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PART V

The Impact of the World Economic Depression on the International Gold Standard, 1929-1931

CHAPTER 22

The International Distribution of Credit under the Impact of World-wide Deflationary Forces

For about twelve months after the critical decisions of June 1927 the international effects of generally easy money were among the most fundamental causes of a world-wide upswing in business.[1] Though prices in gold standard countries were falling gradually, increasing productivity would probably have forced them much lower had it not been for the expansion of credit. There was an upward pressure in many price groups. Profits from security and real estate speculation stimulated demand for many commodities. Low interest rates made it easy to finance valorization schemes and price control arrangements and promoted the issue of foreign loans, particularly in the United States. Foreign loans in turn helped to maintain prices in many debtor countries and also prevented the growth of tariffs from checking the expansion of international trade.[2] The continued extension of international credit was a dam that was holding back the onrushing torrent of economic readjustment. The strength of this dam depended upon the continued de facto cooperation of the center countries in reinvesting their currently accumulating credits in debtor countries. It did not long survive the completion of the gold standard facade.

The End of De Facto Cooperation by the Nucleus

Until the end of 1928 the principal stock exchanges of the world were enjoying a common upward trend in security

[1] League of Nations, *Course and Phases of the World Economic Depression*, prepared by Bertil Ohlin (rev. ed., Geneva, 1931), p. 127. This source will be cited below as 'Ohlin.'

[2] League of Nations, *World Economic Survey, 1931/2*, pp. 111–2, 152–3.

prices. The amount of capital exports from most creditor countries was consequently curtailed by the attractions offered speculators and investors at home by local booms. The new issues market in London was no exception to this rule, though Professor Ohlin has drawn from the British balance of payments figures for 1928 the inference that the reduction in the outflow of capital from Great Britain by new issues

TABLE 63

New Foreign Capital Applications in London 1928-1929, monthly (thousands of pounds)

	1928	*1929*
January	19,616	29,372
February	5,245	6,864
March	23,043	9,007
April	7,978	6,011
May	13,523	8,833
June	15,968	11,387
July	17,705	8,325
August	984	1,378
September	10,731	1,205
October	10,883	4,055
November	11,009	6,673
December	6,699	1,237

SOURCE: Midland Bank figures

was replaced by other forms of capital export.[3] For the first seven months of 1928 average monthly new foreign issues placed in the United Kingdom were £14,725,000 and for the last four months only £9,830,000 (Table 63),[4] and throughout the year new foreign issues in London were a progressively declining proportion of total new issues. In the United States new foreign issues also declined in the second half of 1928 when they were only $409 million as compared with $842 million in the first six months. As in Great Britain they were a declining percentage of total new issues. Here also there was an offsetting factor, for "during the second half of the year foreign borrowers were able to draw upon their

[3] Ohlin, *op. cit.*, pp. 200, 210.

[4] The seasonally low total for August distorts the comparison and is omitted.

deposits in American banks consisting largely of the proceeds of loans previously floated." [5]

The beginning of a contraction in total international lending in 1928 was accompanied by a phenomenon far more serious in its implications for world stability—a diversion of this lending from debtor countries. The superior attractions of the New York market from a speculative point of view diverted a portion of the reduced long term capital exports of other creditor countries to New York, and shifted to London, and to other creditor markets in less degree, the burden of short term advances needed by debtors. Professor Ohlin has described this process (*op. cit.*, p. 205):

"In the second quarter of 1928 the (American) boom gathered strength, bond yields began to rise and continued to do so until the autumn of 1929. The consequence was an increase in the actual interest rate necessary to induce lenders to take up issues of fixed interest securities, and this increase, though small, was sufficient to discourage such issues in the United States. Foreign governments to a large extent turned to other capital markets where conditions, although affected by those prevailing in the United States or by local booms, were generally less unfavourable. In other cases these governments were able to meet their requirements for current expenditure or for refunding of matured loans by short term banking advances, thus avoiding the flotation of new bonded loans or at least postponing it in anticipation of more favourable conditions in the market."

The Independent Course of the New York Market in 1929

These more favorable conditions did not appear in 1929. By about the end of 1928 and the beginning of 1929 the gathering forces of postponed economic adjustment had begun to be reflected in most of the world's stock exchanges. Stock prices began to fall in Zurich, Amsterdam, Vienna, Milan, Paris, Brussels, Berlin, and Tokio. On the London Stock Exchange the upward trend in share prices that had been in progress since the autumn of 1925, came to an end in the

[5] Ohlin, *op. cit.*, pp. 200, 208–9, especially the chart on p. 208.

summer of 1928, and in January 1929 share prices began to fall steadily. In these countries a turning point in the cycle had clearly been reached. Exports of capital from most creditor countries were now reduced because their markets were unfavorable for capital flotations in general. In the United Kingdom new foreign loans were on a very small scale after February 1929 (Table 63), but they were no longer a declining proportion of total new issues. New foreign loans in America also declined sharply, as shown in the accompanying tabulation.

Movement of Long Term Capital Items in the American Balance of Payments, 1927–1929[6]

Capital imports +, Capital exports − (millions of dollars)

	1927	*1928*	*1929*
New foreign security issues *	−1,183	−1,124	−635
Direct investments (net)	−178	−258	−261
Movement of old securities (net)	+422	+416	+556
Bond redemption and sinking fund (net)	+234	+291	+199
Net movement of long term capital	−705	−675	−141

* Refunding excluded and after discounts and underwriting commissions are deducted.

The reasons for the reduced capital exports from the United States were not the same as those for the reduced capital export from other creditor countries, but are to be found in the independent course of the New York stock market. The general downward turn in the world's stock exchanges at the beginning of 1929 was reflected in New York by a temporary check to the tide of rising stock prices during the first four months, but this was followed by a new and rapid rise in stock prices from June to September. The diversion of international long term funds to New York continued, but there was no offsetting American short term capital export. On the contrary, short term funds moved to

[6] From unpublished thesis, Some Post-War Balance of Payment Problems of the United States, by E. J. Stone, p. 102. The 1928 figures are smaller than those given by Professor Ohlin; they are net after discounts and underwriting commissions have been deducted.

New York from all over the world [7] to take advantage of high interest rates (Chart 49). The dollar was, in consequence, strong on the world's exchange markets, and to support their exchanges central banks in other countries were obliged to raise their rates and to sell some of their balances in New York. This contributed still further to stop capital exports from other creditor markets.

In the first half of 1929 America drew gold in large amounts from Germany, Great Britain, Canada, and Argentina, while French demand was concentrated first on Germany and then on Great Britain, thus undermining the whole basis of the inter-central bank cooperation of 1927. New York was continually a competitive bidder for gold in the London bullion market (Chart 50), while at the same time, and as a direct consequence of developments in New York, an increasing demand by other countries for short term accommodation, even for ordinary commercial needs, was concentrated upon London. The traditional British technique of making a cyclical adjustment by cutting down long term foreign lending while shifting a part of the burden to the short term shoulder was made extremely difficult to apply at a time when the New York market was following a course that diverged from that of the London market. For the world as a whole the position was rendered extremely difficult because the two great center countries did not act as a unit at the turn of the cycle according to the precedents set by the single center before the war.[8]

The American Credit Base and Credit Superstructure June 1928 to October 1929

The independent course of the American market that led to these results was due to the long continued prosperity in the United States under the stimulus of the cheap money policy

[7] Cf. Hardy, *op. cit.*, p. 51.

