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"AMERICA AND THE DEBTS OF EUROPE"

Address by

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VICE-GOVERNOR FEDERAL RESERVE BOARD

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The topic assigned for discussion this evening "America and the Debts of Europe" is broad enough to allow of considerable latitude and does not necessarily imply that discussion is to be limited to the debts of Europe to America, but I take it that it is with such debts that we are chiefly concerned, and I propose to speak particularly of the debts not of European governments to our government or even to our people who have purchased the bonds of European governments, but of the debts which business men, manufacturers and bankers of Europe owe to our business men, manufacturers and bankers.

With regard to the great debt of our former allies or associates in the war to our government I merely want to say in passing that I have been rather surprised as to the source from which the principal demand for its early payment appears to come. If this demand came from the great financial centers or from men of large incomes who pay the most burdensome taxes, it would be explained by the desire for relief from taxes through the application of the sums received to the reduction of the war debt, but it appears to come from producing centers, and particularly from agricultural sections which are dependent upon export demand for their products for maintenance of prices. It would seem clear that early payment of any part of this debt must decrease the purchasing power of the people of the allied countries and must therefore make for lower prices for the products we sell to them.

It is of course well known that European merchants, traders and bankers owe large sums of money to Americans. Even if we had no direct proof of this we should know that it must be true from the fact that large flotations of foreign securities have been made in this country without turning the tide of gold importations. Since last October the foreign financing in this country has at times almost equalled the current trade credit balance, but gold importations have continued, with only a slight slackening due evidently to the stoppage of gold production in the South African mines through strikes.

How much of an unfunded trade balance is there? This has proven an interesting study for economists and statisticians and they have assembled many columns of interesting figures, but have differed considerably in their conclusions. I think the first serious effort to bring together the known facts, the visible items, with some estimate of the "invisible" items was made by the Federal Reserve Board's Division of Analysis and Research in the Federal Reserve Bulletin for September, 1920. A merchandise balance had accumulated in our favor of $6,062,000,000 between November 1, 1918 and July 31, 1920 and it had become very evident long before that such a one-sided trade could not be carried on indefinitely. The Federal Reserve Bulletin brought to light offsets that appeared to reduce this balance of more than six billion dollars to about three billion dollars, adding that "from this, of course, must be deducted the amount of indebtedness to European and other countries which existed at about the time of the Armistice."

This was followed the next month by a much more elaborate study by Dr. B. M. Anderson in the Chase Economic Bulletin on Europe's unfunded debt. His conclusion was that "on September 15, 1920 Europe owed an unfunded debt of over $3,500,000,000 to private individuals, banks and corporations in the United States," this being in addition to the ten billion dollars which European governments owed to the United States government, and in addition to the debt of Europe to investors in the United States holding European securities. Dr. Anderson maintained that the primary explanation of the tremendous expansion of bank credit in the United States in 1919-20 was "our unbalanced and unfinanced export trade, together with the rising prices, fictitious prosperity, and speculation which have grown out of the unbalanced export trade." Our exporters had borrowed money from our banks in large amounts because of inability to collect what was due them abroad, or because they had taken payments in foreign currency balances which they thought they could convert into American dollars at more favorable rates of exchange later. Dr. Anderson declared that computations as to the unfunded balances owed us on our world trade were not particularly valuable - that the European balance was the only one that counted, as the triangular exchange of goods and of credit by which America's credit balances in Europe had been settled through debit balances with South America and the Orient had broken down.

This idea was combatted by Prof. John H. Williams in the June, 1921 Review of Economic Statistics of the Harvard University Committee on Economic Research. He gave reasons for believing that it is still permissible to subtract from Europe's debt to us the amounts we owe to non-European countries, and his final conclusion was that the unfunded debt to the American merchants, bankers and corporations was considerably smaller than others had estimated. "Our international situation since the Armistice," he declared, "has been less alarming than has frequently been stated. It appears improbable that our unfunded balance exceeded a billion dollars at the end of last year" (December 31, 1920). Our unfunded balance from Europe was estimated at from half a billion to a billion greater than our balance with the world as a whole, but he concluded "It is not possible to believe that so prolonged and pronounced a recovery could have occurred (in European exchanges) had London and the Continent been indebted to the United States - besides the $10,844,000,000 of obligations held by our government and the private long term indebtedness - by some three to four billion dollars". In November, 1921, the Federal Reserve Bulletin returned to the subject with a much more complete statement of items of credit and debit than in the study of September, 1920, the conclusion being that so far as visible items, and items which could be estimated with some approach to accuracy were concerned, the sum due our merchants, bankers and corporations was on October 1, 1921 no less than $3,408,000,000. The Bulletin mentioned offsets that might reduce this amount, such as the speculative purchases of foreign currencies by Americans, but did not attempt to estimate their amount. This sum referred to our trade with non-European as well as with European countries. It was swelled half a billion dollars by the inclusion of an item with relation to the cost of cancellation of European war contracts in this country in 1919, an item not included, I think, in any previously published estimate.

