A SURVEY OF THE MALDISTRIBUTION OF THE WORLD'S GOLD STOCKS, AND A STUDY OF THE POSSIBLE CAUSES AND EFFECTS THEREOF

by

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Ricardo, father of the orthodox theory of the gold standard, asserts: "Gold and silver having been chosen for the general medium of circulation, they are by the competition of commerce distributed in such proportions amoungst the different countries of the world as to accomodate themselves to the natural traffic which would take place if no such metals existed, and trade between countries were purely a trade of barter."

The gold standard, like so many of the man-made institutions of society, came in time to be regarded as a fixed, a non-changing thing. It became part of our orthodoxy. In 1900 Congress fixed as law what had for some time been our practice to accept, and we remained on the gold standard until early in March, 1933. The standard of value within the country was a fixed thing. It meant (1) a free gold market, and (2) often, although not always, the unrestricted and unlimited redemption of notes in gold.

The problem as viewed from the national scene was relatively simple in the pre-war era. The problem still remained of fixing, or rather, of accomplishing an international standard. Each nation came to accept its "unit",

this unit being simple and universally acceptable within the country. Gold became the common denominator in the international economic system which was based on the principle of the division of labor and interchange of commodities, services, and labor. Thus the free movement of gold between countries assured stable exchange rates, and permitted a correspondingly free international movement of funds which tended to equalize interest rates and price levels and consequently, to maintain a certain degree of adjustment between the national economics of the principal commerical countries.

The international gold standard is essentially a creation of the second half of the nineteenth century. At the end of the Napoleonic Wars the currency systems of the world, with very few exceptions, Great Britain being by far the most important, were based either upon silver as the sole foundation of the system or upon silver in combination with gold. Between 1848, when gold was discovered in great quantities in Australia and California, and 1914, there occurred a gradual but almost universal transition from these silver or mixed currency systems to gold. Between 1919 and 1925 the international gold standard was restored.

Now the gold standard in any country can be established by national legislation. Its success-

ful functioning as an international standard depends upon the existence of conditions too broad to be defined, or to be regulated by the domestic legislation of one country. There are certain rules for the operation of the gold standard which any country must observe if the gold standard is to operate satisfactorily: (1) absence of legislation restricting the free movement of gold from one country to another, as laws nullifying convertibility of notes, imposition of embargoes on the export of gold and interference with the ordinary procedure for the purchase and sale of gold. Since the primary purpose of gold movements is to facilitate the international transfer of funds, it follows that dealings in foreign exchange must also be free of restrictions. (2) a state of international economic equilibrium, a condition which can be brought about and maintained only by a reasonably free movement of commodities, services and capital, which tends to create a comparatively stable balance between the international income and outgo of each individual nation. Often equilibrium in the international accounts is achieved by capital transactions, and the free movement of long-term capital is just as essential to the maintainence of the gold standard as is the free move-

ment of gold and short- term funds. Countries with a consistently favorable balance of payments which are unable or unwilling to make foreign loans and investments can be paid the balances due them only in gold, and the continued accumulation of gold by some countries at the expense of others must sooner or later force the losers to abandon the gold standard. Political manipulation of credit as seen in the 1914 to 1918 Anglo-American maneuverings created a condition which caused the abandonment of the gold standard, because it was impossible to stay on. (3) Willingness on the part of the central banks to permit gold movements to exercise their full effect on the credit structure of their countries. If central banks counteract the effects of gold movements through open market operations, the semi-automatic adjustments which normally correct the conditions giving rise to gold movements do not take place, and a situation of disequilibrium is maintained.

(4) The last prerequisite is of a political nature. The gold standard operated successfully before the war because political hazards interfered with the movements of funds, short-term as well as long-term, much less than in the post-war period.

Political uncertainties not only interrupt the normal movement of short-term and long-term capital to the countries affected, but often give rise to a flight of capital which may cause the collapse of one country's currency system and create abnormal conditions in the money markets of other countries.

The international gold standard and the international credit system built upon it are a delicate mechanism which is very easily thrown out of adjustment. Since the war nations have tended more and more to adopt policies of national self-sufficiency which, in violation of the fundamental prerequisites, involve restrictions of the international movement of gold, capital, commodities, and services. The result has been an almost complete breakdown of the international gold standard and a collapse of the international credit structure. Superficial observers have hastily concluded that the defect lies in the gold standard itself; actually it lies in the impossible conditions, such as the unbalanced credit structure, under which the gold standard has been expected to function.

Under the international gold standard as we see it in the pre-war period, gold was used as a basis for currency and credit and to a lesser extent, for the settlement of temporary marginal differences in the international

balances of payments. However, a difference existed between temporary deficits and more permanent maladjustments. Here equilibrium was generally achieved by means other than gold shipments, namely by long-term and short-term borrowing until such time as the fundamental causes for the deficit could be rectified. In this era, gold was not ordinarily used as a medium for the actual payment of international debts; it was an instrument of commerce but not a commodity of commerce. The use of gold for settling marginal balances was comparatively small because the international accounts of the principal countries were much better balanced than in the post-war period. Foreign trade was better adapted to the international economic status of each country. The great creditor nation, having an unfavorable balance of trade, thus enabled the debtor countries to pay their debt in services and commodities. Debtor countries, young and economically undeveloped, attracted foreign capital for use in the exploitation of their natural resources. Thus it was this equilibrium in the balance of payments of the various countries of the world which prevented gold from becoming a means of debt payment and which brought about a more or less satisfactory international distribution of gold.

The usefulness of gold insettling balances was due to the fact that, as a commodity with a world market and

a relatively stable value, it was universally acceptable. Also, since the monetary units of most countries were defined in terms of gold, the movement of gold provided an automatic check on fluctuations in foreign exchange rates. Whenever a monetary unit on the gold standard fell below a certain point in the exchange market, gold exports immediately rectified the situation. Gold exports for such purposes, however, were generally small. If they assumed large proportions, a contraction of credit and an increase in interest rates ensued, which in turn led to an influx of short-term funds from abroad and a rise in the exchange value of the currency.

This direct effect of gold movements on interest and exchange rates led to the general belief that the operation of the international gold standard was automatic. This view was only partially correct, since the central banks could, and did, influence interest rates and thereby affect the movement of funds regardless of gold movements. However, in the pre-war period the central banks rarely used open market operations to influence credit conditions and counteract the movement of gold. The control over the money market was effected chiefly by manipulation of the discount rate; but discount rates as a rule were determined chiefly by the movement of gold, and it was the gold position of a central bank

which determined its discount policy. Thus, while they were able to influence and counteract the movement of gold, in most cases the effects of gold imports or exports on the money market were direct and immediate.

Up to the outbreak of the war, the gold standard fun ctioned with relative success in most of the countries of Europe, in the United States, Australia, Japan, and in several South American countries. Gold moved freely from one country to another; actual shipments were not large, and gold was fairly well distributed throughout the world, the amount of gold corresponding more or less to the economic or political needs of each country. These needs and the maintainence of stability constituted the motivation of the central banks of the world for the bolstering up of the supposedly automatic tendencies of the world's gold supply so to distribute itself as to enable all gold standard countries to continue to link their currencies, to gold, the international currency, while at the same time pursue a healthy internal development.

It is the attempted reconciliation of these two aims of financial policy, the linking of the national currency to gold and maintaining a healthy supply of the internal medium of circulation, that made the post-war dilemma. Theorists have regarded the linking of

the national currency to gold as the paramount aim and to anticipate a healthy supply of the internal medium of circulation, as gold was "supposed" to flow towards the country whose internal development warranted the flow, and gold holdings upon which the supply of internal currency depended would therefore automatically adjust themselves to the legitimate demands of each country.

To "maintain a healthy supply of the internal medium of circulation" is one of the reasons given by the Administration for asking Congress for the right to control the monetary policy. This request was granted the President in the Thomas Amendment of the AAA. It was not a request for, nor was permission given for government use of credit for lifting itself up by the bootstraps. We were competing in world markets where inflation was resorted to. We entered the arena of "managed currencies". President Roosevelt was by this Amendment given the power to use inflation, or to threaten to use inflation, as his weapon in the economic warfare among the nations.

World conditions however show conclusively that despite all efforts to retain the desired gold reserves, with all the hardships, the lowering of wages with resulting labor strikes, which these efforts imposed on

home industry, maldistribution of the world medium ensued. This maldistribution has led to the suspension of the gold standard as the measuring rod for the determination of the value of a number of national currency units. The fight to retain the gold standard entails, while it is in progress, steps which if prolonged are normally inimical to internal industry. The factors which are relied upon to redress a threatingly heavy outflow of gold are falling prices and rising interest rates, both of which act as dampers upon the activity of home entrepreneurs. Thus there may be long periods, during which efforts to maintain the gold value of a currency will be in direct opposition to rather than identical with the internal interests of a country. When these efforts succeed they will at best merely link the development of internal industry to the international situation, and the internal price level, whose stability is the key to healthy development, will be open to whatever fluctuations occur in world prices. When they fail, the question arises of whether it is not more important to govern financial policy in the interests of internal price stability, while abandoning the international gold standard altogether if necessary, and allowing the rate of exchange with other currencies to fluctuate freely. The experiences of England and France with labor strikes evi-

dences the repercussions of these internal interests being sacrificed in an international monetary "management".

There are two ends toward which monetary policy must be directed in order that the financial mechanism may subserve the goal of increasing and facilitating production, distribution, and exchange, for which purpose it was created, and may not become an end in itself; (1), the maintainence of a stable internal level of prices in order to combat the alternating waves of inflation and deflation which make up the business cycle; and (2), a steady rate of exchange between the national currency and the currencies of other countries without which international trade must inevitably suffer some dislocation. Orthodox theorists assume the two to be automatically connected so that a policy which is guided in the interests of the latter will automatically react to the attainment of the former. Modern insurgents rise to say that the two aims are generally so thoroughly incom patible that the governors of monetary policy must confine themselves to pursuing the one at the expense of the other, and since internal stability is of greater importance than foreign trade, it should be given priority. Proposed "managed international gold standard" policies which may attain the two aims still have opportunity to prove themselves.