[8] Cf. Ch. 19, The Pre-War Technique of Shifting from the Long Term to the Short Term Shoulder in International Lending.

of 1927, which had prevented the public mind from realizing the weaknesses of the American economic position[9] and had weakened the faith of bankers and other money market practitioners in the applicability of the danger signals of other days to the new situation. The Federal Reserve system, indeed, was aware of the dangers inherent in the situation, but it was divided in counsel and followed a vacillating policy while the American credit superstructure continued to expand.

In our description in Chapter 18 of the restrictive policy followed by the Federal Reserve system in the first half of 1928, we pointed out that by June the member banks were heavily in debt to the Reserve banks, and that a further gold import movement might fix a substantial amount of reserve funds represented by rediscounts permanently in the American credit system. The open market sales of securities, which had chiefly caused the rediscounts, were suspended in May 1928, but the Federal Reserve banks continued to liquidate their holdings of bills until the end of July. Since rediscounts, which amounted to $1,037 million on June 27, 1928, continued at approximately that level until August, member bank reserve balances declined moderately in midsummer, even though gold exports had ceased. In August, however, the principle of distinguishing between the use of Federal Reserve credit for speculative and for legitimate business purposes was again applied.[10] The Reserve banks made substantial purchases of bills in the open market while their government security holdings were kept nearly constant. This took care of the financing of the fall expansion of the currency, and enabled member banks to reduce their borrowings $48 million and at the same time to increase their reserve balances $93 million. Interest rates were actually

[9] Cf. Ch. 18, The Continental Background.

[10] Cf. B. H. Beckhart, ed. *The New York Money Market* (Columbia University Press, 1932) IV, 109. This section draws heavily on Professor Beckhart's account of Federal Reserve policy from August 1928 to October 1929, *op. cit.*, IV, 109–47 passim.

slightly reduced, and the checks placed on speculative activity in the first half of 1928 far from being reinforced, were in effect relaxed. Concerning this Professor Beckhart writes: "It is significant that during this period when the Reserve banks were expanding their open market operations the security loans of the reporting member banks increased by 5.6%, whereas from January to August 1928, a period marked by a rapid reduction in the open market portfolios their security loans increased by only 0.007%." [11] At the same time the Standard Statistics index of stock prices rose from 148.3 to 171.4.

The theory upon which the bill buying policy was based had clearly not been justified by the event, and that policy was not carried through December. Year-end seasonal requirements for currency had to be met by an increase in rediscounts, and immediately after the turn of the year the bill portfolio was allowed to run off sharply. No seasonal easing of the money market was permitted as a result of the return flow of currency. It was clear that the Federal Reserve was attempting a more restrictive policy, but the pull of the speculative market in New York was now beginning to draw gold from abroad. At the end of January gold began to move from London to New York on an arbitrage basis and Governor Norman came to New York for consultation with American bankers. The incoming gold only partly offset the effects of the decline in the Federal Reserve bill holdings, and rediscounts began to rise again, returning to the one billion dollar level in March and April. These relationships may be most clearly seen in a segment of the chart of Federal Reserve credit regularly published in the *Federal Reserve Bulletin*, reproduced in Chart 53.

Advantage was not taken in the spring of 1929 of the increasing demand for Federal Reserve accommodation to enforce a contraction of credit by a higher discount rate. Instead a policy of 'direct action' or 'moral suasion' was pur-

[11] *Ibid.*, p. 113.

sued by the Federal Reserve Board, in spite of recommendations for higher rates made by the Federal Reserve Banks of New York and Boston. On February 7 a letter from the Federal Reserve Board to the member banks was made public warning them against using Federal Reserve credit for specu-

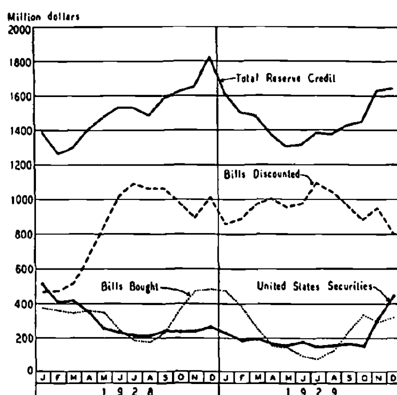


CHART 53
Federal Reserve Credit
1928-1929

lative purposes. On the same day the Bank of England raised its rate to 5½ per cent and the flow of gold from London to New York was, for the time being, stopped. The new policy of direct action remained in force until the first part of June. It was effective in bringing about a reduction in brokers loans by New York banks which was not offset by increases in loans to customers on securities. It was not so effective in the case of out-of-town banks, for these, like the New York banks, reduced their loans to brokers, but unlike them, increased their loans to customers on securities by an almost equal amount. The supply of speculative credit as a whole was not reduced, for the loans withdrawn by New York banks were replaced and increased by loans from private banks, foreign banks, and by 'loans for the account of others.' The rise in stock prices was checked only for a short time, and in May the upward movement was resumed with vigor. In June the 'direct action' policy was relaxed, New York once again began

to draw gold from London, and soon afterward Governor Norman once more visited New York.

Not until August 8, 1929 was permission given to the Federal Reserve Bank of New York to raise its rate to 6 per cent. Simultaneously the buying rate on acceptances was reduced from 5¼ to 5⅛ per cent. The fundamental thesis that it was possible to distinguish between Federal Reserve credit released for speculative purposes and that released to facilitate legitimate business was thus fully maintained. This famous 'straddle' policy was bullishly interpreted by the market. From August 10 to October 19 the bill portfolio of the Federal Reserve banks was increased $261 million and rediscounts were reduced. Banks outside New York City continued to increase their security loans to customers, and the speculative markets continued to draw supplies of credit from outside the banking system.[12] The New York banks continued to exercise restraint and moderation in extending speculative credit in order to be prepared to meet future contingencies already looked forward to with growing anxiety, but the speculative boom on the Stock Exchange, by now highly selective, continued until September. New York continued to draw foreign funds and on September 26 the Bank of England raised its rate to 6½ per cent.

From June 1928 to October 1929 the restrictive measures of the Federal Reserve banks, as a whole, were less effective in checking the growth of bank credit in America than were the measures taken from January to June 1928.[13] A relatively stable credit base was maintained in part by shifting from the discount shoulder to the bill portfolio shoulder and back again, and in part by fixing Federal Reserve funds created in the first instance by rediscounts permanently in the American credit structure by gold imports. On this relatively stable

[12] Beckhart, *ibid.*, p. 146, gives the changes in brokers loans from August 7, 1928 to October 16, 1929, in millions of dollars: Own Account, +6; Out-of-Town Banks, +42; Others, +732.

