity agenda, it is certain that the fiscal prescriptions derived from it were in the framework of austerity. Budgetary rigor was an invariable and fundamental requirement for currency stabilization.

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[40] Hawtrey believed that the gold standard scheme proposed at Genoa (also known as the gold exchange standard) was a great improvement on the pre-war one: "And the present resolutions improve upon the pre-war standard in two ways 1) by adopting an exchange standard which will economize the actual use of gold 2); by coordinating the value of gold as currency so as to stabilize its value in relation to commodities. (The second represents the most hopeful method for attaining stabilization)" (T 208/54). Concerning point one, the gold exchange system allowed all central banks to hold a limited amount of reserves in gold-related currencies as fully equivalent to gold, thus economizing on the use of gold and reducing the excess demand for it, which would further increase the necessity of deflation.

[41] Surely we saw how the attainment of gold par was particularly crucial for great financial centers like Great Britain; yet Hawtrey's general reasoning on the great perils of fluctuating exchanges was true for all nations after WWI.

[42] Hawtrey wrote: "The exchange standard presupposes the existence of financial centers (which under the scheme would be free gold markets) and it is certain that there will be one and only one financial center of the first rank." To Hawtrey, the superiority of London was not due to political arrogance, but rather to its genuine financial superiority: "...the predominance of London and the Bank of England is due above all to the expert skill they are able to supply. The only reason why the proposed reforms will favour London is that London really is qualified to be the financial center of the world." Hawtrey had a clear sense of the Anglo-American hegemony: "The prospective association of the central banks will be simply an association of the Bank of England and the Federal Reserve Board" (T 208/24, fol 11-12).

II.II FISCAL POLICY

Budgetary rigor is a primary prerequisite for currency stabilization, Hawtrey posited. In one of his memoranda for Genoa, he wrote the words that were inserted into the official resolutions: “In each country, the first step towards re-establishing a gold standard will be the balancing of the annual expenditure of the State without the creation of fresh credit unrepresented by new assets. This primary task which must be accomplished by each separate State through its own efforts, is the necessary and sufficient condition for gaining control of the currency” (Financial Subjects, T 208/28).

It is clear that fiscal austerity was a domestic burden that must be dealt with by each country if it intended to adhere to Hawtrey's gold standard currency convention. Hawtrey wrote, "The first condition of participation will be that the government of the country meet its annual expenditure by taxation or loans drawn from genuine current savings" (T 208/ 28, fol 3).

In Britain, the floating debt ought to be funded primarily because of its dangerous inflationary effects: "The weak point of the present condition is of course the vast unfunded debt, this unfunded debt either swells the assets (and therefore the liabilities) of the banks or provides traders with balances which are almost the equivalent of cash. In both cases it induces inflation."[43] The reduction of floating debts had in itself a deflationary effect, as it meant, at implementation, a reduction both in the liquid assets and the deposits of the banks (T 208/50, fol 2).

Hawtrey considered debt refunding an indispensable instrument for the larger effort to prevent credit expansion and inflation. Yet the difficulty of refunding floating debt was really due to credit expansion, as it is hard to attract the savings of the community into gilt-edged securities (fixed interest-bearing investments) when profits in private shares are high.[44] The ultimate solution to credit expansion was thus dear money, in particular, a rise in the interest rate. A budget surplus was not to be regarded as a substitute for a high bank rate but as "a valuable auxiliary to it."

[43] In *The Times* of October 10, 1920, Hawtrey writes: "The dangers are well known. Ways and Means advances by the Bank of England to the government, provide the other banks with cash at the Bank of England which they can and do use as the basis for fresh credit, much larger in volume than the addition to their cash. If Treasury bills are not renewed the government is forced to borrow on Ways and Means advances, thus so long as there are Treasury bills in the hands of the general public or the banks, and so long as the government can borrow by the bank of England on Ways and Means, there is a risk of further inflation on a large and dangerous scale."

[44] "Inflation itself militates against the borrowing. It makes business exceptionally profitable and investment in gilt-edged securities correspondingly unattractive. People will not subscribe to a government loan when they can use their money to better advantage in their business or by buying industrial shares" (HTRY 1/13). On the other hand, when deflation is the problem, gilt-edged securities (which are fixed interest bearing investments) tend to be attractive, and the deflationary effect of paying off the debt is felt in a moment when it should not.

However, the redemption of floating debt had an indispensable political significance: it allowed the Bank of England to gain control of the credit situation.[45] In fact, the bank rate could finally be made effective. Budgetary rigor was a pre-requisite for monetary stabilization chiefly because it handed over to the Bank of England full power over monetary policy. This point is a crucial pillar of Hawtrey's political-economic prescriptions of those years.

II. III POLITICAL INDEPENDANCE AND THE LEADING ROLE OF THE CENTRAL BANKS

The second paragraph of the Genoa draft prescriptions reads: "The return to sound currency will be assisted if reliance is placed on the international cooperation of the banks of issues rather than on direct government action" (T 208/28, fol 2). For Hawtrey, not only must central banks be independent from the State, they should also have absolute preeminence in the formulation of national economic policies. These technocratic institutions should have the lead since they would act according to the right economic principles. In a memorandum called "The Future of Currency Notes" (1925), Hawtrey argued that the legal regulations of the gold reserve ought to be abandoned in favor of "the unrestricted freedom of the Bank of England which existed before 1844," so as to leave full discretionary power to the central bank in the regulation of credit.