The international gold standard worked so seemingly smoothly before the war that with hardly a dissenting voice it was reestablished at the earliest possible moment after peace was made. The return was made in the belief that monetary stability would provide a basis for necessary readjustments in the wider field of financial and trading relationships. Within a decade the gold was abandoned, in some cases unavoidably; in other cases, the move was taken as a voluntary measure of monetary policy. Mr. J.M. Keynes expresses himself thus anent England's experience in this field, " . . the disastrous inefficiency which the international gold standard has worked since its restoration five years ago(fulfulling the worst fear and gloomiest prognostications of its opponents) and the economic losses, second only in amount to those of a great war, which it has brought upon the world . . . "[1]

Mr. Keynes' proposal for reform, contained in his Monetary Reform, suggests stability of internal prices, at the sacrifice if necessary of exchange stability; the means to this end would be the regulation by the central bank, aided by the treasury, of the volume of credit, and the complete severance of the volume of currency from the gold reserves. Gold would be im-

1. The Money Revolution, Sir Charles Morgan-Webb, p.44

portant only to meet sudden emergencies and "as a means of rapidly correcting the influence of a temporarily adverse balance of international payments and thus maintaining day-to-day stability of the sterling-dollar-exchange."[1]

In the post-war period the departure from equilibrium, as shown above, was so extreme that adjustments under the pressure exerted by gold movements seemed impracticable. Immediate collapse was threatened. Policies of cooperative support were adopted by the central banks in the hope that somehow adjustments would of themselves be made. The result was still further departure from equilibrium. Typical manifestations were a large increase in the foreign indebtedness of many countries and a persistent and growing maldistribution of monetary gold stocks. The experience of those years surely leads to the inevitable conclusion that a reasonably close approach to equilibrium must be reached before there can be established an international monetary system which promises to yield satisfactory results to be permanent. An international monetary system is a means of maintaining equilibrium; it cannot create equilibrium. That must be established within nations as well as

1. Monetary Policy and Economic Stabilisation, A.D. Gayer, p 190

between nations.

The war, on which we have come to blame practically every difficulty which besets us today, changed the whole obligation and currency setup. Two factors stand out in the early part of this era; namely, the breakdown of confidence,thus ending old trade channels, and the drastic reduction in the flow of capital. Pre-war Britain had built up an enormous body of foreign investments. Germany had been slower in this trend, but had been very active during the early years of this century. These investments had been beneficial both ways, were sound, and were used in the building up of gainful enterprises. Repayment of principal and interest seldom caused fearful difficulty. But the war indebtednesses were huge, were for shorter periods, and, most of all, were used for the unproductive business of war. Governments mortgaged their future productivity for the mad business of killing off the enemy, who, very often was a strong customer of former days, who had helped him build his wealth. At the end of 1930 approximately one-third of the total interest payments which had to be made to the United States on long-term account each year were incurred by the borrowers on loans made for unproductive purposes. Germany, on the other hand, constitutes the largest debtor on unproductive account with a debt of annuities, which when cap-

italized at 5½% represent a sum of some eight billions.

The old picture of Great Britain being the luminary in the investment world changed and in 1930 the United States was a net creditor on long-term account to the extent of some eighteen billion dollars. In the post-war decade, while the net export of gold was continuing on a scale undreamed of before the war, the United States continued to enjoy a sizeable net commodity export balance varying from $254,000,000 in 1923 to $905,000,000 in 1928. This further changed the pre-war picture, as Great Britain now no longer the capital exporter, has had a consistent adverse balance on commodity account. The United States, a potentially self-sufficient country, thus changed places with Great Britain, who, except for oversea products and trade therein hovers close to the poorhouse or starvation.

Another phase of this changed scene is that the war-incurred international debts finds the new debtors are in many cases governments rather than private individuals and corporations who commonly constitute peace-time borrowers. This is significant in that a government fears having its future borrowing power jeopardized by defaulting. The field of money and banking, heretofore largely dominated by bankers and economists now became largely a political field.

Besides the government-incurred indebtedness, there was an enormous post-war epidemic of foreign bond investing by the American public. In 1923 flotations of foreign government bonds in the United States amounted to $186 million; during the next five years these flotations averaged $56 million a year. Among these were the ill-fated South American bonds. A number of governments having no connection with the war were incurring debts for unproductive purposes. Peru was among these.

The new international obligations are owed largely to countries whose economic policy differs from that of the chief pre-war creditor, Great Britain. The United States, and to a much lesser degree, France, now assumed important roles as creditor nations, yet both are strongly committed to a policy of protection, while Great Britain herself, the other great international creditor, has abandoned her free trade policy since the war.

The United States was becoming a lender of growing maturity in the few years prior to the war. She was in a high degree of industrialization; she was producing largely her own raw materials; and, she had already started on the track of lending and still being economically independent of those to whom she loaned. Her debtors had difficulty repaying for want of currency necessary to meet the obligations, as this currency was already largely centered in the creditor nation. Here the self-sufficiency of the United States becomes a

difficulty of primary importance, for by reason of it she is naturally less receptive to overseas goods than Great Britain, the historical creditor. This very self-sufficiency, moreover, has endowed her with a heritage from the days when she herself was a debtor nation with rapidly developing resources, the heritage of protection. Nor is she alone in this, for France is tightened up with restrictions and quotas on incoming goods, in addition to duties. Even Great Britain has forsaken the free-trade policy for tariffs. Thus we have three nations, the United States blessed with resources, and Great Britain and France, both dependent upon foreign sources for a large portion of their requirements, all demanding that their oversea claims be honored.

The bearing of tariff policies upon the question of maldistribution of the world's gold supply is now evident. It has steered the course of political action in these three countries, governments rising and falling on their stand on this issue. Even though the philosophy of central banking had never grown up, so that gold movements had continued to have their traditional effect on prices, the tariff policies of creditor nations would have largely, if not totally, nullified this effect by raising prices on incoming goods, and so destroying the relative trade advan-

tage which whould normally accrue to the debtor nations under the deflation of their prices caused by a steady drain of their gold. Even though international lending had continued at a normal rate, the current obligations of the debtor coutries could not have been permanently met by further borrowings, so that if tariff policies continually precluded them from paying in goods, defaults were inevitable as soon as their gold stocks had been sufficiently depleted.

The normal effect of a prolonged drain of gold must be to force the gold-losing country off the gold standard, whether, as in the case of Brazil, the drain is allowed to continue until the whole gold holdings of the central institution are exhausted or whether, as in the case of Great Britain, gold payments are suspended when gold holdings have sunk to a point where their further reduction might make a subsequent return to the gold standard a virtual impossibility. The suspension of the gold standard is the means of rectifying a prolonged adverse balance of international payments, for, in the subsequent depreciation of the national currency, the price of imports is raised to levels which discourages importers, while the world price of the country's exports is lowered and the volume of the exports is correspondingly increased. By this means a stimulus is given to the favorable export commodity

balance.

The part played by gold movements in the establishment of the conditions necessary to secure equilibrium in the international balances of payment of the various countries is significant. The quantity of money in the country depends ordinarily on mines, and balances in the simple case. This has come to be purely a matter of control in the present scene. The aggregate money income depends on current output of goods, that is efficiency, multiplied by the prices. Gold flows to the country with excess of imports thus affecting prices, and through prices, money incomes in both areas. The country with the greater efficiency will tend to have the lower level of prices, and the higher range of money incomes. Specifically, this flow of gold will affect import and related industries first and with greatest force. The international gold standard creates not a common price level but an integrated price and income structure, the various parts of which stand in organic relationships to one another. These things remain fundamentally true when allowances are made for the complexities of modern currency systems, for the existence of tariffs and of transactions other than the direct exchange of present goods for present goods, for exampþe, capital and interest

transactions and such extra-economic payments as tributes. Thus a transfer of reparations, for example, involves an adjustment of the price and income structure in both the paying and recipient countries.

The price and income structure is determined by the operations of the organized banking system. It must control effective volume of purchasing power so that its aggregate amount does not exceed the amount dictated by the necessities of international equilibrium. Thus, if in the outside world the price and income structure move upward, due to inflationary manipulation, the bank must prevent an upward movement at home until equilibrium is restored. It may attempt to lower the level of local prices and incomes, or attempt to increase efficiency in production to lower selling prices without a lowering of level of money incomes.

Tariffs alter the relative level of prices and incomes in the areas concerned in international trade. Imports are checked while exports are not immediately affected. The balance of payments is adjusted by inflow of bullion which raises both prices and the level of money incomes. At the higher level of prices and income the importation of bullion ceases and goods take the place of gold. But, if the gold flows are not allowed to influence the price and income structure in either area, the tariff,

in one case, and the rigidity of the cost and income structure, in both cases, may become the cause of a quasi-permanent drain of gold, and the old equilibrium will not be obtained.

Interest and capital receipts take shape of excess of imports over exports, the borrowing country, as a group, receives more purchasing power for immediate disposal, while paying country has parted with this immediate purchasing power. Instead of borrowing country paying for imports by exports, they can now pay by these loans, thus a high level of money incomes and prices maintains; this checks exports, and leaves imports at higher level than formerly possible.

Thus we see that the international gold standard supplies a mechanism for maintaining fixity of exchange and for keeping the price and income structures of the various countries in touch with one another. But, this calls for not only the existence of a common currency basis, but also the administration of the gold standard in each and all of the countries adhering to it, by refraining from inflationary measures under which the gold standard cannot maintain.

The gold standard was resumed by several of the leading nations in the post-war era. The period of 1918 to 1925 wrought havoc in the gold picture. Once a depression has been initiated, it tends to perpetuate itself, as the decline in productivity tends to affect one industry and branch of employment after another. These fall roughly

under unemployment being a direct cause of reduction of demand for consumption goods, partly because orders for raw materials fall off and partly because the decline in business profits check flotation of new loans. Thus governments fall back on the expedient of abandoning the gold standard since it gives the immediate opportunity of checking the fall of prices. That is the immediate result; but the far-reaching consequences may not make the move one of rar-reaching wisdom. The leading nations have thus far so completely deserted the international viewpoint in favor of nationally managed currencies, that results of the international gold standard "would have beens" can only be highly problematical. Again we quote Keynes, "Even though there is feasibility in departing from the gold standard it does not follow that these difficulties were caused by the existence of the gold standard."

One may view the depression as due to "gold mal-distribution", but the facts of gold redistribution proves nothing since it may be an effect, not a cause, of change. The concentration followed after the depression in Europe had begun, so it could not have been a causing or initiating feature. The depression has produced drains by uncertainty as to future position of various currency systems; and currency management has been subjected to much political "footballing". An unwise inflationary

measure, for example, has been resorted to in order to win an approaching election or vote. Again, sometimes gold drains have come from impossibility of raising fresh loans or exporting enough to adjust balance of payments by gold shipments when it was impossible to reduce local income by deflationary steps; other times the gold standard has been abandoned and gold reserves used without effect on the local price situation.

In 1921 heavy gold flows to New York and to Paris led to an orgy of bank-rate changes in Europe, caused dear money, and aided in producing the depression in those centers. The 1929 gold flows were important factors but the seeds of the depression were already sown in business conditions in the United States. The cheap money policy of the Federal Reserve System in the winter of 1927-1928, and the reluctance of American banking authorities to put brakes on its amplitude, were contributing factors. But the United States was even then already helping Europe spend its way out of its depression. The economic life of the world came to a high degree under political influence; the world has become "inflation conscious" and aware of possibilities of a currency becoming worthless; the economic structure has become rigid to an unprecedented degree; tariffs have increased and difficulties of adjustment have thus also increased.

We are becoming part of an international network which will have to cope with these factors and obstacles in concert. Britain and the United States will be looked to as the leaders in the move toward stabilisation and the return to normal tieups because they are most intimately tied by economic bonds and international thinking. We shall, in the last chapter, view the present trends and accomplishments in these international tieups.