[13] Cf. Ch. 18, The Attempt to offset Gold Redistribution without having previously offset Gold Accumulation.

credit base the unexhausted powers of expansion of the American commercial banking system continued to build an expanded credit superstructure (Table 64).

TABLE 64

American Credit Base and Credit Superstructure
Factors of Change

THE CREDIT BASE

TRANSACTION (millions of dollars)	EFFECT ON MEMBER BANK RESERVE ACCOUNTS	
Increase in Monetary Gold Stock	+263	
Decrease in Money in Circulation outside the Reserve Banks, the Treasury, and All Reporting Banks (estimated)	+2	
Increase in Cash in Vault of All Reporting Banks (estimated)		−25
Increase in Treasury Currency	+2	
Decrease in Government Securities held by the Reserve Banks		−66
Increase in Bills Bought held by the Reserve Banks	+99	
Decrease in Bills Discounted at the Reserve Banks		−101
Increase in Other Deposits at the Reserve Banks		−35
Increase in Unexpended Capital Funds of the Reserve Banks		−90
	+366	−317
Increase in Member Bank Reserve Accounts due to these Items	+49	
Actual Increase in Member Bank Reserve Accounts	+54	

The results of fifteen months of effort to prevent the creation of credit for, or its diversion to, speculative purposes were far from brilliant. American banks as a whole, without any substantial increase in their reserves, increased their total loans and investments a billion and a half dollars. Though their investments declined $1,167 million, their 'loans and discounts (adjusted)' increased $2,695 million, mostly in the form of loans on securities. Bank credit directly supported the speculative boom, and at the same time the banking

system was accumulating an additional contingent liability in the form of an uninterrupted growth in loans for the account of others. From June 1928 to September 1929 these

TABLE 64

June 30, 1928–October 4, 1929, a Period during which the Federal Reserve System was carrying out a Cycle of Open Market Operations in Bills Bought and Gold was flowing in

THE CREDIT SUPERSTRUCTURE

TRANSACTION (millions of dollars)	EFFECT ON DEPOSITS (EXCL. INTERBANK DEPOSITS) OF ALL BANKS REPORTING TO THE COMPTROLLER	
Increase in Monetary Gold Stock	+263	
Decrease in Money in Circulation outside the Reserve Banks, the Treasury, and All Reporting Banks (estimated)	+2	
Increase in Treasury Currency	+2	
Increase in Commercial Bank Float (incomplete)	+570	
Decrease in Net Indebtedness to Foreign Banks (Member Banks only)	+87	
Increase in Loans plus Investments (adj.) of All Reporting Banks	+1,527	
Decrease in Government Securities held by the Reserve Banks		−66
Increase in Bills Bought held by the Reserve Banks	+99	
Increase in Real Estate owned by All Reporting Banks (estimated on basis of a monthly increase of 7 million)	+105	
Increase in Capital Funds of All Reporting Banks (estimated on basis of a monthly increase of 42 million)		−630
	+2,655	−696
Increase in Deposits (adj.) of All Reporting Banks due to these Items	+1,959	
Actual Increase in Deposits (adj.) of All Reporting Banks	+1,782	

increased $1,858 million as shown by the accompanying monthly figures.

Loans for the Account of Others (millions of dollars)

1928		*1929*	
June	1,744	January	2,434
July	1,760	February	2,656
August	1,881	March	2,879
September	1,924	April	2,893
October	2,048	May	2,965
November	2,248	June	2,940
December	2,319	July	3,290
		August	3,642
		September	3,602

The International Redistribution of Funds of 1929 contrasted to the Redistributions of 1914 and of 1919–1920

The continued expansion of the one-way American banking system after the cyclical forces of economic adjustment were making themselves felt found no counterpart in the English banking system. The deposits of the London clearing banks ceased to rise at the close of 1928, and the increase in their advances, in progress since 1925, stopped in February 1929 (Chart 45). Both in internal credit policy and in international lending practice the 'active partners' in the world's international gold standard nucleus had ended their de facto cooperation. The 'silent partner' in the nucleus was also pursuing an independent course. At the moment of greatest divergence in the international positions of the New York and London markets France, for reasons already described in detail,[14] appeared upon the international stage as a sort of segment of the 'automatic gold standard' of the textbooks operating in a world in which the other segments were missing, and able, by strict adherence to orthodox principles, to exercise a pull over the exchanges and draw gold to herself.

Because two strong magnets, Paris and New York, were pulling upon the international flow of funds, a redistribution of inter-market indebtedness took place during the culminating stages of the prosperity phase of the international business cycle of 1920–29 that was comparable in importance to the redistributions of 1919–20 and of 1914. Its significance for the interpretation of the post-war gold standard is sharply brought out by comparing it with these two earlier periods of disturbance in the mechanism of inter-money market adjustment.

In the opening sentences of Book One we stated that in 1914 an entirely new current of payments back to the central money markets was superimposed upon the normal movement of inter-market and international indebtedness, culminating in a temporary breakdown of the world's financial

[14] Cf. Ch. 20, The Foreign Exchange Portfolio of the Bank of France in 1929.

machinery. This movement disclosed the hierarchy of financial centers as it then existed. In this hierarchy London was supreme, and the whole movement was dominated by the calling in of foreign assets by London, yet the strength of Paris was sufficient to allow France to draw gold from London at the height of the crisis.

During 1919–20 there was another major redistribution of inter-money market indebtedness, again dominated by a single center, this time by New York. It was part of the liquidation of the indebtedness to America and to neutrals incurred by European countries during the war and post-war booms.[15]

In 1929 New York was again the predominant influence in a world-wide movement of funds, but the situation was more complex than during 1919–20 and still more complex than in 1914. A double pull was being exercised on the world's exchanges, for just as France shared with London in the major movement of funds at the international centers in 1914, so the flow of funds to New York in 1929 coincided with a calling in of foreign assets by France. But in 1929 the double pull of the franc and the dollar over the world's exchanges was complicated by many cross currents. The most spectacular was the flight of foreign capital from Germany in connection with the negotiation of the Young Plan, followed by a return flow, especially of short term funds, when a final agreement was reached by the Experts. The return flow was so strong that in June and July 1929 the Reichsbank was moved to intervene in the foreign exchange market to prevent gold exports from London to Berlin in order to forestall an increase in interest rates in London detrimental to the Berlin money market.[16] Less spectacular, but far more fundamental was an underlying movement of funds from

[15] Cf. Ch. 9, Clearing the Decks for a General Stabilization Program.

[16] Cf. *Verwaltungsbericht der Reichsbank fuer das Jahr 1929*, p. 6. The actual language employed in this report is less direct than that in the text, but the meaning is the same.

debtor to creditor countries characteristic of the recession phase of international business cycles in general, and illustrated by the concentration of gold exchange standard balances in the hands of central banks of creditor countries (Tables 60 and 67). The major international flow of funds during 1929, however, was the movement toward New York to take part in the American boom. Like the movement of funds to France, and the flow to and from Germany in connection with the Young Plan, this was not part of the cyclical readjustment. It was not part of an adjustment of any sort, but was a new disturbing element in an already strained situation.