The following words fully disclose Hawtrey's political intentions:

> To abandon all statutory regulation of the gold reserve would be merely to eliminate the interference of the Treasury. It may be thought, at first sight, an anomaly to confer upon a closed oligarchy like the Bank an uncontrolled power over the gold reserve. But whatever the forms may be, our currency system is in fact entirely in the hands of the Bank. Even before the war, if the Bank made a mistake, and an excessive drain of gold occurred, the government and parliament were faced with an accomplished fact and had no option but to suspend the fiduciary limit. And whatever the faults of the constitution of the Bank from the standpoint of political theory, the undoubted fact stands out that the Bank commands confidence in a way that no

[45] During the war, the huge increase in government expenditure beyond what could be raised through taxation was financed by making three-, six-, and nine-month Treasury bills available on tap (that is, in any amount at a fixed rate of interest) instead of the normal practice of weekly tender (that is, at the rate the banks offered). As a result, the Bank of England could not make its discount rate (Bank rate) effective above the Treasury bill tap rate. Bank rate is only effective if banks have to go to the Bank for money. However, once the banks held lots of Treasury bills, they could obtain money from the government by not renewing bills at maturity. The government would then have to borrow from the Bank of England (a form of borrowing known as Ways and Means). When the government used this additional money created by the Bank to pay contractors, contractors would then deposit the money in commercial banks, which would then find their reserves rising. Banks made profits from lending, not from accumulating reserves, so the additional reserves would make the banks more willing to lend a multiple of the additional reserves. In other words, borrowing on Ways and Means is inflationary in the sense that it increases the supply of money and credit. As Blackett wrote in February 1920, "The banks can let Treasury bills run off to a considerable extent and so prevent deflation" (Howson, 20). In fact, so long as the Bank of England has the obligation to extend Ways and Means advances to the government, the Treasury bill rate determines the market rate of discount.

> political organ could. In practice it is most important that the cooperation between the Treasury and the Bank should be close. But it will be no less close if undivided responsibility for the regulation of credit (and therefore in all essentials of the currency) is placed upon the Bank. (T 208/54)

Hawtrey believed that the priority of economic principles such as market confidence discounted the possible political doubts that may emerge from the absolute economic power of "a closed oligarchy." The court of the Bank of England had the technical capacity to manage the bank rate efficiently, with the sole goal of stabilizing the wealth value of the monetary unit. It is clear that currency stability overrode all other national socio-political concerns.

So far, the overview of the Hawtrian economic prescriptions has highlighted that all components of the austerity policy are present: budgetary rigor; monetary rigor; and the absolute priority of currency stabilization, which undermines any reservation on the lack of democratic representation. It is true that after July 1921, Hawtrey opposed the persistence of high bank rates. However, he fervently supported the return to gold, a commitment that entailed further deflation for the British economy.

II.IV AGAINST EXPENDITURE FOR PUBLIC WORKS

Hawtrey's austerity agenda comprised of a further building block: the rejection of expenditure for public works as a means to cure unemployment. The Treasury view is widely identified with this specific stance. Hawtrey is considered to be the man who furnished economic robustness to this position through the crowding out argument, of which a topical formulation was given by Churchill in his 1929 budget speech: "When the government borrows in the money market, it becomes a new competitor with industry and engrosses to itself resources which would otherwise have been employed by private enterprise, and in the process raises the rent of money to all that have need of it."[46] These words took direct inspiration from Hawtrey's article, “Public Expenditure and the Demand for Labour,” published in *Economica* in 1925. Grigg, Churchill's private secretary, had sent him a copy in order to refine his budget speech argument. Well beyond the 1920s, the Treasury regularly deployed Hawtrey's theory in order to actively oppose all proposals of expansive fiscal policy to cure unemployment, for example in the influential White Paper of 1929.[47]

This topic functions as a link to the third part of this paper, which considers the theoretical motivations supporting his policy prescriptions. Indeed, concerning public works, it is not Treasury

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[46] M. Blyth (2013), *op. cit.*, p. 124.

[47] Hawtrey's theoretical framework shaped the *Memoranda on Certain Proposals Relating to Unemployment*. This important parliamentary white paper was presented on May 1929, just a couple of months after Lloyd George’s electoral pledge that had as its main topic the promotion of the Liberal unemployment proposals through government investment. Lloyd George's program was set out in the Liberal pamphlet *We Can Conquer Unemployment.* The White Paper is a collection of six different memoranda, each drafted by different ministers of the Conservative Government led by Baldwin; the memorandum on the finance of development loans was written directly by the Treasury (House of Commons, *Memoranda on Certain Proposals Relating to Unemployment*, May 1929, His Majesty’s Stationery Office, Cmd. 3331).

memoranda that furnish policy prescriptions, but an economic article written in an economic journal. The immediate connection between his economic theory and the policy of austerity is unmistakable.