CHAPTER II

During the period from 1914 to the present, gold tended to become grossly maldistributed. It concentrated in centers least receptive to its "automatic" functions and drained from those countries who were in dire need of its use as a basis for restoring wrecked currency systems. This chapter aims to observe these movements and inquire into their causes. The United States has been the magnet that lured the precious metal to her. Gold has accumulated in her centers in great quantities. She has chosen a managed currency system, with gold used only for international transactions, and with vast amounts sterilised and kept in her vaults. Industrial, political, and economic phenomena contributed to this condition we find prevailing in the present scene. We shall in the final chapter attempt to look ahead and foresee consequences from present trends.

Gold is not of paramount importance in the present setup of managed currencies. It might perhaps be said that the huge stocks of gold in the United States are

only of decorative importance. However, one of the primary functions of gold is also, of course, to represent the permanence of value in time and space. Likely, with the return of old trade relationships, we may find gold coming into its own again and becoming once more the foundation of our national monetary systems and relationships. Gold functions in a state where equilibrium exists, it serves to maintain equilibrium; but it cannot function where conditions over which it has no control, and with which it has no connection, bring such maladjustment that no international currency free from management can exist.

In 1914 the United States had monetary gold stocks amounting to $1,813,000,000. From June to December of 1914 exports of gold exceeded imports by $165,200,000. In 1915 we increased our monetary gold stocks to $2,213,000,000 and by 1918 we had $3,160,000,000. Importations of gold from Europe practically ceased with our entry into the war in 1917.

During the period from 1914 to 1917, an enormous balance of trade ran to the United States. War supplies, food, and other commodities the belligerents came to rely upon from the United States so that they could divert their factories to the manufacture of munitions and war essentials, brought the total "favorable" balance to $5,837,000,000 from June 1914 to June 1917.[1]

1. Treasury figures cited from: Documents Submitted to the Gold Delegation, League of Nations Series.1931 II A.7,p 38 and 39

Therein lies one of the greatest factors in the economic dilemma, this huge trading boom consisted of goods of American manufacture, traded for gold from a depletable source. Abuse of credit by foreign nations was rampant. The huge cargoes were paid for in gold and credit, not largely by the exchange of goods as heretofore, and in 1918 and 1919 the trade balance continued high but was settled in part temporarily by credits granted by the United States government to European governments, with which it was associated in the war.

This heavy buying, supported by gold, and then by credits, stimulated industry to a height never before attained on a national scale. We reached a high point of credit inflation. Lumber pilers left $3.60 a day jobs to work in the shipyards at eleven and thirteen dollars a day. Women entered industries never before open to them. Farmers placed mortgages on their 320 acre farms to buy more hundreds of acres to raise wheat. Land which never should have been planted now came into use for dry farming in answer to the universal cry for wheat. Nor was the United States alone in this. The exchange of war commodities brought the volume of credit to proportions that could not possibly be sustained by their holdings in gold. Post-war inflation and monetary chaos followed. The German mark became worthless, the franc fell to one-fifth its former value, Belgium and

Italy suffered, and the pound sterling fluctuated.

The new gold supplies entering the bank reserves of the United States enabled banks to expand their loans. The Federal Reserve Act reduced requirements and credit demands were met with moderate interest rates. They ran:

3.45% in 1915
3.43% in 1916
4.74% in 1917
5.87% in 1918

The American came to be known as "a man who rides in a financed car over a bonded road". Loans and discounts in 1914 were $15,339,000,000, and investments were $5,585,000,000. In 1918 loans and discounts were $22,515,000,000 and investments were $9,742,000,000.[1] This increase is fifty-four percent. However, higher prices absorbed much of the increased purchasing power. Banks were not pressed as interest rates were moderate and funds were continually available. The Federal Reserve Banks further reduced reserve requirements. From 1914 to 1929, the gold stock gained $2,433,000,000 and bank credit added $37,685,000,000, or fifteen dollars bank credit to each additional dollar of gold. Had the note circulation been rigidly kept down to its pre-war figure, inflation could have been reduced considerably. But, in the face of the urgent necessity of spending to meet the war requirements, it was impossible to keep

Figures cited from Gold Delegation Report, League of Nations, 1931 II A 7, pages 40 and 41

the note circulation down. Taxation could not be resorted to for balancing the budget. In flation, the "easier" way was resorted to. Whereas money was "easy", commodities were scarce---the possibilities of making use of this purchasing power was curtailed. There was no wholesale flight of capital to neutral countries. As exchange control was practically non-existent at the beginning of the war, such a flight would have reduced the exchange value of the currencies of the belligerent countries and would have increased the difficulties of governments in making purchases in neutral countries.

There was little flight of capital during the 1914 to 1918 period. Some there was to Switzerland from the Central Powers and from France, while some French capital went to London and to New York. Great Britain averted a flight by paying special deposit rates, and managed to attract considerable funds from neutral countries, notwithstanding the exchange risk, which was temporarily concealed by the policy of exchange pegging by the Allies. Much of the first war loans from the United States to England served to sustain the pound sterling in her position as pivot of currency ratios. She pegged with the dollar, using the early loans raised by our Liberty Bonds for this purpose. France, too, was bolstering her gold with our help. The international credit structure

was becoming pyramided, with the United States playing the role of the mythical Atlas. Each country had to learn that a monetary policy guided exclusively by narrow national considerations was bound to recoil upon the nation itself.

The war ended late in 1918 in somewhat unexpedted manner. Armies,commodity markets, gold stocks and credits were all maladjusted. Peace came with suddenness and found countries as unprepared for it as four years earlier War had. Uncertainty and chaos prevailed except that war demands for man-power and credit were no longer of such proportions or pressure. Business had to adjust itself to peace conditions. The year 1919 began with uncertainty prevailing in business circles, then revived as demands of many kinds arose. Governmental expenditures continued on a great scale, financed by more loans, inflation was rampant, wages and prices advanced, and owing to the disorganized state of trade and tansportation, a shortage of various kinds of commodities appeared to exist. This was a fallacy, later to be discovered to much grief, as the stocks on hand were great indeed in comparison to the ability of the public to pay for them. The American public seemed to be in some happy frame of mind, bolstered up by a philosophy rampant that there was enough for all of wages and the good things of life. The merry circle, they argued, would continue to go around if only no one halted it with inquiries of why

and from whence would come the ability to purchase all these commodities still being produced at "boom rates". The argument was often made that if "purchasing power" were not curtailed, wages would not suffer. Inflation was present but not yet generally detected. We find that during this period loans and discounts increased from $22,515,000,000 in June 29, 1918 to $31,208,000,000 on June 30, 1920; and bank credit expanded from $32,258 million in 1918 to $42,595 million in 1921 Investments increased from $9,742,000,000 in June 1918, to $12,230,000,000 in June 1919, and decreased to $11,387,000,000 in June 1920.[1]

On June 21,1919, Governor Harding of the Federal Reserve Board, addressed a letter to each of the Governors of the twelve federal reserve banks, in which he said;[1]

"The Federal Reserve Board is concerned over the existing tendency toward excessive speculation, and, while ordinarily this could be corrected by an advance in discount rates at the federal reserve banks, it is not practicable to apply this check at this time because of Government financing."

This was shortly after the flotation of the Victory Loan. The commercial paper rate was 4 3/4 percent, but 4½ percent existed on government-secured war loans. By two steps this preference was removed and by June 1, 1920, 7%, the highest rediscount rate ever established in the reserve banks, had been reached. Inflation culminated in 1920, prices were rising and the gold exports continued.

1. Gold Delegation Report,Geneva 1931, p 47

In its annual report at the end of 1919, the Board said:[1]

"The expansion of credit set in motion by the war must be checked. Credit must be brought under effective control and its flow be once more regulated and governed with careful regard to the economic walfare of the country and the needs of its producing industries."

Money was tight. The peak of the commodity-price movement was reached in May, 1920. By 1921 the fall in prices was hitting a fast stride. Many business failures occurred and unemployment was prevalent. We still had a preponderance of gold and had that been allowed to serve as a basis for a corresponding expansion of credit, the result would have been a rise in prices in the United States which would have facilitated the repatriation of gold. This rise of prices would have provoked an upward trend all over the world, but American prices would have held the lead. Such a policy at that time would have obviated the necessity for other countries desirous of restoring their currencies to their pre-war parities to deflate to that end. Thus, According to Paul Einzig, as expressed in his World Finance 1914-1935, the redistribution of gold would have been facilitated and would

1. Selected Documents on the Distribution of Gold, submitted to the Gold Delegation of the Financial Committee. Geneva, 1931. p.41

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have brought inflation to a number of countries, and would have reduced the value of debts in terms of commodities, internal and international alike.

However, such inflation was not resorted to. The other countries went through the disastrous consequences of their deflation, unaided by us. Credit was checked here and staple export commodities were falling in all foreign markets, before any reduction of reserve credit occurred.

The old traditional tieups had changed. The center of the gold universe had shifted from London to New York. The Allies and Central Powers were, in the early part of the war, forced to raise enormous amounts of money. Even Germany, reputed to have such fabulous,mysterious wealth, had to make desperate thrusts for gold. None of the treasuries was adaquately prepared to meet the critical requirements out of its reserves. There were practically no flights to neutral countries. All European belligerents mobilised privately owned resources to pay for purchases abroad. Every government endeavored to increase its gold reserve. London and Berlin sold heavily and at sometimes almost crucifying fugres,long-term investments that had been good and of mutual benefit. The export of gold was soon prohibited everywhere and the convertibility of notes was

suspended in law or in practice.

The Allies bought enormously from the United States and at the end of the war, America assumed her new role of creditor nation. She was inadaquately prepared by training and tradition to assume this strategic position. She now held over half the world's gold supply, had credits on every country of the Allies band; and still entered into an intensive struggle to sell from her overstocked commodity balance on hand, at good prices,payable in gold. She was a nation still in the process of industrialisation and ill-suited to be a creditor. Abuse of credit by foreign nations contributed to the chaotic conditions. The American manufacturers overshot their market capacity woefully and unloaded on European consumers incapable of paying, either in goods or in gold. The credit structure became giddily unbalanced. Great Britain had traditionally, since long before the war, been the world's creditor nation. She bought her raw materials in world markets, manufactured them and sold to world markets, gleaning heavily of the invisible items. Thus she had led the world in a policy of free trade. The English pound sterling was the language of world exchange.

The Americans felt that if a crash could be averted, everything would become adjusted to the levels enjoyed during the war period. Politicians used the war debts

as a subject of harangue, with seemingly an obvious lack of intelligence on the part of speaker and audience. Tariff walls were erected to keep European countries from "dumping" their goods on us to raise enough gold to pay us what they owed. Reading excerpts from the Congressional Record of those days we feel prone to agree with Carl Sandburg when he says in his The People, Yes "And why not say, An empty taxicab drove up to the curb and Senator so-and-so stepped out"?