In 1914 the movement of funds to the international financial centers was due to the withdrawal of funds regularly invested or employed abroad and the failure to reinvest them. It was the exercise of a power which in past crises had been of the essence of London's centralized control over the international gold standard system. This power may often have been used to force the burden of gold standard adjustments largely upon countries other than Great Britain, but it was fundamentally of a stabilizing nature when employed in moderation. Only when combined with the catastrophe of a great war which divided the world economic system into two parts was its use destructive of stability. During 1919–20 the flow of funds to and through New York was also due to a calling in of debts. It was a genuine liquidation of part of an unbalanced short term international debt structure. As such it was part of an adjustment of war-time distortions in international relations and was constructive in character. Neither the situation of 1914 nor that of 1919–20 was likely ever to be repeated unless the World War itself was repeated. But in 1929 the flow of funds to New York was the result of the immense deposit and investment attracting power of the United States, a power *inherently* disturbing to a stable international gold standard system, and which, given the speculative temper of the American people, was likely to come into

play at the end of every cycle even in time of peace. In 1929 it was used on a scale that brought to an end the tendency of international capital movements to equalize international interest rates, forced a competitive raising of central bank rates quite foreign to orthodox gold standard theory,[17] prolonged the prosperity phase of the cycle, postponed many necessary economic adjustments, broke down the de facto cooperation of the center countries necessary to operate successfully an international gold standard in a world with a decentralized financial structure, and finally violated the first principle of any stable gold standard system—the principle that there must be stable credit conditions at the center.

Deflationary Effects of the Ending of Competitive International Long Term Lending

The culmination of American speculation in the New York stock market crash of October 23, 1929, relieved many international strains. It resulted in a return flow of foreign funds from New York and a consequent release of sterling and other exchanges from pressure. Indeed the actual crisis in New York had been preceded, and in some measure, hastened by the withdrawal of French funds as early as July when the end of American prosperity was already evident to many, and by the withdrawal of European participation in the stock market.[18] This release from the temporary though acute international difficulties associated with the American speculation left all the center countries, including the United States, face to face with the double problem of dealing with economic depression within their own borders and of developing a common international policy in the face of world-wide deflationary forces.

Production and Trade before October 1929

The months just preceding the crisis of October 1929 were characterized by the maturing of an unbalanced relation

[17] Cf. Hardy, *op. cit.*, p. 51.
[18] Beckhart, *op. cit.*, p. 147.

between the supply of and demand for many important products. This was a common feature of the position of some of the major crude food staples in 1928–29. Under the stimulus of new techniques wheat production was growing rapidly outside Europe, but the long run trend in world demand continued downward. Russia was still an importer of wheat, but was in a position soon to reenter the world markets, for a bumper crop in 1928 was partly withheld from the market and stored. Somewhat similar conditions prevailed in other staple products, such as sugar and coffee. In the latter commodity a doubly dangerous situation was developing because the Brazilian 'coffee defense' was being financed by foreign loans. Over-production, or tendencies in that direction were clearly in evidence in rubber, timber, copper, and nitrates.

Excess capacity, rather than over-production in the narrow sense, was the outstanding feature of manufacturing industry. In certain industries this was in large degree due to the economic changes caused by the war. In others it was due to continued rationalization and failure to scrap old machinery and to liquidate less efficient firms. Owing to the monopolistic price policy successfully pursued by many industries, the creation of excess capacity went hand in hand with good profits and helped to conceal its dangers. Since the boom had been largely in durable consumption goods and the capital equipment needed for their consumption and utilization, the industries that had expanded most rapidly were unusually subject to sudden shifts in demand.

The accumulating dangers of this situation were reflected in the character of international trade just before the end of the American boom. Up to October 1929 the value of the international trade of 45 countries did not decline, though production curves in most countries were by then already falling. The importance of raw materials in world trade was, however, declining. The import statistics of several important manufacturing countries showed a definite movement toward a higher relative proportion of finished manufactures and a

lower proportion of raw materials. In those countries, therefore, the market for certain kinds of raw materials was narrowing. From 1925 to 1929, for the world as a whole, trade in primary goods increased 15 per cent while trade in manufactured goods increased 31 to 32 per cent. This change in the composition of the articles entering into world trade tended not only to make it more sensitive to shifts in world demand for secondary products, but also introduced a new element of instability because it caused a new geographical distribution of the major risks and dangers inherent in any dislocation of world trade as a whole.[19]

The outstanding features of world production and trade before October 1929, therefore, were, first, the tendency to actual over-production in crude foodstuffs and raw materials, as evidenced by divergent tendencies in supply and demand and by efforts to hold up prices through price controls unaccompanied by production controls; second, excessive productive capacity in many manufacturing industries depending increasingly upon elastic types of demand; third, the reflection of these phenomena in international trade and the development of actual or potential strains in raw material producing countries and in entrepot centers. Any diminution of the flow of new loans from the center countries was certain to disclose these basic instabilities.

The decline in funds available for lending abroad by Great Britain and the United States in 1928–29, accompanied and even preceded by the withdrawal of French funds abroad and the movement of short term funds to Paris, was therefore a profoundly deflationary force in many parts of the world. The first effect on the balance of payments of various countries was felt in gold movements and the shifting of international balances rather than in changes in commodity exports and imports,[20] but by the middle of 1929 the financial repercussions

[19] The generalizations in this section are based on Ohlin, *op. cit.*, pp. 41–5, 48–9, 53–4, 64–9, 117; and *World Economic Survey, 1931/2*, pp. 86–7, 146–50.
[20] Ohlin, *op. cit.*, p. 127.

of the ending of competitive international long term lending, and of the independent course of the New York money market had been translated into other forms of economic pressure which have been well summarized by the *World Economic Survey, 1931/2* (p. 43):

"The shrinkage of overseas loans in these various ways was accompanied by a distinct industrial and investment boom in the main creditor countries, while at the same time it created credit stringency in the borrowing countries. . . . The borrowing countries were forced to decrease imports and increase exports. In the raw-material producing countries there was a contraction of credit which forced extra sales and efforts to counteract lower prices by increased production. On the other hand the credit contraction in such heavy borrowing countries as Germany forced a restriction of imports and a consumption of stocks. Both tendencies contributed to a derangement of the markets and raw material prices sagged. When the investment boom burst in the autumn of 1929, the weak position of these commodities precipitated a rapid fall in prices."