In his *Economica* article Hawtrey sought explicitly to refute the policy of public intervention through public works designed to alleviate the colossal unemployment problem.[48] The concluding words well summarize the essence of his argument: "The original contention that public works give employment themselves is radically fallacious. When employment is improved this is the result of some reaction on credit. And the true remedy for unemployment is to be found in the direct regulation of credit on sound lines" (48). Hawtrey's position was straightforward: public works are an absolute delusion unless they are accompanied by an expansion of banking credit, which would, *in itself*, relieve unemployment without the need for any public relief schemes. This idea was the direct upshot of his monetary theory, which was fully expressed in *Currency and Credit*. To argue his case, Hawtrey envisioned two case scenarios, each of which reveal the essential theoretical building blocks that constitute his austerity doctrine. Let me briefly discuss them in turn.

Hawtrey confirmed that the necessary funding for the extra government expenditure may be provided either by borrowing from genuine savings or by the creation of bank credit. In the case where genuine savings were applied, a crowding out of private investment would take place. The assumption was that the amount of savings is a fixed and limited amount, so government borrowing creates a shrinkage in the outlay of the consumer equal to the amount of government expenditure. Hawtrey defined consumer outlay as the money expenditure out of income. In his words:

> The money borrowed is genuine savings, in other words it must come out of the consumers' income. Investment is a form of expenditure and is one of the items of consumers' outlay...The effect of the diversion of part of the consumers' outlay into the hands of the government is to diminish by that amount the effective demand for products. It must be remembered that the consumers' outlay accrues continuously. We must picture the public starting to curtail their daily expenditure from the time that the prospect of subscribing to the government loan comes in sight. Probably, the greater part of the curtailment however is felt not in this daily expenditure but in the diminution available for other investment. (Hawtrey 1925, 40)

This quote discloses that Hawtrey adherered to the classical economic analysis that pictures savings flowing smoothly into a stream of spending. Private savings-investments were the essential source of capital accumulation and acquired a primary role in Hawtrey's economic model, being a crucial element of his

[48] Hawtrey affirmed that this policy objective was initially proposed by the Minority Report of the Royal commission on the Poor Law in 1909. Already in his book *Good and Bad Trade,* Hawtrey devoted a brief paragraph to refute the agenda of such commission with the same crowding out argument: "If savings...are diverted from the creation of capital by a Government loan, the money to be spent by the Government is no doubt increased by that amount, but the money to be spent by private individuals on the construction of fixed capital is correspondingly diminished, at a time when the industries most affected by trade depression are probably those concerned with the construction of fixed capital" (Hawtrey 1913, 260).

austerity doctrine. Government borrowing diverted private savings from the investment market, acting as an impediment to savings to be invested in other private productive enterprises.[49]

It was in the second case scenario of financing public works by credit creation that would avoid the crowding out phenomenon, yet public expenditure remained a delusion:

> What has been shown is that the expansion of public work, if accompanied by the creation of credit, will give employment. But the same reasoning shows that the creation of credit, unaccompanied by any expenditure on public works, would be equally effective in giving employment. Public works are merely a piece of ritual, convenient to people who want to be able to say that they are doing something but otherwise irrelevant. To stimulate an expansion of credit it is usually too easy. To resort for the purpose to the construction of expensive public works is to burn down the house for the sake of the roast pig. (Hawtrey 1925, 48)

These words highlight the kernel of Hawtrey's economic theory. It was through monetary management that credit was regulated and unemployment could be truly resolved. An economic downturn could be overcome by the simple decrease of the bank rate, which would always prove to be effective, as the central bank could reinforce it "by the purchase of securities on the part of the Central Bank in the open market." Hawtrey had no doubt that "by the former method it is possible to find an escape from any depression, however severe." These ideas were often expressed in his memoranda of 1918-1925. In sum, price stabilization "is not merely a remedy but the remedy for the unemployment evil. Unemployment not only since the war but before it, has been caused by price fluctuations" (underlined in the manuscript, 4 February 1923, T 176/5).

In order to fully grasp the essence of these strong assertions, we must tackle Hawtrey's main theoretical book: *Currency and Credit.* In *Currency and Credit*, economic history is intertwined with economic theory. The structure of the book exemplifies Hawtrey's approach: the initial chapters of pure theory are followed by an analysis of many economic epochs. Hawtrey engages directly with post-war economic circumstances, proposing diagnosis and solutions to the economic difficulties of the moment. Thus the theoretical grounds for post-war austerity directly emerge. I will focus on the building blocks unraveled in his attack on unemployment: savings and the control of credit. I will begin with the latter.

III. ***CURRENCY AND CREDIT*****: The theoretical grounds for austerity**

[49] Hawtrey does admit that there would be a very "exceptional case" in which loan-financed public works could indeed be useful to increase the demand for labor. This would be when there is extreme stagnation of balances that might be overcome by the offer of gilt-edged investment. Yet it would still be delusional as a counter-cyclical measure, since the true source of economic stimulus rested in public borrowing, which could be used for better purposes than public expenditure: "Even in this case it is not the government expenditure that gives employment but government borrowing. The borrowing would have the same effect if it were to meet a deficit due to a remission of taxation" (Hawtrey 1925, 45).