The February 1922 Federal Reserve Bulletin pointed out that in October, November and December our favorable balance of trade was a little less than $300,000,000, from which gold imports of $125,000,000 were to be subtracted, leaving the net addition to the unfunded balance $175,000,000, and conjecturing that the invisible items plus foreign financing probably more than offset that amount. The unfunded balance on January 1, 1922 was therefore given as $3,400,000,000, lopping off $8,000,000 from the November estimate.

There have, of course, been other contributions on this subject. The Journal of Commerce on Monday, April 24th, published a number of articles by leading bankers and economists, and the economic magazines have published occasional papers, but generally speaking these have added only an item or two to the studies already referred to, or have expressed opinions without bringing much that was new to their support.

It is noteworthy that the main studies of this subject coincided with periods of depression or of recovery in sterling exchange. Sterling had been pegged during the war at 4.76, and when allowed to take its own course after March 18, 1919 began to fall until in February, 1920 it reached a low point of 3.18. It recovered to 4.00, then fell to 3.58 in August at the time when the first study of unfunded balances was made in the Federal Reserve Bulletin in September of that year, followed by Dr. Anderson's study of October. In the Spring of 1921 there was a remarkable recovery with cable rates at or a little above $4.00 for more than a week in the latter part of May, and it was during this period of recovery, or before the reaction from it had proceeded far, that Prof. Williams made his elaborate contribution to the Harvard Review of Economic Statistics. It was natural at that time to find reasons for believing the unfunded balance much less than had previously been estimated, and Prof. Williams' conclusion that so pronounced a recovery could not have occurred with so great an unfunded balance as three or four billions of dollars seems justified. By the time of its publication, however, in June the reaction was well under way and before the end of July sterling rates were as low as in August of the year before, below 3.60 from the 19th of July to August 6th.

When the Division of Analysis and Research of the Federal Reserve Board made its second and chief investigation of the question of unfunded debts for the November issue of the Bulletin there had been considerable recovery, but the study was published or was prepared, just before the notable rise in sterling, in French francs and in lira that began about the time the Conference on the Limitation of Armaments met in Washington. By the end of November British pounds had risen to about $4.00, and by December 31st to 4.21 1/4, and by March to $4.40. Since March the advance has proceeded less rapidly, but has been well sustained. There is no further talk of debasing the pound and British bankers express confidently their expectation that par may be reached before the close of the present year, or soon after the end of the year.

There is no necessary conflict between the figures on the unfunded balance as given in the November Federal Reserve Bulletin and carried forward to the end of the year and other studies of the subject, with the exception of one or two items, for the reason that the Bulletin has not attempted anything further than an appraisal of known facts with such invisible items as had long been estimated as offsetting the balance of trade, such as tourists' expenditures, relief contributions, emigrants' remittances, etc., concerning which enough information could be obtained upon which to base estimates. As already stated it appears that the gold imports, the known investments of Americans in foreign securities, and the invisible items included in the Bulletin's figures have somewhat overbalanced the excess of exports over imports for several months, but for more than a year imports have been slowly increasing while exports (in value at least) have been decreasing, so that this change alone is not enough to account for the very pronounced and well sustained rise in sterling and in the principal allied currencies. The conslusion seems inevitable that no such recovery could have been made if there were still an unfunded balance due the merchants and bankers of this country as great as three billion dollars.

That there was such a balance in the summer of 1920, when the Federal Reserve Board first undertook an investigation of the subject I have no doubt. Liquidation had scarcely begun at that time, and Dr. Anderson was doubtless also right in attributing a large share of the overextended condition of banks in the financial centres to the efforts of our exporters to carry this balance. Whether it could have been cut down so much as Prof. Williams estimated by the beginning of the year 1921 seems more than doubtful, but that liquidation and invisible offsets had by that time become well started is reasonably certain. The Federal Reserve Bulletin has suggested that speculative purchases of foreign currencies may have been a large item and has also suggested that American exporters have doubtless charged off considerable losses. It seems probable that the major depressions of exchange mark periods when our people were seeking to convert foreign balances into dollars and that exchange recovered when most of the conversions had been made and losses wiped out. Some very large American exporters are known to have taken considerable losses in this way. They sold in terms of foreign currencies, and found them when payments became due considerably depressed, but when recovery was delayed beyond their expectations they finally bought dollars and took their losses. Very large losses are also known to have been charged off by some of our bankers.

