FEDERAL RESERVE BOARD

STATEMENT FOR THE PRESS

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The following is a digest of the Review of the Month as contained in the forthcoming issue of the Federal Reserve Bulletin.

In the Review of the Month contained in the Federal Reserve Bulletin for February a general discussion of the European economic and financial situation is afforded with special reference to the problems which are likely to be presented at the Genoa Conference. The Review calls attention to the fact that the Genoa Conference is the outcome of the increasingly serious economic conditions abroad, and after sketching the "agenda" which have been proposed for Genoa quotes the explanation offered by Premier Lloyd-George with reference to the reasons for the inclusion of Russia and Germany in the conference. Russian and German problems are treated as being practically inevitable elements in the existing economic situation.

The Review remarks:

The inclusion of Russia has already been the subject of discussion because of the view that her participation in the conference at which Russia was represented would imply a recognition of the present Russian Government or an assent to its policy by other participating Governments. Premier Poincare, of France, in succeeding M. Briand, has apparently held to the view that France could not well be represented at the conference without a previous undertaking on the part of Russia to allow full faith and credit to her prewar debts. On all these points the issues at stake are "political" in the broad sense of that term rather than economic. But the position of those who regard the conference as likely to be successful in the economic sense, only as issues affecting the rehabilitation of Russia, Germany, Austria, and Southeastern Europe generally, can be disposed of, is that the plan which may be adopted is not very likely to succeed on account of the natural limitations to which it would be subject. Somewhat the same position is taken as regards the suggestion that no reference be made at the Genoa conference to the question of German reparations. Within the past month or more it has been contended more positively than ever before that the reparations problem is an almost inevitable element in any discussion which aims to develop a general solution for European questions at large."

The Review then turns to the reparations situation and calls attention to the unsatisfactory position in which the reparations question has been left. The Review then considers the question whether the best way of settling with France during the next few years may not be an extension of the plan provided in the Wiesbaden agreement. As to this it remarks:

"It seems to be more and more admitted that the best way of paying France in the next few years will be by an extension of the method provided in the Wiesbaden agreement, although the use of German labor in the devastated regions, which was contemplated in that agreement, may not prove to be practicable. Payments in kind will not, however, ultimately solve the French situation, because of the large French public debt."

Speaking then of the changes which have occurred since the Brussels conference the Review calls attention to the fact that at the time of the Brussels conference business depression had not begun to develop to any considerable extent. It then says:

"Since that time, however, the demoralizing effect of the conditions in eastern Europe has reacted very directly upon trade elsewhere, with the result that recently there have been several proposals looking to the rehabilitation of the purchasing power or buying capacity of Russia, Poland, Austria, etc. The proposal which appears to have been officially accepted by the Supreme Economic Council at Cannes provides for the incorporation of an international organization based upon private capital, the participants to include representatives of Great Britain, France, Italy, Belgium, United States, Germany, and possibly others if they so desire. The declared purpose of this organization is the rebuilding of railroads and other means of communication in Russia, and the plan contemplates the creation not only of a central international corporation with headquarters in London but of affiliated corporations in the participaing countries as well. Contributions to the capitalization of the corporation are to be made in the currencies of the several contributing countries, but control is to be exercised by the central organization."

The recent developments in connection with the Ter Meulen scheme are outlined and a contrast is drawn between that plan and the recommendations laid before Parliament by Mr. Lloyd-George after the close of the Cannes conference. The Review then comments upon the savings to result from naval limitation, as follows:

"The savings which will result from the limitation in armaments decided upon at the Washington conference will, unfortunately, affect immediately only the three countries whose finances are already in a relatively sound condition. It is estimated that the reduction decided upon for the United States will save about $200,000,000 on the present building program. The saving in England and Japan will reach an amount approximately equivalent. In France and Italy, however, no increase in naval armaments had been contemplated in the near future, and the savings brought about at Washington will not affect their immediate problems.

"It is particularly important in the present situation not only that governmental budgets should be balanced, so that short-time borrowing by the Government may be discontinued but also that the sum of Government expenditures should be decreased in order to reduce the tax burden of the business community. In most countries, however, curtailment of taxes seems highly problematical at present. Only in the United States has it been attempted.

"Any savings which result in England next year from a decrease in expenditures will probably have to be applied to debt reduction. The situation is much the same in France.

"In Italy the difficulty of increasing Government revenue to meet expenditures is almost as great. In Germany the balancing of the budget is complicated by the fluctuating value of the mark, and large increases in taxes are planned for the coming year."

Turning to the actual question of work at Genoa, the Review states that a fundamental issue to be dealt with there will undoubtedly be the restoration of the gold standard or some plan for the stabilization of foreign exchange. Discussing the latter question, the Review says:

"From the preliminary announcements of unofficial character, as well as from the "agenda", it is clear that discussion at Genoa is likely to relate in no small measure to the restoration of the gold standard, or, in lieu thereof, to the development of some plan for the stabilization of foreign exchange. Much difference of opinion exists concerning the specific means to be employed and the incidental difficulties likely to be encountered in bringing about a return to the gold standard in Europe. But there is a gratifying unanimity of opinion among leading economists, financiers, and statesmen to the effect that any permanent rehabilitation of credit and currency systems will necessitate a return to a gold basis of some sort. It is quite obvious, however, that prior to any attempt to reinstate the gold standard, many complex problems will have to be solved. These are problems connected with reparations payments, with domestic and foreign indebtedness, with the effect of national policies upon the amount and direction of current expenditures. The issues involved necessitate far-reaching international adjustments that are likely to be the subject of prolonged negotiations. Extraterritorial interference with power to raise money or to spend it is rightly regarded as an interference with the sovereignty of a State, and can only be justified in extreme cases. On the other hand, a simple ultimatum to insolvent nations to the effect that obligations must be met and budgets must be balanced, will not bring about a solution of international difficulties. The capacity of the several nations to defray recurrent expenditures out of regular sources of income must be carefully appraised, and expenditures in excess of ability to pay must be eliminated before budgets can be balanced and inflation consequently stopped. Until some sort of international agreement based upon recognition of this patent fact has made possible the cessation of deficit financiering no program of currency reform involving a return to the gold standard has any chance of success."

Retention of the gold standard as an international basis of values is endorsed by the Review as follows:

"The argument in favor of the restoration of gold as an international standard of value is twofold - first, that no superior or better basis for prices has as yet been developed, and, second, that the use of gold as an international currency or price basis affords strong protection against pressure to bring about expansion of credit. In international trade the gold standard also constitutes a nexus between the price levels of various countries. It can by no means be said to be an ideal means of payment, but under normal conditions it has been very effective in preventing the price level of any one country from falling too markedly out of line with that of others. When currency and credit systems are erected upon a gold basis, loss of gold following imports tends to check the process of further credit expansion, and the knowledge that gold may be wanted for export is under all circumstances a deterrent to indefinite credit expansion. In short, international purchases and sales tend to offset one another except to the extent that occasional adverse balances can be covered by means of gold shipments. However, if there is no attempt to maintain the gold standard or to link gold in any way with the internal price level, the process of gold denudation can go on to the point of exhaustion. In fact, that is what has virtually happened in a number of countries. Ordinarily the rising interest rates that would accompany an outflow of gold would check such a movement. But if credit expansion by means of paper issues goes ahead unrestricted by the need of redemption, either immediate or prospective, no effect upon interest rates need ensue."

Discussion of the inflation now existing in Europe leads to the question whether a so-called gold exchange standard might not be employed and the Review urges that artificial methods of controlling exchange operations are of no permanent value:

"Their inadequacy as a means of correcting fundamental maladjustments of trade balances has been made so obvious by experience and has been a subject of such lengthy comment that it does not require further elucidation. It is, however, conceivable that the stabilization of exchange and the reestablishment of a satisfactory system of internal payments could be accomplished by a rigorous control over credit and currency without return to the gold standard. But it is highly unlikely that such control would be sufficiently rigorous and discriminating to prevent exchange fluctuations from continuing to be of a magnitude sufficient to constitute a serious interference with foreign trade. It may be that the use of the discount rate as a means of price stabilization could with wise manipulation, unhampered by political pressure, be effective in some countries. Changes in discount rates would then act as a means of encouraging the expansion or forcing the contraction of credit-created currency without either an inflow or outflow of gold. But such a scheme presupposes a centralized control over money markets that was by no means assured even in prewar times, and it also presupposes a sensitive response to variations in the interest rate that implies the existence of highly organized international markets which no longer exist."

The statement is plainly made that the great accumulation of gold in the United States at the present time is gravely dangerous, the Review stating the case as follows:

"It is evident from all that has been said that the United States has an interest in the introduction of some form of gold standard as a means to the resumption of trade relationships through the effective stabilization of exchange. At present, furthermore, the abnormal concentration of gold in this country is a source of danger, because it is a false guide in matters of credit policy - no longer an index of the outside limit of legitimate credit expansion. Considerations of national interest alone are, therefore, a sufficient reason for a careful weighing of proposals looking to a redistribution of the gold supplies of the world and involving a return of some part of the gold held by the United States for use elsewhere. No proposals of any sort should, however, be entertained until far-reaching guaranties of fiscal reform have been secured from the countries that require aid. Otherwise the assistance would be detrimental to the extent that it would lead to the postponement of the necessary fiscal reforms which must be made preliminary to the rehabilitation of currency systems and the reestablishment of stabilized exchange relationships."

The Review closes with a sketch of the present international balance situation in which it is shown that:

"In November, 1921, a detailed estimate of the net unfunded balance due to the United States from abroad was presented. Exclusive of the war-time debts of foreign Governments to the United States Government, which amount to $10,000,000,000, roughly speaking, it was estimated that on October 1, 1921, there was owing to private creditors in the United States a net unfunded balance of $3,408,000,000. During October, November, and December exports of merchandise exceeded imports by a little less than $300,000,000; and for the same period net imports of gold and silver were but slightly short of $125,000,000, leaving a net addition to our unfunded balance from "visible" sources of $175,000,000. When, however, the remaining or "invisible" items in the balance are taken into consideration and summed up, it is likely that they constituted a net debit for the three months of between $175,000,000 and $200,000,000. The result is that the visible items during these three months have been fully offset or possibly a little more than offset by the invisible elements in the balance, leaving the former estimate substantially unchanged and if anything slightly reduced at the close of 1921. In view of all the available facts, therefore, it seems fair to take $3,400,000,000 as the approximate amount of our unfunded international balance on January 1, 1922.