III.I CREDIT CONTROL

Currency stabilization was the primary and sole objective of economic policy, because the primary nature of credit is intrinsic instability. For Hawtrey, the market economy was naturally brought to experience inflationary expansions: "It is the inherent instability of credit that is perpetually involving the world in credit expansions, each of which would threaten the collapse of the gold standard if it were not succeeded by a timely contraction in time. The alternation of expansions and contractions would be comparatively harmless but for the dislocation and distress which accompany the contraction" (Hawtrey 1919, 375-376). Unlike classical economists, Hawtrey did not envision the economy as a harmonious, self-equilibrating mechanism. The instability of the economy, both at the national and international level, was due to the fact that its founding element, credit, is unruly.

Hawtrey modeled the world economy as a "great credit machine." Any sort of economic relation could be understood as an exchange of debt and credit between buyers and sellers. The concept of currency was secondary to credit (or debt, debt being just the opposite of credit). Money was simply "the means established by law (or custom) for the payment of debts, (or which is the same, the contraction of credit)." Credit was not only the medium of exchange but also the source of development of the real economy. For Hawtrey, the initiative of production rested on the orders of the merchant and the promoter, that is, the dealer in commodities and the dealer in capital goods. The subsequent process of production gave rise to a chain of debts. "The manufacturer or contractor becomes indebted day by day to his employees. The merchant becomes indebted to the manufacturer" (Hawtrey 1919, 376).[50]

In Chapter 1 of *Currency and Credit*, there is a sharp description of the transmission mechanism that is at the basis of credit instability.[51] While curtailment of credit could theoretically occur, it is credit expansion and the consequent depreciation of the unit of value which is much more likely to arise:

[50] Hawtrey had specified: "Apart from this shuffling of debts, all the credit created is created for the purpose of being paid away in the form of profits, wages, salaries, interest, rents, in fact, to provide the incomes of all who contribute, by their services or their property, to the process of production, production being taken in the widest sense to include whatever produces value. It is for the expenses of production, in this wide sense, that people borrow, and it is of these payments that the expenses of production consist. So we reach the conclusion that an acceleration or retardation of the creation of credit means an equal increase or decrease in people's incomes" (Hawtrey 1919, 40).

[51] In Chapter I Hawtrey sets out to inquire upon the "logical origin of money" (2). He considers a completely "organized and civilized society, with the modern development of commerce and industry" where money does not exist. The economy functions perfectly through a chain of debts. Hawtrey specifies that these mechanisms occur unchanged for the monetary economies, causing the fluctuations of trade cycles: "The trade cycles are distinguished by a number of symptoms...The period of credit expansion is marked by rising prices, high profits, good employment, rising wages, high interest, falling bank reserves. The period of credit contraction is marked by falling prices, low profits, bad employment, falling wages, low interest, rising bank reserves" (Hawtrey 1919, 126).

> Self-interest prompts both the enterprising trader ever to borrow more, and the enterprising banker ever to lend more, for to each the increase in his credit operations means an increase in his business. Suppose some of the merchants, in the hope of extending their business, give increased orders to the manufacturers. The manufacturers will forthwith borrow more than usual from their bankers. They will urge on the business of manufacture, will pay more to their employees, and will receive greater profits in proportion to their greater output. They and their employees will have more to spend; the retailers will dispose of more goods, and will take over more from the merchants; the merchants will give yet further orders to the manufacturers. The manufacturers, finding their productive capacity overstrained, will quote higher prices to the merchants; the merchants, being unable to supply the retailers fast enough or to maintain their stocks of goods, will raise prices to the retailers, and the retailers will raise prices to the public. The general rise of prices will involve a proportional increase of borrowing to finance a given output of goods, over and above the increase necessitated by the increase of output. This increase of borrowing, meaning an increase in the volume of credit, will further stimulate trade. (Hawtrey 1919, 12-13)

It is this vicious inflationary mechanism that caused an increase in the velocity of circulation of the monetary unit and thus a depreciation of the currency of value. Once started, credit expansion had a self-propelling force. The deviation from equilibrium was magnified because it had its own momentum. Increases in income generated spending while increases in spending generated greater income and higher prices. In turn, rising prices operated as an inducement to merchants to increase their stocks, thereby further expanding credit. Hawtrey formulated an asymmetric theory concerning inflation and deflation spirals. In the case of a credit contraction, a spontaneous action of the economic agents would halt the aggravation of the depression: merchants borrow at rates that are not remunerative to keep their businesses alive, while bankers reduce their interest rates to induce costumers to continue borrowing. No such self-regulating forces would be at play once the vicious cycle of inflation kicks in.