Private lending by American citizens early in the war had proved profitable. The government loaned heavily and hurriedly, raising vast amounts by floating Liberty Bonds, whereas private loans had been calculated on sounder basis. When a corporation comes upon evil days, a dividend has to be passed. Any stockholder in buying knows that the passing of a dividend is one of the chances he is taking and therefore not so much occurs when a private loan defaults. But not so with a government loan to a foreign power. The national budget is the personal grievance of many taxpayers, especially when economic conditions are not running smoothly. In this he is kept adquately agitated by a certain type of politician.

J.M. Keynes, eminent English economist, in his Essays in Persuasion [1] points out that the American

1. page 54

economists estimated that in this post-war era, America was owed more than was due from her, quite apart from the interest on the debts of the Allied governments; and her mercentile marine earned from foreigners more than she owed them for similar services. Her excess of exports of commodities over imports approached $3,000 million a year, while payments,mainly to Europe, in tourist and immigrant remittances were estimated at not above $1,000 million a year. Thus, if the account was to be balanced at all, America had to lend in one way or another,$2,000 million a year, to which interest and sinking fund on the war debts would, if to be paid, add about $600 million. This should have called for a new evaluation of debts and new arrangements for their settlement. Capacity to pay should have been considered. Had these debts been scaled down and provisions for payment agreed upon by both debtor and creditor, the vexing problem problem could have been solved, perhaps to mutual benefit.

In the period following 1919, the United States invested and speculated heavily in foreign markets. From 1919 to 1921 the losses were particularly spectacular. Home markets were tightening, the investor, not yet in sight of bedrock, invested recklessly. Loans and discounts, and investments totaled:

1920------$42,595,000,000
1921------$40,314,000,000
1922------$40,407,000,000
1923------$44,088,000,000

These figures were based on weekly average of high and low rates on choice commercial paper, as quoted in the New York market.

The substantial recovery in 1923 was motivated largely by the credit expansion based on a new gold movement. From late in 1920 to 1924 there was a preponderant gold movement inward, which from 1920 to 1922 served to reduce amounts of rediscounts. In 1923 rediscounts increased and in 1924 business slumped again. Gold holdings had increased from December 31, 1920, $2,059,335,000 to $3,047,393,000 on December 31, 1922.[1] It did not seem to be the policy of the bank to curb this.

Although interst rates were lower here than in Europe, gold continued to come to our banks. This gold movement resulted from the disordered state of financial, industrial, social and political conditions in post-war Europe. England had gone into the Labor government, with Remsey MacDonald as prime minister, France's Socialist party had gained control, and Germany and Italy were starting the march which was to lead them into dictatorships. It is estimated that one billion dollars of operating reserves of foreign Central banks were in the form of dollar exchange.

Despair seemed to have gripped Europe, and the long-drawn out suffering had crushed her spirit. Political reorganization was fraught with danger and uncertainty. America was imbued with buoyant optimism and "Babbitism" held sway. In the face of obviously distorted economic phenomena, the average American business man whistled cheerily on, attended his Rotary Club luncheons, and Chamber of Commerce meetings with guest speakers assuring him that America led the world, and all the time he prayed that when the thing toppled, if it did, he would not be among the casualties.

Starting in 1925, Americans began to invest very heavily abroad and to speculate feverishly at home. The United States lost $100,000,000 in gold in 1925, and regained approximately that in 1926, plus $100,000,000 early in 1927. Then the exports began heavily again. The Dawes Plan reestablished Germany on gold. Great Britain and Holland restored the gold standard. The League Finance Committee arranged the international loans. The Bank of England together with other Central Banks also assisted the borrowing countries after the issue of stabilisation loans by means of a stabilisation credit granted to their Central Banks. Austria was reconstructed and then Hungary. The Dawes Plan regulated reparation payments in such a way as to prevent transfers interfering with the stability of the exchange. Bulgaria, Greece, the Free City of Danzig, and

Esthonia obtained loans under the auspices of the League which enabled them to stabilise their currencies and solve their most urgent financial problems. This proved but temporary and all but Esthonia and Danzig defaulted on the loans aimed to stabilise their currencies.

The reserve bank credits showed the United States as sound and restored. In 1925 and early 1926 gold importations increased and the American bankers viewed this trend with apprehension as unsound for the credit structure. It was an overflow from distraught and shaken European money centers. Its sudden recall would result in drastic contractions to our credit structure. From 1925 to 1927 gold was cheap here but bankers discouraged the speculative fever at home. Foreign loan flotations were great, both to Europe and to South America. Thus was begun the ill-fated run of South American investments and bond flotations that ended so disastrously. It affected many small investors, ill-prepared to take such complete losses.

This unwelcome gold flow from Europe to the United States in 1926 and early 1927 caused also grave concern in Europe. It threatened world equilibrium and free gold payments in Europe where they were making a desperate effort to stay on gold.

On August 5, 1927, the Federal Reserve Bank of New York

reduced its rate to 3½%.[1] In April, 1927, the Bank of England had reduced the discount rate from 5% to 4½%.[2] During the last four months of 1927 gold movements drained $140 million from the United States. Argentine took $61 million, Brazil $33 million, Paris took $10 million and by 1928 had taken $345 million.

France stabilised the franc at 25.5 to the dollar. The declared object of France in these gold purchases from the Bank of England, as well as from New York, was to create monetary stringency abroad, especially in London, in order to discourage the transfer of funds to France and thus to check bull speculation in francs. Motives of prestige, no doubt, also influenced the French gold policy. She was, perhaps, reasserting France's importance in the sphere of international finance. In the three countries eyes were focused on the international aspects of the monetary situation more than on the internal. France paid off a loan of approximately $160,000,000 at the Bank of England, in April, 1927. The security for this loan included a pledge of about $90,000,000 of gold, and, when this gold was released, the Bank began shipping it in $10,000,000 lots to New York. When $30,000,000 had been shipped, federal authorities purchased the remaining

1. Figures from: Selected Documents on the Distribution of Gold, League of Nations, Geneva 1937, p 48
2. Op.Cit. p 47

$60,000,000 to prevent its being brought to New York, and it was disposed of in London. This incident shows the attitude of the federal reserve authorities toward gold imports at that time.[1]

The peak of gold holdings in the United States came in May 1927. We exported in 1928, $560,759,000 and imported $168,897,000, a "loss" of $392,000,000. Unemployment was mounting, the banks sought to keep money cheap, averting the "natural" consequences of gold imports upon the money market, and Calvin Coolidge and Andrew Mellon were voicing faith in the soundness of American business and inspiring confidence in the face of near chaos.

Speculation was rampant, we were becoming a nation of instalment buyers, buying things we could not afford, but making a down payment and hoping that we could keep up the balance when it had to be met. We bought on credit and repented in instalments. We were in 1928 quite out of balance, purchasing far in excess of our ability to pay.

On February 3, 1928 the discount rate was raised to 4%. Gold exports continued, amounting from January 1 to June 1, to $300,000,000. Business was reviving but credit demands were stimulated much more from speculation. The American press began to agitate against such large exports

1. Cited from: Selected Documents on the Distribution of Gold, League of Nations Geneva 1931. p 49

as loss of so much gold provoked a contraction of credit. But the Federal Reserve Bank gave its consent and even encouraged some shipments so as to bring about a contraction of credit in order to check the Wall Street boom. The high rates induced new gold imports in later 1928 and 1929, a flow amounting to more than $300,000,000. It enabled the banks to accomplish the expansion of loans without raising reserve credit. This continued until the crash in 1929.

In the 1929 crash the credit system contracted, money became tight, and a wild scramble for gold ensued. The universal cry was for gold, everywhere we heard of the shortage of the precious metal; there was not enough gold "to finance prosperity", which seemed to have taken up abode,which proved to be of long duration, right "around the corner". However, in June 1931 we find that America's gold constituted 42.7% of the world's monetary supply. Gold holdings of Central Banks and governments were:

	U.S.	France	England	Russia	Other countries	Total
1929	3,900	1,633	710	147	3,363	10,297
1930	4,225	2,100	718	249	3,087	10,907
June 30,1931;	4,593	2,212	793	262	3,063	11,262

The three leading countries were still on gold in 1929. England, exhausted from a depression of four years' duration, France, enjoying artificial prosperity caused by the repudiation devaluing of the franc greedily piling up more gold

by any means possible; and the United States, having just experienced a spectacular crash that started in Wall Street, then spread throughout industry.

When the speculative fever was on in the United States, preceding the crash, a hoarding fever had raged in Europe. The rise in the sterling price of gold from 3 pounds, 17s. 10½d per ounce to 7 pounds per ounce increased hoarding and raised the profits gained by hoarding.

This speculative hoarding forced the Bank of England off gold. From 1822 to 1914, the Bank had successfully withstood every attack of the sterling price of gold without resorting to drastic action. But from 1925 to 1931 the profits on gold as a speculative counter were greater than use as currency, and, naturally, gold forsook the function of currency and departed to the more profitable function, hoarding. The higher the bank rate, the stronger the forces tending to appreciate the price of gold. The more the bank lured gold from the ends of the earth, the more conveniently placed it was to supply the hoarding demand from the continent. Gold was appreciating in price and the Bank of England was compelled by law to sell it at a fixed price. It could control the price of gold if used for currency but not for any other use.

When the Kredit-Anstedt failed in May 1931, continental hoarding grew to new proportions. When the crisis hit Germany, the gold drain became even greater from England. Germany was forced to suspend payment upon its foreign short-term debt. The Bank of England lost 30 millions of gold in July 1931, over 50 million in August, and the demand for September promised to exceed 100 millions. The Bank could hold out no longer and the gold standard was forsaken. In a few months she inaugurated a new currency system based on inconvertible paper. Keynes insists that England was forced off gold, abiding by it as long as it was humanly possible. The prestige of London bankers led them to great sacrifice before they were finally forced off.

The inconvertible currency did not seek its level but was overvalued about ten percent. The countries off gold thus got an immediate trade advantage over gold countries, forcing down prices in those countries. It also caused distrust and huge withdrawals from the United States were made by France.

The United States held out for eighteen months longer and went off. France alone remained on, squeezing and hoarding, sacrificing commercial and industrial progress for gold.

The Young Plan had been based on Germany's purported capacity to pay in 1929, and on the assumption that pros-

perity would continue. Even after the Wall Street slump this was not revised. It should have been if the Plan was to be at all practicable. Germany undertook at the Hague to pay more than she could afford. She had been doing just that for some time. Until 1923 she financed reparations payments by selling mark notes to foreign speculators who hoped the Germany currency would recover. Much American gold came to Germany via this channel. From 1924 to 1929, the reparations payments were financed by foreign lending to Germany. But then long-term issues abroad ceased, and the only way to finance was by an increase of short-term indebtedness. Had the Hague Agreement not been met in 1931, this short-term indebtedness might have been smaller. The moratorium by President Hoover was a breathing spell. It served to moderate the disastrous consequences of absolute defaults, which seemed inevitable then. It should have pointed the way to a reopening of the whole debt-payment problem. France defaulted on the December,1932 payment.