It should be remembered always that even if the balance of trade were actually against us European exchanges would not be at their old gold pars. The principles laid down in the well know Bullion Report of 1810 with regard to the effect of irredeemable paper currency on exchange still govern. With the English budget in balance and British prices about as low as ours, sterling might be nearer the old par than it is now if there were no unfunded balance due us, but it can not go to par until the paper currency of England is actually and freely exchangeable for gold.

Predictions as to the future course of exchange are rather thankless, however. As already mentioned there were British economists and bankers who declared no longer ago than last fall that the pound sterling could never recover, or that its recovery could not be attained without a ruinous decrease of prices, and that it would be better to stabilize it at about 3.65 or 3.70. There has in fact been a considerable decline in prices in Great Britain and that decline has been doubtless a leading factor in the recovery of sterling and also in the recovery of Britain's export trade.

No longer ago than April 1st the editor of the Economic World whose articles are always worth reading and usually sound predicted that "no person now living will ever see the value of the present French franc of actual currency normally and regularly equal to one-half of that of the gold franc established by law as the monetary unit of France". At the time that was published the French franc was quoted at about 9 cents in our currency. It had been as low as 5.79 in 1921 but had recovered to 8.13 at the end of December. Within a little more than two weeks after Mr. March made this prediction French francs sold at 9.37 1/2, and had little more than a quarter of a cent to go to reach half par. They have since fallen back somewhat, but I see no reason why they should not continue to advance, if France makes progress towards balancing her budget. They are not lower now than our Civil War greenbacks were at one time, and complete restoration does not appear impossible, though it may take a considerable number of years.

I am not going to undertake to estimate how great an unfunded balance may still be due to the merchants, bankers and corporations of America. They had a severe lesson in 1920 and have since then preferred a diminishing business for which payment was reasonably sure in dollars. It appears at any rate clear that they have for many months been collecting or funding in some way, or charging off debts due them. I believe that investments in real estate in Europe and in the shares of European enterprises have been a very large off-setting factor. Prof. Williams states in the May number of the Quarterly Journal of Economics that foreign investments in Germany since the Armistice have been estimated at nearly $250,000,000, and it is well known that Americans have been large investors not only in German property, but in Poland, in Italy and in the states which formerly made up the Austrian empire. This item of foreign investment, with the wide-spread speculative purchases of foreign currencies might easily have amounted to a billion dollars.

The debts of individuals in Europe to individuals and corporations in America, at any rate can not at present, I believe, be so large as to present any insuperable bar either to the restoration of the exchanges that seem within reach of restoration or to the stabilization of exchange with countries where inflation of paper currencies has reached a point beyond the possibility of restoration. Fluctuation of exchange, due to inflation, is annoying and introduces a very undesirable element of speculation in foreign trade. An irredeemable paper currency even if not constantly expanded is subject to changes of value from political and other causes not related to trade balances or international debts. Our Civil War greenbacks went up or down in value in accordance with the fortunes of the Union armies, and later with relation to policies under discussion in Congress. The depreciation of some European exchanges has undoubtedly been increased by the instability of some governments or by socialistic policies. Confidence, as Secretary Hughes has well said, must precede credit. Given good government and balanced budgets something could doubtless be done in the direction of stabilizing exchanges between countries having an irredeemable paper currency and countries on a gold basis. It would probably be in the nature of recognition for fixed periods, or in some cases permanently, of new pars around which fluctuations could be controlled within something approaching normal limits. No outside or international attempts at "stabilization", however, could perform miracles or take the place of the necessary internal conditions and efforts in each country. Stabilization of exchanges between the United States and the neutral countries, whose currencies are not greatly depreciated, such as Holland and the Scandinavian countries, seems within reach on the former gold par bases, and foreign trade would doubtless be benefited by such control of fluctuation as might be instituted in other cases, but so long as our own currency is sound and our prices attractive and so long as the pound sterling continues to maintain itself at a point so near par, with francs and lira showing progress, it can hardly be said that the continuance or recovery of our foreign trade are really dependent upon any such stabilizing measures.