> Where will this process end?…An indefinite expansion of credit seems to be in the immediate interest of merchants and bankers alike. The continuous and progressive rise of prices makes it profitable to hold goods in stock, and the rate of interest which the merchant who holds such goods is prepared to pay is correspondingly high. (Hawtrey 1919, 14)

Hawtrey affirmed that in the post-WWI years this dangerous inflationary spiral was having a record manifestation in the history of Great Britain: unfavorable foreign exchanges, loss of gold, and depreciation of the monetary unit up to the point of a loss of the gold standard were typical symptoms of inflation. These elements caused a lack of confidence in the monetary unit, which undermined the hegemony of Britain as the world's great financial center. Ever since the rise of capitalism, Britain had been the world’s clearing house, financing the vast volume of international trade and investment transactions. In order to maintain its financial preeminence, which was at the basis of the national economic wealth, two requirements must be fulfilled: "The solvency of the borrowers and the stability of the currency must command the confidence of the foreign lenders" (Hawtrey 1919, 117).

These aims could be secured only through a constant control of the stability of the monetary unit. To be sure, the problem of stabilizing credit was for Hawtrey equivalent to the problem of stabilizing the value of money, since "the value of debt immediately due is necessarily equal to the value of the means by which it can be legally paid" (Hawtrey 1919, 15).

The author clearly declared that national sacrifice was the prerequisite to be redeemed from post-war debauchery:

> The danger is that the unit may wander far beyond these limits. Beset by the tendency of credit towards inflation, it is always liable to fall away from whatever standard should be adopted. Unless a return to the standard is regarded as an unequivocal obligation, there is no limit to the possible depreciation...a return to a standard once lost is a painful and laborious journey. And if a standard must be preserved, the painful and laborious journey must be travelled, after every indulgence in inflation...after the debauch comes the headache. (Hawtrey 1919, 375)

In *Currency and Credit*, the steps of this painful and laborious journey are clearly described. They were the exact counterparts to the recommendations of Hawtrey's memoranda. Once more, the first step was budgetary rigor:

> If the monetary unit is to be restored the natural procedure is to contract credit. In normal times this would be done by raising the rate of interest. But the inflation which grows out of war finance differs from an ordinary credit expansion in that it is caused not by an extension of advances to traders but by excessive Government borrowing. The assets of the banks are swollen, not by commercial bills and loans, but by Government securities of short or long date...What is really wanted is a reduction of the indebtedness of the Government to the banks. (Hawtrey 1919, 348)

Yet, once balances were restored and the Bank of England had regained economic control, the bank rate was the ultimate instrument to secure currency stability. Indeed, for Hawtrey it was thanks to the active control of the bank rate that the market economy could attain the equilibrium that it naturally lacked: "the price charged for a loan is the interest upon it. If the demand for loans is outstripping the supply, the market can be brought into equilibrium by an increase in the rate of interest" (Hawtrey 1919, 25).

What was the theoretical reason for this Hawtrian optimism in the power of the bank rate, and especially in the effectiveness of short-term rates of interest? The answer is found in the pivotal role of the wholesale merchant (or dealer) in shaping the level of economic activity. In Hawtrey's economic model, the wholesale dealer held large stocks of goods, having the role of clearing demand and supply as he related the demand of consumers to that of the producers. By giving orders to producers, the merchant started the machinery of credit (Hawtrey 1919, 8). The fundamental characteristic of the dealer was his unmatched flexibility in responding to changed market conditions. The Hawtrian observation was that, in order to avoid holding large amounts of idle cash when holding of stocks fell temporarily below their minimum requirements, the dealer largely financed his business with bank advances.[52] Wholesale dealers were immediately "frightened by the high interest rate" (Hawtrey 1919, 24), since they made profit out of the difference between the price at which they bought and the price at which they sold. A rise in bank rate implied a substantial increase in the cost of holding stocks. If the latter was high enough to diminish the high profits of an inflationary phase, dealers reduced indebtedness with banks and ran down their stocks.[53] Reduction in stocks led to a decline in orders to producers. After a time lag, the latter reduced their output. This resulted in a reduction of employment and, thus, an overall reduction in consumers' income, which decreased the level of demand in the economy. The consequent reduction in consumers' outlay once more induced the trader to run down his orders as his stocks were at a higher level than the demand for them required. We see why he said, "the original restriction of credit will tend to repeat and reinforce itself."

Hawtrey's original interpretation of the quantity theory of money, which accorded attention to the varying velocity of circulation of money and to the pro-cyclical expectations of the economic agents, furnished greater support to the effectiveness of even a small change in the interest rate:

> With a given volume of business, prices depend not only upon the quantity of the means of payment, but upon its *rapidity of circulation*...Above all, an expectation that prices will rise

[52] Hawtrey often stressed the exceptionality of the merchant's position: "It is perfectly true that the producer is not much troubled by the rate of interest he has to pay his banker. But that is not so in the case of the merchant or dealer, who is constantly carrying stocks of goods large in proportion to his own capital, and makes very nice calculations as to his margin of profit and the cost of borrowing. A moderate rise in the cost of borrowing will make the carrying of stocks appreciably less attractive to him. He will buy less and sell more, and so a fall of prices can be started" (Hawtrey 1919, 297).