Anticipating the 1932 payment, Great Britain experienced a slump of the pound, and the flight to the pound after its depreciation brought adverse pressure on the dollar in January, 1933. America's insistence on this December instalment became a factor in pushing us off gold. Until 1932 the Exchange Equalisation Account

kept part of its resources in dollars. When the Bank had to give up 20 millions of gold on December 15, to meet the war-debt instalment, dollars acquired by the Exchange Equalisation Account were converted into gold. This outflow from the United States was part of the flow that caused the crisis that led us off gold.

England suffered as a nation in the crisis that led her off gold, but the policy was firm and directed, and they were spared many of the earmarks of a "panic" that Americans experienced. Professor Luther A. Harr, of the University of Pennsylvania, points out that "the Big Five" along with the Governors of the Bank of England and the Chancellor of the Exchequor, meet and make decisions that affect the entire English Banking system. In the United States, the Federal Reserve Board, governors, and state banking officials and bank presidents would make such a great aggregation that such unity would be impossible. Thus when the crash came, some banks weathered the storm, some went to the wall rapidly and completely, some reopened later.

The Federal Reserve had increased the rate to five percent in pursuance of its international policy and checked domestic industry, which in the depression could not stand up under such high rate. In the last months of the Hoover regime, in 1932, numerous banks

were forced to close. President Hoover publicly stated that the country had once been within two weeks of going off gold. Five months after this statement had been made, we started the march off gold. Governors closed state banks; the governor of New York closed the banks after midnight of March 3, 1933 to protect the Federal Reserve System from further losses of gold and currency. President Roosevelt, confirmed this on March 5, by a proclamation prohibiting hoarding and the export of gold. Some there are who point to the staggering withdrawals of the immediately preceding weeks, but O.M.W. Sprague in his Recovery and Common Sense, states, "We abandoned the gold standard because it was believed by the government that a depreciated dollar would be helpful in bringing about a trade recovery, not because we were unable to maintain the gold standard."

On March 6, 1933, a proclamation was issued suspending the gold standard, but exports of gold were made to keep the dollar at par in foreign exchange. The old price of $20.67 an ounce still held. On April 19, 1933, the provision for keeping the dollar at par in foreign exchange was discontinued. The dollar immediately fell below par and prices of a number of commodities responded. On May 1, 1933, gold was refused to holders abroad of United States securities. On May 12, 1933, the AAA, with

the Thomas Amendment was passed, which gave the President power to regulate the dollar, On June 5, 1933, the gold clause was cancelled. Since that time the policy of the President seems to have been against stabilisation with any degree of permanency. Regulating the dollar to raise commodity price levels, mainly agricultural, has been his avowed purpose. The price of gold was raised, over a period, to $35 an ounce for newly-mined gold. The Secretary or the Treasury controls the stabilisation fund. Gold is purchased and sterilised. This artificial bolstering of prices has led to a huge inflow of foreign gold for three years. Net imports have averaged $6,400,000 daily from January to June 30 of this year and then dropped to an average of $4,100,000 a day. Since 1934 the nations's gold stocks have mounted more than $5,000,000,000 to $12,433,190,000.[1] Thus far the Treasury has borrowed more than $1,000,000,000 to operate the sterilisation plan. The increased cost by the sterilisation plan has totaled $1,898,000,000.[2]

In his America Must Choose, Secretary of Agriculture, Henry A. Wallace suggests that America either prepare to

1. "The Morning Oregonian", July 30, 1937
2. "Foreign Policy Report" June 15, 1937

import heavily to meet this uneven trade balance; become economically "self-sufficient" and curtail production to control prices; or choose a middle of the road policy between these two. Curtailment was planned to fit into a synchronized program, as cotton and certain leading commodities being curtailed. However, the southern planter found he had plowed under his export as well as his home market product and his new price was too high to call for bidders in the world markets. Agreements have recently been reached with the Japanese producers of cotton textiles and of hosiery manufacturers. The newer program is being worked out of curbing in certain fields of foreign trade, while working for a development of a larger total of exports. Last year the United States sold $440,000,000 worth of goods to the United Kingdom, a gain of one percent compared with 1935. We imported $200,400,000 worth, an increase of 29% compared with the year before.[1]

Importing such quantities would bring disaster to us now. Such a program must be accomplished gradually. Plowing under and other forms of crop curtailment are unsound and have proved not to be the method of accomplishing the desired end, namely, the raising of prices. There is little to commend them except that they point out the situation and its most glaring bad points in the present scene.

1. "The New York Times", May 16, 1937

In 1933, prices were low, people demanded inflation. Now, as we are recovering, and have already experienced a considerable rise in prices of stocks and commodities, we are hearing talk about the "cost of living", and Washington is becoming "inflation conscious". Newspaper agitation, and the voice of the people give evidences of this.

For three years a heavy inflow of foreign capital has been expanding our bank deposits, increasing our excessive credit base, and boosting stock prices. This restless migration of what President Roosevelt referred to as "hot money" presents a problem as there is no way of knowing how long it will stay with us, how it will be employed, or how it will leave. This term "hot money" has now come to denote money of this nature that we do not want in our possession.

As we are trying to control our price level, we do not want interest rates to be too easy or too tight. We do not want interest rates to be the cause of our receiving any more gold or short-term investments, nor to divert investment within away from stimulating activity; "neither swell nor stifle". This foreign money, coming in, tends to accentuate inflation, and its sudden leaving may cause serious disturbance.

After the war, as noted above, we continued to lend heavily abroad, and thus increased our net creditor position. Since 1934, however, foreign money has again been

coming here. Through foreign defaults, and through sinking-fund purchases of foreign securities, and through new foreign investments in the United States our creditor position is rapidly melting away. During the war, the total resale of American securities by Europe amounted to two billion dollars.[1]

This, plus the "favorable"trade balance from 1914 to 1918, financed by private loans to foreigners later by direct advances by the United States Government, and publicly offered foreign issue, taken by our investors, have been estimated at over two billions for 1914 to 1917. Thus in 1914 we were a debtor country of about $2,650 million, our net creditor position at the end of 1918 was $10,161,000,000,[2] These estimates exclude short-term investments.

Three-quarters of that debt, however, represented intergovernmental obligations held by the United States Treasury, impossible to collect. The investment history of this post-war period is shown thus:

net outflow on Govt. capital account, 1919-21 $2,107
net outflow private capital account,through 1933 6,060
Gross increase in our creditor position, from 1919 to 1933 was $8,167,000,000

1. The Balance of Trade in the United States. "Review of Economics Statistics", July 1919,p 246.
2. "Foreign Policy Report",June 15, 1937, p 79.

Capital outflow continued, despite the intensification of the depression, due to fear of currency depreciation in this country. Foreign-banking funds in the United States declined from $870,000,000 at the end of 1932 to $487,000,000 at the end of 1933.[1] In 1934, following stabilisation of the dollar, that movement was reversed; capital began to return in volume and much new money came in from abroad. In 1935 the movement reached its peak, most of the flow representing short-term balances. In 1936, although the total flow declined, new long-term investments by foreigners increased. The $792,000,000 was the greatest inflow to our stock and bond markets on record. Net short-term inflow in 1936 was $397,000,000 and in 1935 it was $964, 000,000. Thus we trace the movements:[2]

private loans abroad, 1914-1933	$11,433
Govt. loans abroad, 1917-1921	9,535
	20,968
1934 net inflow	3,064
1914-1936 net outflow	$17,904

Of the total capital imports amounting to $2,606,700,000 in 1935 and 1936, almost one-third, or $829,300,000 came from the United Kingdom. From Switzerland, France and the Netherlands came large amounts, $335,500,000, $299,500,000 and $229,700,000 respectively. From Germany came $83,100,000 and Italy $45,600, 000. Canada contributed $150,500,000; Latin American$199,600,000

1. Federal Reserve Bulletin,May 1937,p. 399
2. "Foreign Policy Report" June 15, 1937,p. 79

and the Far Est $184,000,000. A little more than half of the capital entering this country in 1935 and 1936 was left in short-term balances. $116,100,000 was repatriated by the United Kingdom and Germany repatriated $22,500,000 worth of bonds previously floated in New York markets.

There have been several reasons for the unusual inflow of capital commencing 1934. Economic and political uncertainty in Europe has been a major factor. The flight from the dollar of 1932 and 1933 came back when it looked safe to European investors, even at about fifty-nine cents. In 1936, fears of "socialist" measures by the Blum government sent a gold flight here. War scares, almost constantly occurring, stimulated flows to the safety of the United States. Then the gradual release of frozen funds also brought back repatriation of considerable American balances abroad. In 1936 these had dropped to $657 million from 1934's total of $1,123 million.[1]

Our economic recovery has been healthy since 1934 and many foreigners anticipate an American boom in which they desire to profit. Also, depressed prices on some foreign bonds stimulated the repatriation of those securities. Thus foreign banks increased their working balances in this country. Whether or not the $35 an ounce price for

1. Fed.Res. Bulletin, May 1937,p.399

gold has been effective in stimulating a flow is a controversial question.

Through the eyes of 1936, our position as creditor national is questioned. American long-term investments abroad at the end of 1936 were down to $8,800,000,000, which is $200,000,000 less than foreign long-term holdings here. This,however, is controversial as the figures are based on market value, and "direct" investments are not included and appraised. Acting Secretary of Commerce, Ernest G. Draper, insists that we, at the end of 1935, were a net creditor in excess of $7,250,000,000. He also offers another test of the country's net creditor position in the actual flow of money from the respective groups of investments.

As stated before, if we are to become a creditor nation, we must bring about an "adverse" balance of trade; an excess of imports over exports, a practice of dubious value and no expediency in the present setup, when resorted to as an emergency measure. During the last two years this adverse trend has been developing. Meanwhile, if we are lessening our creditor position, such commodity import stress need not be continued. The adjustment can come more slowly.

The best test of our position is the extent to which gold movements materialize into real investments. This movement is still heavily in our favor. Our receipts

of interest, dividends, and earnings are in exess of our payments. In our own best interest, we should receive these payments in the form of more goods and services.

It has been suggested that with such large volume of capital movements coming to use, we should force resumption of war-debt payment. But much of this flow comes from nations not in default, as Switzerland, the Netherlands, and the like. In France, the flight of capital has created serious financial difficulties for the government. Again, governments have little control over private capital, they could stop these gold movements, but there would be no wisdom in such a move.

But this "hot money" is not the kind that establishes us as a creditor nation, nor does it become part of a chain of long-time investments. It is transient. It makes our stock market more susceptible to international and foreign developments. It might generate a boom, with 1929 results repeated. Forces over which the United States has no control might break the securities prices and America would suffer. If all remains calm in Europe, this will not occur and repatriation will be a normal and slow process. But Europe is potential dynamite now, in the throes of three dictatorships. One cannot depend on stability in this turmoiled scene.