Temporary Revival of Long Term International Lending in 1930

These pressures were relieved by a vigorous but temporary revival of foreign lending in the spring of 1930, chiefly by the United States, but also by the Netherlands, Switzerland, and to some extent by the United Kingdom. Table 65 shows clearly the concentration of new lending in the first part of 1930 and its subsequent decline in both London and New York. It needs, however, careful interpretation. After a quiet start the bond market in New York improved in March, April, and May. An optimistic spirit prevailed and the opinion gained ground that the recession was merely temporary. The foreign bond market was stimulated not only by favorable domestic conditions, but also by active purchases from abroad for the repatriation of foreign issues. The latter influence was largely due to French purchases [21] and was there-

[21] U.S. Department of Commerce, *Trade Information Bulletin 746*, pp. 6–7.

fore part of the continuing movement of capital into France[22] which, from a world point of view, was a deflationary force offsetting the relief given by increased American and other international lending. The peak of activity in placing new foreign issues in New York was reached in April; thereafter a downward trend in the volume of new foreign issues began,

TABLE 65

New Foreign Loans offered in the London and New York Markets Refunding excluded, 1930-1931, monthly (thousands)

	1930		1931	
	United States	United Kingdom	United States	United Kingdom
January	$ 61,986	£ 5,589	$ 95,657	£ 4,489
February	96,038	18,190	5,156	13,654
March	111,391	9,436	7,246	6,005
April	151,211	9,381	42,553	316
May	100,639	20,083	15,284	10,086
June	177,615	5,522	35,286	8,466
July	78,238	3,324	1,900	2,906
August	17,000	3,106	none	34
September	4,829	2,630	23,602	21
October	85,661	17,734	none	10
November	1,347	8,394	2,150	74
December	19,377	5,415	none	16
Total	$905,333	£108,803	$228,834	£46,078

SOURCES: United States: *Trade Information Bulletins 746* and *802;* United Kingdom: Midland Bank figures, *Board of Trade Journal,* Jan. 7, 1932, p. 8

broken in June by the flotation of the German International Loan (the Young Loan) and in October by a large Canadian government issue. The declining trend was intensified during the last three quarters of the year by the deepening of the depression itself, and also by unfavorable political developments abroad, including revolutionary activities in certain Latin American countries, and the electoral victory of the German Nazi party in September. British foreign lending did not, like that of the United States, experience a genuine revival in the spring of 1930, but like the American lending it was much heavier in the first than in the second half of the year. With

[22] Cf. *World Economic Survey, 1932/3,* p. 291, table.

the exception of February and May the only large monthly total during 1930 was in October,[23] and this was almost entirely accounted for by a single large loan to India. After May 1930 new competitive foreign lending declined steadily in both New York and London. Its character and geographical distribution also changed.

In New York Canadian borrowing amounted to $281 million in 1930, and an unusually large proportion of all loans was relatively short term, from one to three years. Such loans amounted to $167 million, of which the bulk was for the Argentine government. The American share of the international loans to Germany and Austria amounted to $125 million. These three types of loan accounted for $573 million of a total of $905 million for the year. The revival of American capital export to debtor countries other than Canada, of the type that had constituted the major part of the flow of American credit supporting the international gold standard facade from 1926 to 1928, was therefore much less than is suggested by the increase over 1929 in the total of new foreign issues. New long term lending in London in 1930 also gave less support to the international gold standard system in general than the total of new issues would indicate. Of the £109 million of new capital provided, £70 million went to the Empire, and of this a large proportion was Indian government borrowing. Of the remaining £39 million for the rest of the world the bulk is accounted for by a few special transactions of an emergency character. Of the £17 million lent to South America, £8 million was the British share of an international Coffee Realization Loan to Brazil, and of the £18 million lent to Europe £14 million was the British share of international loans to Germany and Austria.

When the course of foreign borrowing in the American and

[23] The British share of the Young Loan, amounting to £12 million, was floated in June but is not included in the Midland Bank figures. Since the proceeds were retained by the government, contrary to French wishes and in the face of French pressure, the effect of the loan in the London market was held to be the equivalent of a government conversion loan.

British capital markets in 1930 is considered in conjunction with the simultaneous flow of capital into France, it is clear that the relief from deflationary pressure experienced by the world as a whole from a revival of the central capital markets in 1930 was wholly inadequate to postpone further fundamental economic adjustments. These adjustments themselves, complicated by unfavorable political factors, reacted on the willingness of the central capital markets to lend, and potential borrowers were also in many cases unwilling to assume heavy future obligations under such unfavorable circumstances. In 1931 long term foreign lending by the central markets, American loans to Canada excepted, had virtually ceased. Of the small total of American foreign loans in 1931, 63 per cent went to Canada.[24] The only loan to Latin America was for the reorganization of an American company in Cuba. Only one loan was made to Japan, and only two to Europe, both to American-owned corporations, the International Match Company and Ford Motors Ltd. Indeed, when the total movement of old as well as new securities is considered, the United States in 1931 had become a net importer of long term capital.

Movement of Long Term Capital Items in the American Balance of Payments, 1930–1931 [25]

Capital imports +, Capital exports − (millions of dollars)

	1930	*1931*
New foreign security issues *	−833	−213
Direct investments (net)	−183	−182
Movement of old securities (net)	+565	+406
Bond redemption and sinking fund (net)	+173	+207
Net movement of long term capital	−278	+218

* Refunding excluded and after discounts and underwriting commissions are deducted.

The figures in the accompanying table are to be compared with a net outward movement of long term capital from the United States of $141 million in 1929, $675 million in 1928,

[24] In the last quarter of 1930 Canadian loans were 95 per cent of the total.
[25] E. J. Stone, *op. cit.*, in note 6.

and $705 million in 1927. New capital lent abroad by Great Britain in 1931 also fell to a very low figure, £46 million. Of this, £21 million went to India, partly to take advantage of a moment of easy money induced by the Bank of England and the Treasury in preparation for a British government conversion loan.[26] The only loan to Argentina was to repay temporary advances, and it was arranged that the proceeds of the only loan to Chile were to be left in London.[27] Only one issue, a Greek loan, was placed for all Europe.

As in 1930, France continued to be an importer of capital and the revival of lending in the smaller creditor markets of 1930 was not repeated. The stream of competitive long term international lending had dried up.

Capital Flows Uphill

This was the main constituent in a general reversal of the international movement of capital. Beginning in 1929 it became increasingly evident, in the felicitous language employed by the *World Economic Survey, 1931/2* (p. 177), that "capital was flowing uphill from the debtor to the creditor countries." This was strikingly true of the situation prevailing in 1931, when the United States had a very small surplus of capital exports, the United Kingdom was a net importer of capital, and France still further increased her capital imports. The efforts made by the center countries to fill the gap created by the decline in long term advances and the private movement of securities by granting short term credits, according to the precedent set by Great Britain before the war, were totally inadequate,[28] and several important debtor countries were

[26] *The Economist's* comment in this connection is (May 23, 1931, p. 1118): "The fall in the Bank rate has already produced a stirring of activity in the moribund capital market. The Indian government's short term issue of £10,000,000 at 6% prompted slightly amused comment in view of the expeditious use of an opportunity believed by the market to have been arranged by the 'powers that be' for quite a different purpose."

[27] *The Economist*, April 4, 1931, p. 742.