[53] Clearly, in a time of inflation, in order to be effective, the interest rate had to be raised high enough to offset the extra profit that the dealers were anticipating from the rising prices of commodities. In Hawtrey's words, "It is sometimes urged as an objection to this course that the interest on advances is so unimportant an item in the profit and loss account of a trader that a rise in the rate would only have a very gradual effect, and that something much more drastic is needed, especially at a time of high profits. Now the high profits must of course be taken into account in deciding just what increase in the rate of interest is needed. The reason why they are high is that prices are rising, and the value of any stock of goods grows, even while it is in the dealer's hands. But if the rate of interest is raised high enough to offset the extra profit anticipated from this cause, there is no reason why it should not react rapidly, almost immediately, on the demand for new credits" (Hawtrey 1919, 24).

> makes people less willing to hold such balances, and an expectation that they will fall makes them more willing. When, therefore, the Central Bank, by re-discounting at low rates, has once succeeded in stimulating trade borrowing, and the increase in the supply of the means of payment has started a rise in prices, the consequent increase in rapidity of circulation immediately tends to exaggerate the tendency. And vice versa, when high re-discount rates have checked trade borrowing, the consequent decline in rapidity of circulation exaggerates the fall of prices. (Hawtrey 1919, 296)

These theoretical beliefs surely gave grounds for the dear money prescriptions of Hawtrey's Treasury memoranda until 1922, together with his idealization of the role of the Bank of England. The economist remained faithful to his economic reasoning to the point that, in an interview in his old age, he repeated, “Keynes was always unsound on interest rates. He never understood its effect on dealer’s stocks” (HTRY 13/13, interview with Sir Alec Cairncross 1965).

Hawtrey's model explored the depressive consequences of too sharp or too prolonged a deflationary intervention. In the former case, a crisis could ensue, characterized mainly by an over-appreciation of the currency, pressure to sell, and widespread bankruptcy (Hawtrey 1919, 132-133). Yet, after the Great War, Britain was crisis-proof, since the government—not private traders—was the main debtor.[54] The latter case of a much-protracted deflationary intervention could cause a state of long-term depression. In *Currency and Credit*, Hawtrey already warned, "Financial correctitude, if pressed to the point of pedantry, may lead to a vice of deflationism as bad in its way as inflationism. Indeed one of the evils of inflationism is that when the monetary standard has lost stability, confidence can only be restored at the cost of a drastic currency contraction with all its attendant tribulation" (Hawtrey 1919, 331).

We know that after 1922 this was exactly the policy that Hawtrey criticized. Yet, from this quote, it is clear that, as much as it was deprecated, the "vice of deflationism" was judged as the *direct* and *inevitable* solution to the primary source of currency instability: inflation. The continuation of this quote is key:

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[54] "Too rapid a restoration of the currency may provoke a crisis. But it is a necessary condition of a crisis of any gravity that a serious proportion of the country's trade should be financed with temporary borrowing. Otherwise the shrinkage of the money value of the traders' stocks of goods, though it would make them apparently poorer, would not threaten them with bankruptcy. It may happen, therefore, that a country is left by a great war proof against crises; it has been as it were inoculated; the Government is the only debtor of any importance, and there are practically no trade debts for the crisis bacillus to feed on…it is possible that after the most exhausting war the world has ever known the whole world will be crisis-proof. But as the work of reconstruction progresses, and normal banking business revives, it may be that traders' indebtedness will reach an appreciable amount while the process of deflation is still taking place. In that case crises may break out…when crisis occurs the progress towards deflation will be suddenly accelerated. Apart from crises, the rate of progress is more or less within the control of Governments and banks" (Hawtrey 1919, 353).

> Inflation means inflation of the consumers' income, and more especially of profits and wages, the two principal variable constituents of the consumers' income. Deflation therefore means a reduction of profits and wages. If wages resist the process and it falls unduly on profits, the result is unemployment. When the country is tied to the gold standard, and an abandonment of that standard means loss of touch with the world's currency, there is a plain motive to induce the commercial community to undergo the ordeal. But when the gold standard has once been relinquished, it becomes very difficult to resist the traders' desire to have just so much credit created as is necessary to finance their business at the existing level of wages and prices...The inflation will be reflected in the value of foreign monetary units, that is to say in the foreign exchanges. (Hawtrey 1919, 361)

These words once more underline the reasons for the exquisite fear of inflation that our author manifested. Yet another point comes explicitly to light that is essential to pinpoint the theoretical support of Hawtrey's austerity doctrine. Inflation essentially meant the increase of consumers' income. In particular, credit expansion was due to the reaction of consumers' outlay to the acceleration of credit, consisting in an increase of consumption.