More serious is the effect of this foreign transient

money on our credit structure. Large imports of gold have accompanied the inflow of foreign capital. From 1934 to 1936, net gold imports amounted to $3,989,515,000. In the first four months of 1937, gold continued to come at the rate of $1,835,000,000 per annum. This swelled our bank reserves and aggravated danger of credit inflation. Until recently, member banks of the Federal Reserve System could legally extend credit to about ten times the volume of their reserves. Thus the importation of about four billion dollars of gold during the last three years, created the basis for an enormous expansion of credit, which might have been serious, had it been uncurbed.

To offset the effects of gold imports on bank reserves, the Board of Governors of the Federal Bank System twice raised legal reserve equirements. Under authority given it in the Banking Act of 1935, the Board on July 14, 1936 increased reserve requirements, by 50% effective March 1, 1937, and 33 1/3 percent and the remaining half on May 1. On May 5 excess reserves were down to about 890,000,000 dollars.

Net imports of gold into the United States were:

1934	$1,133,912,000
1935	1,739,019,000
1936	1,116,584,000
1937	
Jan.	120,325,000
Feb.	120,326,000
March	154,326,000
April	215,332,000
May	155,362,000

Figures cited from: Hot Money; An International Problem, H.M. Bratter, Foreign Policy Report, June 15, 1937

This balance was held down also by American governmental policy of "sterilising" further gold imports. On December 21, 1936 they announced their policy of buying gold with proceeds of the public debt obligations and hold such gold in inactive account in the general fund. By June 10, 1937 the Treasury had in this way bought gold to the value of $896,110,032.

By these two methods, "sterilising" and raising reserve requirements, the government has offset potential inflationary effects of the gold influx. But the buying of gold in this manner by the Treasury will involve an increase in the public debt of over $1,898,000,000 a year. This is particularly unfortunate now when the bond buying public is becoming concerned over continued budget deficits. Moreover, the interest charges on this debt are not in step with promised attempts at economy. Therefore, the "hot money" problem is vexing. The government will not coin the gold as that would restore convertibility of gold at a fixed rate, and the Administration is opposed to that policy for the present at least.

Imposition of additional taxes on foreigners might make our securities less attractive investments. But, according to international law, a country may not tax foreigners more heavily than it taxes its own nationals.

Also, such a measure would not halt short-term investments, the greater source of this difficulty. As Europe is anxious to check capital exports, perhaps Washington can cooperate to this end with other governments. However, we will not lend abroad when our own money markets attract foreigners because of superior profit, prospects, and safety.

It is only in international economic and political trends toward security, in which the United States takes an important part, that this problem of gold movements and their effects can be solved. The American government appears ready to collaborate in the attainment of international trade and of monetary stability.

Budget and price developments, difficulties of dealing with "controlled" currencies, like the German Reichsmark, remain obstacles to minimizing the harmful repercussions of restless migrations of capital.

Dropping down from $35 an ounce would not be feasible unless understanding is reached with France, and Britain, in the manner agreed to last September, and to which other nations have since adhered. Existing relationships between the dollar and foreign currencies would once more force the question of whether or not to revalue their monetary units. Again, if the price of gold dropped, other prices would drop, although price and gold are no longer that closely linked, they are psychologically

linked in the public mind, and it would therefore affect business unfavorably. International agreements providing for all-round reductions might be wise, but the idea does not merit much consideration for it would involve too much international cooperation for an end of questionable attainment and desirability.

World gold stocks today, though maldistributed, are in the aggregate ample, especially since gold no longer circulates except almost solely for the settlement of international accounts. Britain and the United States both have more than enough. Sterilising it at public expense, and the United States absorbing much of current output actually subsidizes British gold producers in South Africa, Rhodesia, Canada, and Australia, who together produced almost one-half the world production in 1936. Foreign capital in the United States also means we bear the expense of holding gold reserves which in reality belong to other countries.

It will hardly be possible to lower the price of gold within the framework of the tripartite monetary understanding without distrubing existing exchange ratios. British opposition would no doubt be aroused by such a move, as they not enjoy the "subsidies", and it also forms an important item in the balance of payments. The United States Treasury, too, would forfeit part of

the "profit" of $2,800,000,000 obtained through revaluation in January, 1934. However, if the gold price is to be lowered, it must be done by international agreement. In its last annual report, the Bank for International Settlement comments favorably on the idea of countries, by mutual agreement, lowering the price of gold.

Gold production value and gold reserves:

year	volume million of fine ounces [1]	value in million of dollars	World [2]	U.S.
1929	19.7	397	10,166	3,900
1930	20.7	432	10,675	4,225
1931	22.4	461	10,970	4,051
1932	24.3	498	11,540	4,045
1933	25.5	525	11,529	4,012
1934	27.6	958	21,051	8,238
1935	31.0	1,050	21,583	10,125
1936	35.3	1,055	22,663	11,258

The flow of capital, as we have seen, is in large part attributable to factors with which this country cannot cope alone. The Administration views its monetary policy from two angles, thus justifying its monopolistic control of gold, namely,(1) to cope in the international arena, and (2), to control price levels, particularly of agricultural and basic commodities, internally. Thus it revalued the dollar at fifty-nine cents, and integrated the program of

1. Bank for International Settlement, Seventh Annual Report, p 37
2. Director of the Mint, Annual Report, 1936

curtailed production with managed currency to secure the price levels they deemed desirable. President Roosevelt is not satisfied with these prices and has refused to stabilise the dollar permanently as yet. He expressed this viewpoint in one of his radio messages. We do not know his final objective.--Where and when he will be satisfied to stabilise.

When the power to regulate the monetary system was granted, the main international problem confronting the Administration was to cope with gold movements in the international arena. As we have seen, continental hoarding forced England off, Germany drained every possible resource for gold and then defaulted, France strained every possible channel to get more gold, and we, safest of a ll centers in the scene, got huge gold flows, presenting a problem which is still with us defying solution. Our most significant moves have been in the tripartite agreement, the Hull tariff agreements, and the proposed Angl0-American Trade Pact negotiations.

It is interesting to note that those countries producing gold seem to hold it in lesser regard than the non-producing countries. Great Britain has led the world for many years in gold production, and is off gold. The United States is trying to check this inward flow, and still her production is high. France, a non-producer,

stifles her industry and commercial life in the struggle to acquire gold. Belgium, the Netherlands, all desire it. Germany, whose Dr. Schacht directs her battle for gold, is a non-producer. In the case of Germany, desire for gold is for the purpose of bolstering up her currency, but even more, for the backing of her armanents program.

There has been in Europe in recent months a more determined movement of intense nationalism, pointing to almost inevitable conflict. Nations now pit their strength not as money markets, scrapping for gold as such, but bending every effort towards a sound credit basis to finance huge armaments programs. The United States is not among the leaders in this contest; but, as she is in the creditor position, she holds the whip hand.

Hamilton Fish Armstrong, editor of "Foreign Affairs," in a little booklet, We of They, a discussion of regimented dictatorships vs. democracies, which seems to have found its way to the desk of most social science teachers, points out that the liberal states hold between them the world's purse strings. In rough figures, as of August, 1936, the United States had 49% of the world's gold reserves, France 16.5%, Great Britain 9, Belgium, Switzerland, Holland, and the Scandinavian states together about 9; a total of four-fifths of the world's gold reserve holdings. Japan had about 2%, Italy about 1 and Germany practically none.

American bankers financed Mussolini in the early days of Fascism. He was, they felt, a safe risk as he was getting order out of run-down, post-war Italy. Italy loaned to Albania at the same time we loaned to her. The Johnson Act now technically, but not actually, precludes any further loans to the Fascist or Communistic countries. Italy, Russia, and Germany are in default. Germany has repatriated vast quantities of its bonds at "fire-sale" prices. It is estimated that long-term German bonds for which Americans paid $400,000,000 have been bought back by Germany, after she defaulted, at about $160,000,000, a loss to Americans and a gain to Germany of sixty percent.[1]

Will Germany and Italy rearm by means of drafts on the future and get European and American loans and credits to meet the day of payment? Italy went into Ethiopia despite protest. Then the United States, though not a League member, placed sanctions at a loss to herself. She virtually "outsanctioned" the sanctions. As a government we will stay out, perhaps, but, with the return of "good times", and "easy money", much American gold will no doubt go along to the battlefields in the next war.

Consider Germany in passing. Her armaments program starting in 1933 totalled ten billion dollars to 1937, according to Mr. Winston Churchill. When Prime Minister

1. We or They, H.F. Armstrong, page 50.

Baldwin said that the Rhine is England's frontier, the world wondered if England would help finance Germany, as she did to quite an extent, and yet watch like a hawk lest Germany try to possess the Low Countries and the French channel coasts. Hitler is very open in his attitude and announcements that France must be regarded always as the deadly enemy of Germany. (Mein Kampf). German prices, currency and the Germany economy as a whole have become increasingly divorced from the rest of the world. Since 1933 the government has prohibited private share and bond issues. Industry has financed replacements and new investments largely out of its new resources, but even Germany admits that borrowing by the Reich is likely to meet with much greater difficulties in the future. Idle capital is contracting. Dr. Schacht in his speech of last December 9, prophesied "an explosion" leading to forcible territorial expansion, or the integration of Germany in the world economy. Germany refuses to negotiate in international conferences as she claims that all proposals made to her call for the sacrifice of her "political freedom". Dr. Schacht, who in many ways seems out of sympathy with the economic thinking of the Fuehrer and his cohorts, has already made agreements with Belgium for gold, with trading agreements stipulated. He is building a new Reichsbank building, and has publicly declared that the Reichsbank wants "honest money and honest raw materials" plus a return to the gold

standard to end "arbitrarily falsified currencies."[1]

German money is 14 to 175% less than face value outside her borders, but still at par within them. By export subsidies and further decreasing her debt payments abroad, she awaits ovations from other countries to resume her place in world economy. Dr. Schacht has stated that he wants(1) German colonies returned, thus enabling her to obtain her own raw materials,(2) existing foreign debt cancelled or greatly reduced,(3) new credits to keep her currency stable.

Frederick T. Birchall says in this regard,"In other words, Germany wants the rest of the world to pay for her participation in the "immoral act of devaluation" just as the rest of the world now is paying in a large part for her rearmament."[2]

Present trends in Germany lead to a complete planned economy. She is largely self-contained and has concentrated upon the invention of substitutes for materials hitherto imported.

Mussolini, Hitler, and Japan have shown that when a strong state attacks a weaker one, the other countries must either watch, condone, and accept that aggression, or oppose it by preconcerted action. This is done by economic channels or by preparedness. This seems to be the motivation of the

1. "Time", July 12, 1937
2. "The New York Times", Oct. 11, 1936

tripartite agreement of last September, agreed to between England, France, and the United States, which will be referred to later.