[28] Cf. Ch. 28, The Attempt to Finance the Depression by Short Term International Lending.

in the position of actually exporting capital on balance.[29]

Under these conditions the flow of international capital tended to accentuate rather than to equalize international interest rate differentials. The *World Economic Survey, 1931/2* makes this point as follows (p. 188):

"In the main creditor countries the price of long-term capital fell from 1929 to the middle of 1931. A precisely opposite movement is clear in the debtor countries where the yields on bonds rose rapidly from the middle of 1929 on. A temporary resumption of capital movements in the first half of 1930 brought a fall in these yields, but from the middle of 1930, they increased again rapidly, until in the financial crisis of the latter months of 1931 they rose to alarming heights. . . . Throughout this period there has been a flight of capital from countries of high interest rates to those whose interest rates were low and falling."

To the deflationary consequences of the ending of the flow of competitive international long term lending already mentioned, one further consequence must therefore be added, its contribution to increasing the cost of long term capital in debtor countries.

Prices, Production, and Trade, October 1929 to Mid-1931

From the end of 1928 to the early part of 1931 the artificial barriers that impeded the full tide of economic readjustment from asserting its power gradually yielded and finally crumbled away. With the drying up of competitive long term international lending new defenses against deflation were established at strategic points by special types of government loan and by short term financing. At the same time the ability of various segments of the world economy to resist the necessary adjustments by price and production controls was being put to a series of severe tests, and a very unequal power of resistance was displayed in different fields of production. In the fertile soil created by such a series of rear guard actions

[29] Cf. table of international capital movements, 1928–32, in *World Economic Survey, 1932/3*, p. 291.

against deflation, an ever increasing movement toward the further restriction of world trade by tariff and other barriers grew and flourished. In this whole process the ending of the speculative boom in New York marked a major turning point.

PRICES AND PRODUCTION

The fall in prices at the end of the boom was heaviest in crude foodstuffs and raw materials where supply was least elastic, and smallest in manufactured goods where supply was most easily restricted. The dominant factor in the depression in 1930 and 1931, in fact, was the fall in agricultural prices. Agricultural producers, when faced with a declining demand had, in general, to accept large reductions in price. Their efforts to resist these price declines through schemes of price control and valorization led to a breakup of the world market in certain commodities and to an accumulation of stocks in certain producing areas that pressed continually on world prices. The weakness, moreover, that developed in the financing of some of the price control schemes in raw materials added greatly to the fall in world prices, when one after another these schemes broke down. Industrial producers were better able to maintain prices by large reductions in output. These began in the second half of 1929. Though checked somewhat in the spring, when a more hopeful view of the general economic situation was bringing about a revival in the capital markets, the downward trend of production gathered force in the second half of 1930 and continued in 1931. It was heaviest in the United States and Canada where credit expansion had been most pronounced, and in Germany, Poland, and other countries whose industrial production had been most dependent on foreign borrowing.

In the general fact that raw material production was maintained while prices were low, and industrial production was low while prices were maintained, lay perhaps the most important key to the depression. Price maintenance and production control of the raw materials for producers' goods and

equipment helped to concentrate the full force of the catastrophic decline in prices on the uncontrolled raw material producing areas, and at the same time, by helping to keep up the cost of producers' goods, it encouraged still more the contraction of industrial production. A sort of 'price deadlock' occurred which, according to the *World Economic Survey, 1931/2* (p. 132), was "a central cause of the persistence of depressed conditions."

TRADE

The interaction of so many mutually forwarding deflationary forces could not fail to leave an unmistakable impress upon the value, the quantum, the direction, and the barter terms of international trade after October 1929. From that time on the descending spiral of world trade, the graphic portrayal of which forms so depressing a frontispiece to the *World Economic Survey, 1932/3,* began to accelerate. The value of world trade expressed in dollars in 1930 was 19 per cent less than in 1929, and during the first six months of 1931 fell another 13 per cent. The volume of world trade declined, however, only 7 to 8 per cent from 1929 to 1930.[80]

Though long term lending by the central capital markets to European borrowing countries was curtailed earlier and more severely than long term lending to countries outside Europe, European trade was relatively well sustained during 1930. This was partly due to favorable barter terms of trade with non-European raw material countries and partly to a shift in the source of the imports of cereals and animal products taken by western European countries from other continents to eastern Europe. The United States also benefited by the change in the barter terms of trade, but the quantum of North American trade in 1930 fell far more than that of Europe, partly because of the dependence of American exports on new foreign lending. This dependence was unavoidable as

[80] League of Nations, Memorandum on Trade and Balances of Payments, 1930: Vol. I, *Review of World Trade, 1930* (Geneva, 1931), p. 7.

long as America continued to receive interest from abroad and to attract to herself a large and steady stream of private foreign capital. In part the drop in North American trade was due to the passage of the Hawley-Smoot tariff bill in June 1930 by which nearly 900 duties were raised. Special developments, in both Europe and America, therefore, intensified the impact of the depression on the raw material producing countries of other continents. The unequal incidence of the fall in prices upon the economies of individual countries is brought out in Table 66. Such a movement of prices meant a loss of purchasing power abroad on the part of countries dependent on food and raw material exports and reacted on the trade of other countries, especially after the revival of foreign lending in the first half of 1930 had run its course. Professor Ohlin, in his schematic presentation of the spread of the depression from the original sources of disturbance, therefore, describes the crisis in the food producing countries—Argentina, Australia, the Balkan countries, Brazil, Canada, Colombia, Cuba, and Hungary—and in the raw material producing countries—Bolivia, British Malaya, Chile, Egypt, Ecuador, Finland, India, Mexico, Dutch East Indies, New Zealand, Paraguay, Peru, Uruguay, and Venezuela—as combining with the 'original recession' in manufacturing industries in Germany and the United States to spread the influence of falling demand and prices in world markets, first, to countries sensitive to foreign conditions—Austria, Czechoslovakia, Greece, Japan, Poland, and the United Kingdom—and, finally, to countries less sensitive to foreign conditions, or selling much to Europe—the Baltic countries, Belgium, Denmark, France, Italy, Irish Free State, the Netherlands, Norway, Russia, Spain, Sweden, and Switzerland.[81]

The adverse terms of trade experienced by raw material and food producing countries not only contributed to the spread of the depression, but also greatly increased the burden of foreign debts owed by countries of this type. Many

[81] *Op. cit.*, p. 240, diagram.

debtor countries were in the position of seeing the payment and service of their foreign debt absorb an increasing proportion of the proceeds of their exports. They were faced with the alternative of cutting down their imports, defaulting on their foreign debt, or increasing their exports. In their effort to choose the third alternative they encountered a severe

TABLE 66

Average Export Prices in Gold, Percentage Changes, 1929–1930

1	Coffee (Brazil)	−43
2	Rubber (British Malaya)	−42
3	Wool (Australia)	−40
4	Maize (Argentina)	−40
5	Raw silk (Japan)	−30
6	Tin (British Malaya)	−28
7	Cotton (U.S.A.)	−25
8	Copper (U.S.A.)	−25
9	Wheat (Australia)	−22
10	Sugar (Czechoslovakia)	−20
11	Butter (Denmark)	−19
12	Bacon (Denmark)	−15
13	White cotton piece goods (U.K.)	−11
14	Petrol (U.S.A.)	−11
15	Frozen meat (Argentina)	−9
16	Silk tissues (France)	−9
17	Wood pulp (Sweden)	−8
18	Motor cars up to $1000 (U.S.A.)	−2
19	News print paper (Sweden)	−1
20	Steel girders (Belgium)	−1
21	Pig-iron (U.K.)	+3
22	Coal (U.K.)	+3