III.II ABSTINENCE AND THE CENTRALITY OF SAVINGS

In the previous section I discussed the theoretical basis for Hawtrey's primary concern with monetary stabilization, most importantly, the reasons for his faith in the effectiveness of a rise in bank rate to cure the inflation orgy. The ultimate objective of its effect was sharply pinpointed by Hawtrey's question: "We have already shown that a high rate of interest acts in the first instance on the wholesale dealer or merchant, who restricts his orders to the manufacturer or producer. How long will this restriction of orders take to affect the consumers' income and the consumers' outlay?" (Hawtrey 1919, 108). Changes in the bank rate transmitted into changes of output and prices only when the consumer outlay was affected. Hence, credit contraction was fully effective only when it had an impact on the consumer's outlay, that is, when consumption was decreased. Hawtrey was very explicit:

> This gradual diminution of the consumers' outlay is of the essence of currency control. If the consumers' outlay has become excessive this is due to a too profuse creation of credit…in the first instance a credit expansion stimulates production; it is when production ceases to respond easily to the stimulus that prices begin to rise. Inflation consists in the spread of the infection of high prices through production to the consumers' income and thus to the consumers' outlay. When the whole productive machine is working at a high level of money values, and markets have become unduly attractive to foreign trade commodities, imports increase, exports decrease, and a balance of indebtedness has to be paid. If matters are allowed to drift, the balance is paid in gold till the gold is exhausted. (Hawtrey 1919, 114)

In this section I show that the central role of savings in Hawtrey's economic theory was one of the major theoretical elements that supported his austerity doctrine. It was the economic analysis of the historical circumstance of war and post-war finance that revealed the ever-greater centrality of the role of the saver. In Hawtrey's economic model, savings was essential both in its positive and negative understanding, in the sense of abstinence. I begin by exploring the latter case.

Hawtrey wrote, "It must be remembered that the direct cause of an adverse exchange is too much buying…For this purpose the buying in question is mainly that of the dealers. But the buying of the dealers tends to follow the buying of the consumers; it rises and falls with the consumers' outlay" (1919, 351-352). Again, "It should be observed that the unfavourable exchange is the result not of the additional credits in themselves, but of the additional expenditure by the consumer. Insofar as the people into whose hands the credits are paid away by the Government abstain from spending these credits on themselves, but either accumulate them in balances, or else subscribe them to war loans, there is no tendency to attract additional imports or to divert potential exports to the home market" (Hawtrey 1919, 223).

After WWI, sober individual behavior acquired ever-greater importance. Since the gold standard was not effective, it was the abstinence of consumers that must compensate for the risk of adverse exchanges that would have otherwise been controlled by the drainage of gold and the automatic rise in the interest rate.[55] In Hawtrey's model, the maintenance of the exchanges essentially reduced itself to the regulation of the consumers' outlay. In order to maintain a sound currency system, it was citizens who should practice the expected sacrifice, and this could only occur if abstinence was enforced. "The inflation of credit, by financing the war with less than the due amount of *sacrifice* on the part of the people, actually attracts superfluous imports; the problem is then not so much to finance the imports, as to avoid attracting them. The solution is to be found not in borrowing more money abroad, but in *encouraging or enforcing abstinence at home*" (Hawtrey 1919, 230).

The author of *Currency and Credit* clearly identified two instruments of abstinence. The first was dear money, which, as we know, affected consumers indirectly through the contraction of dealers' stocks. Yet it was taxation that directly diminished the consumer outlay (Hawtrey 1919, 230). Hawtrey was explicit: "It is only by financial methods, such as drastic taxation, which tend to curtail the expenditure of the individual upon consumable commodities, that deflation and capital expenditure can both be encouraged" (Hawtrey 1919, 351). This quote embodies an essential aspect of Hawtrey's economic belief: curtailment in consumption went hand in hand with an increase in capital expenditure—that is, the genuine and direct

[55] An increase in war expenditure would increase the consumers' income, and if the consumers devoted their increased purchasing power to their own consumption, this would mean that an increased money demand was applied to a limited output of commodities. If the values were still based on gold, a rise of prices would have attracted increased imports; now, however, it only makes the exchanges more unfavorable (Hawtrey, 1919, 227).

destination for individual savings. To fully appreciate why this was the case, one must first give attention to savings in its positive meaning.

In Hawtrey's economic model, the "consumer outlay" included two distinct actions: consumption on expenditure goods and services and savings in the form of investments in assets, shares, and bonds.[56] The latter were the crucial pillars for the functioning of the market economy, especially during the war and the post-war years. One must keep in mind that, in normal circumstances, sound finance could be maintained thanks to the "genuine savings of the community" with which the Government financed its temporary borrowings, either by taxation or by loans. During wartime the State required more resources, hence private savings were drawn into war loans. "The people may abstain from spending money that they would otherwise have spent, either on their own enjoyment or on investment, and may surrender the purchasing power thus kept unexercised to the Government in exchange for holdings in the War Loan" (Hawtrey 1919, 214). After the war, not only were savings the source for the funding of government floating debt, thanks to investments in gilt edged securities (see section II.I), they were also the principal resource of the restoration of fixed and circulating capital. Hawtrey wrote, "Production must exceed consumption, the surplus taking the form of the restoration of the nation's equipment of fixed capital and of its stocks of commodities" (1919, 348). Once savings that were subscribed for war-purposes were released, they became available for private investment, where the dealer had a primary role: "A trader does not carry the whole of his stock in trade with borrowed money. A portion is supplied from his permanent capital, representing his own savings, or those of other people definitely invested with him" (Hawtrey 1919, 349).