The other, or more definite viewpoint, is for actual preparedness, We have always inclined to the viewpoint that armies for the preservation of peace do not exist. England states that she is departing radically from such a viewpoint. She is arming to make it possible to keep the peace. The English temper was tried to the near-breaking point when Mussolini occupied the Meditterranean Basin area with such bravado, and many an Englishman smarted, even though Anthony Eden lauded and majestically dramatized the glories of peace. Such action and view cannot continue. At a certain point, one of these international bluffs must be called. Spain is already an international battlefield. It may spread. So England is launched on a preparedness armament program that is burdening her people to the straining point. The British government is trying to discourage the outflow of capital. It was reported to have requested insurance and investment companies to avoid unnecessary foreign investments.

"If dictatorships are better to prepare for war, democracies are better to finish wars. Despots have forced American and Britain to undertake rearmament and, having undertaken it, we must necessarily win the rearmament race", said United

States Ambassador to Britain, Robert Worth Bingham, in his Independence day address to the American Society in London.[1]

Wars are fought with gold. The United States will be a large factor in the next few years in European political considerations, whether she is belligerent or neutral.

1. "Time", July 12, 1937

CHAPTER III

Stabilisation, if it is to be accomplished, should be the final phase of a kind of experimental period during which there must be restored rational purchasing power parity conditions. J.M. Keynes vehemently asserts,"When the Council of the B.I.S. contemplates(as in their last report) a return to a regime of fixed gold parities, they are living in an unreal world, a fool's world."

Today's situation is one of dynamic symptoms, the process of change is evident and we can but follow the course, not the avowed or even "eventual" end. The major countries, England, the United States, and France have established stabilisation funds. Candda has also set up a fund, which has never been used. Its existence is perhaps one of the contributing causes for this lack of use.

Britain's Exchange Equalization Fund account is about $2,000,000,000, ours is of like amount, the new French fund of somewhat under $500,000,000, the new Swiss fund is possibly about $133,000,000, and the fund of the Netherlands is about $159,000,000. Others

are of undisclosed amounts. The aggregate is possibly $5,000,000,000.

By active dealings in foreign exchange for the purpose of eliminating undue fluctuations, these funds can throw influence on the demand or the supply side of the market as is desired and can usually exercise a compelling influence on the movement of the rates. The fund of the United States was established for a three-year period, but has been now extended to June 30, 1939. The Secretary of the Treasury is empowered to deal in gold and foreign exchange and to conduct other operations which will stabilise the value of the dollar exchange in foreign currencies and maintain the market for government securities.

These funds may become mobile armaments of modern economic warfare, or they may be employed in the international money market to curb and stem rushes of capital leaving one country to seek refuge in another.

Under the gold standard of former days there was no need for equalization funds. Since every currency was worth so much gold, each was convertible into the other at a fixed price called its gold parity. International shipment of gold, or the fact that it could be shipped, kept those gold parities from varying more than about one-half of one percent.

Britain's suspension of the gold standard broke this

automatic control of exchange values. The pound sterling became an irredeemable paper currency. Its previous over-valuation caused repercussions, strikes, and the conditions which we find motivate the British economist J.M. Keynes to such fervid denunciation of this attempt to remain on gold during that period following 1925. It was in an effort to protect her interests in a depreciated currency, while at the same time seeking to guard against disturbing fluctuations in the exchange, that Britain in April, 1932 established her exchange equalisation fund. Most of the later funds have followed this model. When the United States undertook to stabilise the dollar in January, 1934, it, too, formed a stabilisation fund. Britain established her fund by Treasury borrowings in the London money market, and the United States set aside $2,000,000,000 of its gold "profits" resulting from devaluation. This fund is operated by the Secretary of the Treasury, the operations carried on in Washington D.C. are secret.

The idea perhaps hailed from the international pools of credit which were mobilised in the post-war period to assist the various European nations to return to gold.

This fund has now been in existence for four and one-half years. Britain seems to be satisfied with it and it will likely serve her along with other managed currencies until the concerted return to gold is accomplished or re-

jected. Only ten percent of the American fund has been mobilised for effective use. The workings of these funds are secret, and the idea is so new that even those in control seem to be feeling their way as they go along. The British fund gets orders from Whitehall, which are carried out by the Bank of England. Secretary Morgenthau and the President direct ours, and the Federal Reserve Bank of New York carries out these policies. Since the primary function of the funds is to influence the value of their respective currencies, their chief activities consist in buying and selling their own and other nations' currencies and gold in the international money markets. They must always play on the "wrong side". When the fearful Frenchmen sell francs for sterling, the British Fund must buy francs and sell sterling, or maybe deal in dollars.

Critics have accused the British of using the fund as a monetary weapon to drive down the pound and thus obtain a competitive advantage in foreign trade. The British steadfastly deny this and are justified in this stand. Externally it must keep the pound steady in terms of dollars and other currencies; internally, it must offset effects on London money markets of sudden influxes or withdrawals of foreign capital. The two functions interlock.

The fund started at a low ebb on sterling. It has survived and flourished. It sold sterling for foreign

exchange, then converted to gold. The fund was not a substitute for the gold standard but it depended on it. Elliott Bell, of the New York Times staff, expresses the opinion that Britain seems to be attempting temporarily to supplant the stabilisation fund by the gold standard as a regulator of currency values.

When the United States suspended the gold standard in 1933, the British could not get gold for dollars, so they turned to the franc for a gold peg upon which to hang the pound. Now, with gold suspended universally the situation clears the monetary highways for action. France, the former obstacle, is now in the game.

France remained on gold, directing by stern and strong governmental control, all attempts to drain the precious metal from her. In attempts to stabilise, the United States, and Great Britain did not find it feasible, or according to some authorities, possible to climb back onto the gold standard to join her. After the latest political upheavals, France has now deserted her stand, and the way is open.

In the New York Times of October 12, 1936, Sir Arther Salter, director of the economic and financial section of the League of Nations, expressed the opinion that the pound was overvalued at $4.83, and the consequent deflation caused a general strike and the fall of the pound.

"Uncertainty of the franc has weighed upon the world

for years. All the most important impediments to world trade, whether in the form of new tariff quotas or exchange restrictions are mainly due to currency fears," he said.

He believes such conditional stabilisation can be reached for long enough to create a stable condition, and a recovery in foreign trade, now most in demand, can thus be facilitated. Rigid gold parities would be a hindrance to trade.

When England in 1931 went off gold, the world was amazed and regarded the matter as an economic tragedy. There followed intensification of the depression into a world-wide monetary crisis. Today the devaluation of the franc is looked upon as a favorable economic development, whereas Britain's departure was hailed as a calamity. The gold standard once hailed as a fundamental requisite of a sound financial system, went down with France's departure, and the world now anticipates economic development which will contribute to recovery. That is, unless War, or unforeseen international complications arise. The path is at least partially cleared for the road to recovery.

As noted above, all countries had forsaken the gold standard by 1933 except France, Switzerland, Belgium, and the Netherlands, Five years of guerrilla warfare in international monetary affairs having culminated in the downfall of the pre-depression gold standard in its last stronghold, the leading nations have now turned to the cooperative task

of rebuilding a system of ordered currency relationships. Fresh importance is being given to the exchange control funds and increased attention is fixed on them.

Somewhat paradoxical is the fact that France went off gold in the regime of the Socialists; the move had long been necessary, but all parties tried to avoid it because of the great unpopularity of the move and results bound to follow.

However, now that all significant countries are off gold, it may be possible to begin the task of rebuilding a new system of order in international monetary affairs. As long as a country as significant as France remained tied to gold, no effective monetary system could be evolved. Again, paradoxically, perhaps out of this new system, the countries may collectively tie to gold again.

Banking has become less of a profession and more of a political phenomena. This is true within the country; the small self-made, community-proud banker is rapidly becoming extinct. Banking is becoming linked into large units. Internationally this scene is frought even more completely with political maneuverings. President Roosevelt, through Secretary Morgenthau, refuses to stabilise. England is cautious, protecting her existing empire agreements, and working toward her eventual goal--the restoration of the international gold standard with London again the dominating factor. France, now off the gold standard

and with an internal situation like a keg of dynamite, is just now trying to accomplish the drastic measures called for by her new finance minister, Georges Bonnet, in his determination to balance the budget. She sees what England has gone through to keep the budget balanced, only the task will be harder, as she has delved deeply into public works and other expensive government activities.

These three countries must cope with the monetary situation jointly. If out of this organization, built around their monetary agreements, there can come a sound understanding and working agreement to let the price level and credit structure seek its level and be based on economic phenomena rather than political strategy, we shall have eventually a smooth reestablishment of trade and financial channels. But this is an aim very hard to realize.

Two or three "possibilities" have been suggested as vehicles for accomplishing these aims. The possibility of using the Bank for International settlement as the nucleus for a world gold reserve, has been proposed by the Royal Bank of Canada. Some have thought that the Bank would in time absorb the functions of banking and the routing of international monetary channels; that it would swing away from its present trend of serving only or mainly in an advisory capacity. It was created by the Young Plan which stated, "the essential reparation functions of the bank were

such as to form a solid reason for its existence, cognizance also was taken of the auxiliary, but none-the-less material advantages it might have in the general position of present international finance."

The Young Plan made clear that the bank would be "assimilated to ordinary commercial and financial practice" and one of its major purposes was "to provide additional facilities for the international movement of funds and to afford a ready instrument for promoting international financial relations."

The Bank, because of its intimate tieup with the League, is suffering the same stigma. To function with such an agreement as the present tripartite, it would have to be revitalized, would have to become more of a banking institution. Bankers rather than advisers and consultants would have to comprise the staff for the formation of its policy.

More and more it is the common impression that the depression resulted from bad management and lack of reasonable cooperation between the dominating financial powers of the world. It will call for intelligence and a keen international viewpoint to root out the causes of the depression and point the way out.

Perhaps, had there been a sudden large volume of new gold offered in the markets of the world in the early stages of the depression, it would have tended strongly to defeat the deflationary processes which were then rampant

and would have mitigated the severity of the depression. Had the volume of new gold been large enough it would undoubtedly have reversed the trend as fast as such new money permeated the banking system. It would, for example, have made unnecessary the 1931 to 1933 struggle of England against the United States when Britain forsook gold and we stayed on.

This raises the question of whether or not it is worthwhile to accumulate a gold reserve outside the banking system of the world which may in the future be used for these purposes. This was suggested recently by the Royal Bank of Canada.[1]

Dr. Charles O. Hardy, of the Brookings Institution, says, "We believe that, if the gold standard is restored, the objectives stated can best be achieved by the establishment of some plan under which a large part of the existing world gold stock would be segregated in extraordinary reserves."[2]

These reserves, which would not necessarily be under the control of central banks, would be drawn upon to take care of extraordinary transfers of balances from

1. "The New York Times," financial section, August 8, 1937
2. "Is There Enough Gold?" C.O. Hardy

one country to another, but would not be taken into consideration in determining the credit policies of central banks and other monetary authorities in their attempt to control the volume of domestic credit.

"What is really needed, if the percentage reserve principle is to be retained", according to Hardy, "is a segregation of the gold stock into two parts, only one of which need grow by a given percentage in order to provide for an expansion of credit by that percentage; the remainder would be isolated from the reserve that controls ordinary credit policy."