SOURCE: League of Nations, *Review of World Trade, 1930*, I, 12

check in the growth of tariff barriers. As already noted, shortly after 1927 the growth of agricultural protection brought to naught the efforts of the World Economic Conference at Geneva to promote freer trade. With the deepening of the depression this movement gained great impetus, and several debtor countries found that they could not increase their exports or even maintain them. Hence they had to reduce imports. This was true mainly of countries whose terms of trade were very adverse, but with the passage of the Hawley-Smoot tariff bill and other tariffs established either in retaliation or for similar reasons, similar pressures developed on debtor

countries dependent more on the export of manufactured goods, of which Germany was the outstanding example. The desire of debtor countries of all classes therefore to reduce imports in order to maintain their credit abroad and to support their exchanges by building up an active trade balance became an added impetus after 1929 to the growth of a severe international tariff raising competition.

With the falling off of demand for manufactured goods on the part of countries producing chiefly raw materials and food, with the general spread of the depression throughout the world, and with the added impediments to trade imposed by an all round increase in tariffs and the introduction of other trade barriers, the clearly marked characteristics of the decline in international trade in 1930 were gradually lost in 1931. Manufacturing countries reduced their exports at least as much, and in some cases more than other countries. The value of United States exports as well as imports, for example, was 36 to 37 per cent lower in the first half of 1931 than in the first half of 1930. Trade between manufacturing countries, which had been relatively well sustained in 1930, fell off more rapidly than trade between manufacturing and other countries, and by the second half of 1931, "the sequence of events became so confused that it was not possible to state anything more than that there was a general decline proceeding at an uneven pace, and distorted by a variety of restrictive measures." [32]

[32] *World Economic Survey, 1931/2,* p. 156. The generalizations in this section are based on this source, especially pp. 63–6, 86–91, 140–1; and on Ohlin, *op. cit.,* pp. 146, 163, 198; and the *Review of World Trade, 1930,* pp. 14–15, 25–7, 32–3.

CHAPTER 23

The Influence of World-wide Deflationary Forces on the International Distribution of the Precious Metals

Until the middle of 1931, in spite of all efforts to resist necessary adjustments in commodity balances of trade, there was a clear tendency for debtor countries to increase their active trade balances, mainly by drastic curtailment of imports, and for the major creditor countries to increase their passive balances or to decrease their active balances.[1] This was accomplished, however, in very unequal degree and by different methods in different countries. It was part of a readjustment in total balances of payments that imposed great strains upon the whole decentralized world credit structure, introduced further complications into the mutual relations of the center countries, and broke down the international gold standard facade at the periphery. One of the most striking features of this adjustment was a remarkable redistribution of gold internationally. In this the Eastern countries, particularly India, shared, but in a different way from other countries because of the fundamentally different character of their demand for the precious metals.

The Influence of World-wide Deflationary Forces on Indian Demand for Gold and Silver

In the long history of India's demand for gold the three years, 1926, 1927, and 1928, constitute a sort of plateau with very rough terrain on either side. From 1917 to 1925 her demand was never entirely independent of the repercussions of the

[1] *World Economic Survey, 1931/2*, pp. 172–3, and *Review of World Trade, 1930*, pp. 42–3.

return of the West to the gold standard. After 1929 it was deeply influenced first by the impact of the world depression upon India herself, and later by the impact upon India of the disintegration of the gold standard system in the West. The three intervening years may be considered as a brief return to 'normal' conditions of gold absorption by India, and it may be recalled with profit that one of these years was the only one in the whole post-war period during which the international gold standard existed on a truly world-wide scale.[2] In order to bring out clearly the nature of this 'plateau,' and of the forces that brought it to an end, it is necessary to gather the threads of our previous analysis of India's relation to the gold standard world.

As pointed out in our discussion in Chapter 10 of New York as a residual buyer of gold, the most important fact about Indian demand for gold is that it is a consumer demand. It is part of a total demand for the precious metals arising from the need of the Indian masses to find a means of accumulating savings, and is therefore fundamentally limited by the amount of these savings. The degree to which the will and capacity of the Indian masses to save has to be satisfied by imports of the precious metals, instead of being met by the use of currency, bank deposits, or investments depends upon the spread of banking facilities and investment habits in India. In the post-war period these were still in a rudimentary stage of development but were growing quite rapidly. Given the total of savings available for the purchase of the precious metals, the actual amount of gold and silver imports becomes a function of their cheapness or dearness in rupees. Whether gold or silver shall be imported and in what proportions depends in some degree upon the relative value of the two metals in rupees. Fluctuations in either the rupee-sterling or the

[2] The short duration of 'normal' conditions has been a general feature of our post-war analysis; e.g., from 1914 to 1933 in only one month, July 1920, did the 'normal' condition of absence of large surplus reserves exist in the American banking system.

dollar-sterling exchange, or in both, influence the rupee price of both metals and therefore the ratio between them. These exchange rates were unstable during Restoration, and therefore the size and timing of Indian demand for gold during that period became in part a function of their fluctuations.[3] For this reason the general return of the Western world to the gold standard, combined with a stable rupee-sterling exchange rate, eliminated a major disturbing influence upon the trade of the Orient in the precious metals, and therefore upon Indian and other Eastern demand for gold in the West.[4]

The combination of a stable dollar-sterling exchange rate and a stable sterling-rupee exchange rate was an accomplished fact in April 1925, but a large section of Indian opinion would not accept it as such. Dissatisfaction with the then existing 1 s. 6 d. rate on London was widespread, and a vigorous political agitation was launched to change it to the pre-war rate of 1 s. 4 d. This situation offered possibilities to the gold speculator which resulted in abnormally large imports of gold into India in 1925 and the first part of 1926.[5] These speculative hopes were shown to be illusory when the Indian government undertook to buy and sell sterling at the gold points corresponding to the 1 s. 6 d. rate. They were completely destroyed as a practical market influence by the passage in March 1927 of amendments to the Currency Act legally establishing the 18 d. rupee, but were for a while revived in 1931 in connection with the Round Table Conference.

The amendments to the Currency Act passed in 1927 were embodied in a measure known as the Ratio Bill, which was forced through the Legislature only after a bitter three month struggle. This bill was proposed and passed as the first step in a program growing out of the recommendations

[3] Cf. Ch. 9, The Change of Policy in India.

[4] Cf. Ch. 10, The Gold-Silver Ratio in India.