From the above, it becomes unmistakable that the Hawtrian model prescribed the economically virtuous behavior of the consumer. In *Currency and Credit*, the author explicitly distinguished between two types of consumers in the two circumstances of abundance or scarcity of credit: "Where there is an accession of income, the thrifty man will tend to invest his windfall, the unthrifty to spend it...Where there is a reduction of income, the prudent man, at any rate, will try to make an equal reduction of expenditure as soon as he can" (42). It is the thrifty and prudent man who acted in accordance with the primary economic principle of maintaining a stable and sound currency. In times of credit expansion, his small expenditure on consumption goods reduced the inflationary pressures, while, when contraction was initiated, he responded by reducing expenditure and thus making the increase of the rate of interest immediately effective.

This excursus fully rationalizes Hawtrey's favorable account of taxation as the means to produce both price deflation and capital expenditure. After the war, the majority of taxation revenue was used to redeem debt, thus repaying loan holders, that is, the portion of the community that was inclined to save. "This money becomes investible savings or alternatively loanable credit in the hands of the people to whom

[56] Deutscher (1999) commented that Hawtrey's terminology did not distinguish spending on goods and spending on securities. Both elements were part of the consumer outlay.

it is paid. In fact taxation for debt redemption takes money from people who might otherwise spend it on themselves and uses it to increase the resources of the capital market" (HTRY 1/20). Clearly, the idea was that taxation forces savings upon the community at large in order to reward and incentivize the virtuous agents of society: savers-investors rather than consumers. Similar ideas were expressed by Niemeyer in an influential memorandum: "Debt repayment extracts money from those who are not likely to save and invest and makes it available to those that are likely to do so" (T 176/5, fol 40).

In sum, abstinence ought to be enforced upon the majority who are prone to spend, and ought to be incentivized for the saving-investor type. These Hawtrian economic ideas gave theoretical support to the austerity policies of price deflation and taxation, and they were fully diffused among Senior Treasury officials.

CONCLUSION

Hawtrey was not a man of the backwaters. On the contrary, he had direct influence upon the most commanding minds of the Treasury and of the Bank of England, the two institutions with primary responsibility over the British austerity agenda after WWI. As director of Financial Enquiries, Hawtrey, on occasion, participated in policymaking, especially during the Genoa International Financial Conference. He attended as an active delegate and personally drafted the resolutions that were inserted into the official records. Yet, rather than single historical episodes, this work put an emphasis on a much more entrenched and long-lasting Hawtrian influence. The powerful controllers of Finance, Blackett and Niemeyer, and the Governor of the Bank Norman, were well educated in Hawtrian economics. After the war, economic theory became concrete policy agenda in the hands of the influential men Hawtrey advised. Existing scholarship has not accorded the necessary weight to this fact, which is indispensible for assessing the nature of the "Treasury view." The Treasury view was not simply a pragmatic stance: Hawtrey's macroeconomic theory comprehensively grounded the Treasury view well beyond his renowned crowding out argument.

I have undertaken an analysis of two levels. Hawtrey's Treasury memoranda were studied in parallel with his scholarly publications, with a focus on his masterwork *Currency and Credit*. It emerges that his policy prescriptions ensued directly from his economic model. After WWI, Hawtrey upheld a firm austerity agenda. He advocated drastic budgetary and monetary rigor in the name of price stabilization. After 1922, he insisted on the need to decrease the bank rate, yet remained a committed supporter of the gold standard, an objective of absolute priority even if it required further monetary revaluation. An important building block of his austerity agenda was the advocacy of the preeminence of the technocratic institution of the Bank of England over British economic policies. The orthodox principles of a sound currency overrode all other national socio-political concerns. Finally, Hawtrey famously rejected public investment in public works as a means to cure unemployment. In his 1925 article in *Economica*, the chief theoretical elements that grounded Hawtrey's austerity prescriptions are detectable; they were fully elaborated in his earlier *Currency and Credit*. Hawtrey modeled the economy as a great credit machine that was constantly subject to the threat of indefinite credit expansion. Yet he gave strong reasons for efficient credit management due to the force of the bank rate, which was grounded upon the central role of the dealers and his original interpretation of the quantity theory of money. These elements justifed Hawtrey's austere monetary prescriptions to cure the "vice" of post-war inflationism, together with his idealization of the role of the Bank of England. The rationale of Hawtrey's austerity agenda cannot be fully grasped without considering the centrality of savings in his economic model. Savings, he thought, should be understood both as abstinence from consumption goods and as savings-investments. The essence of currency control rested in enforcing abstinence on the consumer, while the basis for sound finance and capital development was the investment of thrifty men. The essential ground for taxation for debt repayment was to incentivize such economically virtuous behavior.

Hawtrey wrote his economic theory with the objective of putting it into practice. His prescriptions of austerity were best immortalized in the Genoa Draft Resolutions, the instructions stemming from this sophisticated economic model. He advocated monetary stabilization through the management of the bank rate, budgetary rigor, and rejection of public investment, all of which became widely established goals among other orthodox economic institutions, from the Bank of England to the League of Nations. In the early post WWI years, economic theory had clear operative force on policymaking.

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