That really is what we are doing through our "sterilization" program, by which the Treasury to date has sterilised $1,239,229,420 of gold by placing it in an inactive fund.

The process is expensive, as noted in the preceding discussion, and lacks the international point of view. For the United States to be the independent manager of this increasingly large block of the world's gold might make for more instability in world monetary affairs.

The outward movement has already started with changed world conditions, and international movements may drain this inactive gold supply, so we hang tenaciously to it.

The Treasury feels that this gold supply is a decided advantage to the United States because of its importance in monetary affairs, and because it provides a cushion against rapid movements of world capital. It is a protection against "hot money."

Several other considerations indicate the difficulties in attaining the degree of international cooperation which would be necessary to carry out the gold reserve plan. For example, our historic policy of detachment of the United States from European affairs, somewhat weakened by the New Deal, but still an essential element in American thinking. George Washington's admonition to "avoid entangling alliances" is still a very great part of our thinking as a nation.

Again, while the United States is not officially a member of the Bank for International Settlement, American bankers have served on its board and as its president, and some banking interests have owned securities. If this Bank is going to be used as a vehicle for international agreements, we will have to take our whole-hearted part. Our entrance into agreement with France and Great Britain last September was accomplished with very little journalistic "ballyhoo". Maybe the monetary alliances can be kept from political"footballing"and the United States could play her part with dignity.

Still another difficulty to the working of such an agreement, is the controversy between world bankers on whether central banks should be controlled by their governments. Members of the independent school of foreign bankers have frequently criticised the strong ties between the United States Government and the Federal Reserve Banks. This is only a discordant note, but is typical of the difficulties that must be cleared up before a footing is made for sound agreement.

It is more likely that this banking and trade agreement will have to be formulated by a group chosen for that specific function. American, English, and French bankers will have to compose the initial board. Later, perhaps, this will expand to include Japan, perhaps Russia, China, the Scandinavian and South American countries and finally Germany and Italy may be absorbed. It is to be hoped that this will materialize within existing agreements.

Within the country two attempts of the government to aid in the investment field in an advisory or aiding capacity are noted. The United States Congress provided for an analogous agency in a rider to the Securities Act of 1933, establishing an agency similar to the British Corporation of Foreign Bondholders. But, because this smacked of dollar diplomacy, President Roosevelt instigated a private agency called the Foreign Bondholders

Protective Council, now headed by Joshua Reuben Clark,Jr., onetime Ambassador to Mexico. They have published their annual report for 1936, an 866-page study in American "susceptibility", it was the most complete record of the country's investments abroad ever compiled. It showed that of $5,374,000,000 in foreign dollar bonds outstanding, no less than 38% were in complete or partial default. The South American issues seem to be the greatest in that line, Europe having a better record, except for Germany. Lately the defaulters have indicated a renewed interest in settling their debts, presumably looking to the day when they will want to tap the United States capital market once again. Even China has resumed partial payments on some of its American issues.

The fact that this book is compiled and circulated may be of some significance in slowing up the tendencies of Americans to invest wildly, then agitate for aid when the investment goes bad. It is not a form of regulation, but it is an airing. We know now that it is the investments and contracts made that make it hard for a country to remain unbiased and neutral when war breaks out.

The Export-Import Bank was launched by President Roosevelt in early 1934 as the nub of a "balanced foreign trade" which would eventually offset the most fundamental

change in American economic history, the switch from a debtor to a creditor nation. With almost every foreign nation in debt to the United States they no longer had money to buy products from the United States. The New Deal proposed to give them long-term commercial credits. But the established United States banking system, provided no course for such long-term commitments. The first Export-Import Bank was created to fill the need in the case of Russia. The original idea included several banks, but the Johnson Act which forbade extension of credits to nations refusing to pay their debts to the United States killed the extension of the idea. The second, and presumably permanent bank, followed with a plan embracing any or all nations. Recent deals include $3,500,000 to Italy to stabilize its cotton, and $27,500,000 to Brazil to clear dollar exchange.[1]

President Warren Lee Pierson saw the advisibility of loaning money to China for the building of railroads. The manufacture will assume one-half, the Bank the other one-half of the $1,500,000 loaned to China for this purpose. The debt, paying 6%, will be evidenced by notes of the Chinese government and the Minister of Railways, guaranteed by a Chinese bank.

Jesse Jones declared:"The participation in the credit is in accordance with the bank's policy of assist-

1. "Time", July 12,1937 (Business and Finance).

ing American exporters to maintain and to expand foreign trade."[1]

The three countries, France, Great Britain, and the United States, which will, no doubt, stand for the forces of democracy are lined up in a mutual agreement controlling their monetary systems. Trade balances will flow their direction, particularly to Great Britain and the United States, as they produce the goods most in demand at the present.

Industrial activity has begun to be affected by increased expenditures. War has steadily extended its scope as armies are mechanized and made dependent on those specialized industrial and scientific enterprises, which flourish greatest in British and American industry. Motor vehicles, railroad equipment and roads, are in demand for the armaments programs now in full sway. Besides these there is demand for durable consumers' goods as motor cars, etc. in those countries now emerging fully from the depression.

C.F. Hughes in the "New York Times" of August 8, 1937 in his column, "The Merchant's Point of View", points out that exports for January to June 1937 were $1,536,380,000 and imports were $1,683,700,000. The unfavorable balance,

1. "Time", July 12, 1937

he comments, shows that the "world commerce jam has been broken and that international trading is moving into an arena of freedom that it has not enjoyed for a long time."

He adds, "Monetary decisions must still be made to promote the free movement of capital as between nations. A rising flow of world commerce, however, provides a much more substantial basis for such decisions and doubtless they will be reached."

Gold having been purchased here for $35 an ounce for about three years, there is relative assurance that gold can be withdrawn again some day at the same value of the dollar, about fifty-nine cents. If Great Britain would put a nominal value on gold, it would give it comparative assurance and likely would start the gold flow away from the United States(now in evidence as cited above). The cure for the money ills of today lies in all countries moving toward stabilisation of their currencies in relation to gold as well as to each other. Each one is now coping with the domestic problem.

Let us view France in the present scene. Finance Minister, Georges Bonnet, said there will be no vacations in his determination to abide by a balanced budget. He said that neither the United States nor Great Britain would support French finances if she patterned them after

the totalitarian states. On the other hand, he rejected inflation.

"If at certain times, under conditions of freedom, governments can spur business by credit inflation or the devaluation of currencies,"he said, "they must always quickly reverse, as the United States is now doing, and seek a balanced budget."[1] He added that President Roosevelt had admonished him to balance the budget. The tieup of Bonnet, until recently in Washington, is considered a good link in international negotiations.

He added that "several billions of exported capital had returned to France."

Edward J. Condlon, in reviewing the history of the franc, placed it in four stages thus; the pre-war with 2 90.32 milligrams of pure gold, the Poincaire with 59.85, Auriol with 44.1, and the Bonnet with 38.7. France now has gold holdings of 55,667,000,000 francs.[2]

These internal problems weave into the international problem, which is now taking on new significance, the tripartite agreement of last September, to which we have already referred, being the most important trend.

This agreement between France, The United States, and Great Brtiain was entered into in September 1936, effective October, 13, 1936, and was later subscribed to by the Nether-

1. "The New Yqrk Times", August 8, 1937
2. Op.Cit, August 8, 1937, financial section.

lands, Switzerland, and Belgium. It embodies a gold-content range for the franc, leaving the exact figure to be fixed by governmental decree. This gives for some time at least currency relationships with a certain amount of elasticity. All attempts to continue pre-depression values have been abandoned. The avowed policy is expressed thus "one constant object of which is to maintain the greatest possible equilibrium in the system of international exchange and to avoid to the utmost extent the creation of any disturbance of that system". The agreement assures against any outbreak of competitive currency depreciation, establishes a new basis for international cooperation which presumably can be broadened until it approaches the task of final stabilisation.

This guarantee not to compete for advantages by sudden fluctuations in their monetary systems, bolsters up each others' monetary backing to tide over any sudden upheavals. This was made before France's recent departure from gold and the agreement still stood. This agreement has been given little publicity and, although its workings are not secret, they have been remarkably free from journalistic exploiting.

In order to accomplish the aims of this agreement, the gold-bloc nations will have to establish new values for their exchanges that will bring them into equilibrium

with the devalued currencies. Thus the way will be open for small countries to enter.

The policy must be elastic. When Belgium left gold on April 1, she cut 28%. France now cut 30%. Perhaps Belgium will reopen the question. France, in her recent devaluation causes a severe strain on the agreement. Secretary Morgenthau and the Chancellor of the Exchequor both insisted that the agreement could and would bear the strain. London has much surplus gold now, which keeps the pound too high. Perhaps with the reestablishment of confidence in France and on the continent, this gold will flow and "normal" trends will resume.

The main difficulties are its political nature, and the short notice required to terminate the understanding greatly weakens its stabilising influence. However, it may well serve if guided wisely and in faith, as the vehicle for mutual agreements leading to stability.

True, Germany, Japan, Russia, and Italy are still out of the present tieups, but channels of trade and monetary negotiations can flow between these three major countries and gradually establish stability again. The world seems to feel that if England and the United States can evolve a sound international currency system, and take a strong lead, the foundation for world monetary stability will have been laid.

Germany and Italy are each under a controlled economy tied nominally to gold, but working quite separate from it. In Germany there exists one parity for internal exchange and

another for international exchange, subject to very direct control by the government. No capital can leave the country without the specific consent of the government. This provision was an important part of the anti-Jewish program. Germany, after the announcement of the tripartite agreement declared that gold is not the only basis for a stable currency and it can be replaced by international credit agreements. She has no gold to maintain a parity.

Italy also forbids gold movements outward. Her armaments program is built on credit based on gold she has been able to raise and confiscate in her domestic channels. Russia, thought to have much gold, has recently failed to meet internal obligations. This means either a drain on her gold has depleted her supply, or she is launched on a campaing to further nationalize gold.

Another important factor in reestablishing trade and gold channels is in the purported Anglo-American Trade Pact. Both countries are moving cautiously as England fears empire protests, especially from Canada. The United States has seemingly been more amenable as she has more to gain. With the increased prosperity of England more call is made for the commodities we produce most effectively. With France entering a new regime, trade agreements with the United States may be possible.

She produced those things which our increasing prosperity clamors for, as art pieces, silks, wines,etc. The network of trade agreements already entered into by the Administration may well expand into more significant channels.

Monetary stability will be contingent on resumption of trade stability which seems on the way unless war changes the scene. In the throes of nationalism we find the seeds of international cooperation, whether or not these will bind and hold in the next decade is a matter of hope rather than prophecy.

If these tendencies, which seem to have "shoots" already appearing, materialize, we shall then see an international economy based on international credit and mutual agreements and quite free from the effects of gold distribution. Very likely, under such an economy, gold would soon redistribute itself again to where it "fills economic and political needs" and the desired state of equilibrium without which the gold standard cannot be expected to function, "will have again been accomplished".

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