[5] Cf. Ch. 12, The End of the Regular Pattern of Gold Distribution.

of the Hilton Young Commission for the introduction of the gold bullion standard in India. It was intended to put India for a 'transitional' period upon the gold exchange standard. The second step was to be the passage of a Gold Standard and Reserve Bank bill, under which the full legal obligations of the gold bullion standard were to come into effect, and a central bank was to be established having control of the Indian note issue and provided with the necessary gold and other resources and the necessary powers to administer such a standard. The Currency Act of 1927 placed upon the government the obligation to purchase all gold presented to the mints in India at a fixed price of Rs. 21–3–10 per tola, corresponding to a sterling parity of 1 s. 6 d. per rupee. It withdrew the legal tender character hitherto enjoyed by the sovereign and half-sovereign in India, but provided that these coins could be sold as bullion to the mints at the same price.[6] The Act also placed the government under obligation to sell gold at Rs. 21–3–10 per tola, or sterling at an equivalent rate at the option of the Controller of the Currency. This rate was to be calculated on the basis of the cost of shipping gold to London.[7] In practice it was fixed at 1 s. 5 49/64 d. per rupee.[8] The option to sell gold was not intended to be used, for the government was determined to strengthen its gold holdings during the 'transition' period in preparation for the permanent gold bullion standard regime in prospect.[9]

[6] *Annual Report of the Controller of the Currency (India) for 1927–28,* pp. 5–6.

[7] The relevant paragraph of the Currency Act reads: "For the purpose of determining the equivalent rate applicable to the sale of sterling . . . twenty-one rupees, three annas and ten pies shall be deemed to be equivalent to such sum in sterling as is required to purchase one tola of fine gold in London at the rate at which the Bank of England is bound by law to give sterling in exchange for gold, after deduction therefrom of an amount representing the normal cost per tola of transferring gold in bulk from Bombay to London including interest on its cost in transit." Under the Act purchases by the Mint were limited to a minimum of 40, and sales to a minimum of 1,065 tolas fine.

[8] The *Annual Report of the Controller of the Currency (India) for 1930–31,* p. 14, speaks of this rate as the 'statutory rate.'

[9] *The Economist,* Feb. 19, 1927, p. 378.

The Currency Act of 1927 went into effect on April 1. This date therefore marks the official adherence of India to the gold standard.[10] Yet there was an atmosphere of unreality about the whole procedure. The terms 'gold bullion standard' and 'gold exchange standard' have no substantive significance as applied to India.[11] The Currency Act of 1927 added a moderate potential monetary demand for gold for the purpose of building up the Indian gold standard reserve to the basic consumer demand of India. Its practical importance, however, in the actual management of the Indian currency was nil, except for its power to convince speculators in gold that the government was determined that the 1 s. 6 d. rupee had come to stay. This determination and the means taken to enforce it, however, were quite independent of gold standard arrangements in India. The rupee continued to be managed by a variation of the old Indian Council Bill system. The government intervened regularly in the foreign exchange market in order to purchase sterling for the double purpose of obtaining remittance to meet its statutory obligations in London and of controlling the exchange rate. These purchases were made partly at its own initiative without previous notice to the market and partly by a system of requesting tenders of sterling for certain stated amounts, first initiated in 1927 upon representation by the Exchange Banks that unexpected government purchases were inconvenient for them. By varying the amounts of these requests for tenders, by timing them appropriately, and by refusing to accept tenders at rates it did not consider desirable the government was able to exercise a system of exchange control.[12] For example, by increasing the amount of tenders requested it could weaken the rupee, and by reducing the amount or by

[10] In a chronological list showing the progress of the world's return to gold, published in the *Federal Reserve Bulletin,* Aug. 1928, the date of India's return to gold is given as April 1, 1927.

[11] Cf. the discussion of Argentina's 'return to gold' by the opening of the Caja de Conversion in August 1927, Ch. 14, Argentina.

[12] The purchase of gold by the government in India, of course, had the same effect upon the rate as the sale of Council Bills in London.

refusing to accept tenders it could strengthen the rupee. This type of intervention was supplemented, when the rupee was weak, by government offers to sell sterling in limited amounts at fixed rates. Such sales, for example, were made at 1 s. 6 d. in March 1929. When the rupee was exceptionally weak sterling was made available in unlimited amounts at 1 s. 5 49/64 d. as required by the Currency Act of 1927. This was the case, for example, at the end of 1930 and the beginning of 1931. The fact that sterling could be obtained at this rate as of right did not introduce anything essentially new in Indian currency management, for under the old system sufficient sterling would have had to be sold to keep the sterling rate stable.[13] As under the old system, the exchange control aspects of government intervention in the exchange market sometimes interfered with its other object, the remittance home of government obligations in London. When this happened, the Indian government borrowed in London as in pre-war times. The weakness of the rupee, under the impact of the deflationary forces after 1929 therefore accounts for India's urgent need to break through the unofficial embargo on foreign lending prevailing in London intermittently from 1929 to 1931.[14]

By these essentially familiar means, and not by the assumption of gold standard trappings, the sterling-rupee exchange was kept stable, and since the pound sterling was part of the

[13] For detailed accounts of these operations, see the Annual Reports of the Controller of the Currency and the Annual Market Reviews of Premchand, Roychand & Sons, Bombay.

[14] Cf. Ch. 22, The Deflationary Effects of the Ending of Competitive International Long Term Lending. The *Annual Report of the Controller of the Currency for 1930–31* describes this aspect of the situation during that fiscal year (p. 14): "Sterling to the amount of £5,395,000 only having been purchased through the market during the year it was necessary to meet the Secretary of State's requirements by other means, such as remittance through the Paper Currency Reserve or by borrowings in London. As described elsewhere in this report there were three sterling issues during the year, totalling £31 millions. In addition to these loans temporary advances to the extent of £6 millions were taken from the London Office of the Imperial Bank of India —£4 millions in July and £2 millions in August of which only £2 millions were repaid during the year."

international gold standard system, the price of gold in India was also stable. From 1926 to 1928 the price of silver, though on the whole declining, did not fall sufficiently to offer great inducements to holders in India to shift their savings from gold to silver. Freed from speculative influences arising from currency instability in the Western world and prospective changes in the sterling value of the rupee, and essentially unchanged by the legislation of 1927,[15] Indian demand for gold became for a while relatively stable. Imports seemed to have settled down at a new normal level of about 200 million rupees per annum, the 'plateau' referred to at the opening of these paragraphs. Though from 1926 to 1928 India was relatively prosperous, this was considerably less than the average of pre-war years, which confirmed the Controller of the Currency in the view that "with the growth in the investment habit in India, gold imports in the future are not likely to be as large as in the past." [16] An apparently permanent reduction in Indian demand had lightened England's share in the joint British and American responsibility for the international distribution of gold.[17]

In 1929 the situation began to change. India's prosperity was converted into depression by a long series of adverse developments. The country suffered a series of natural calamities and was subject to grave industrial and political disturbances. These were described by Premchand, Roychand and Sons in their *Annual Market Review for 1929* (p. 6) :

[15] E.g., the *Annual Report of the Controller of the Currency (India) for 1927–28* said on pp. 5–6: "In Section 4 of the Indian Currency Act, 1927, an obligation is laid on government to receive at the Bombay Mint, at the rate of Rs. 21–3–10 per tola fine gold, all gold in the form of bars containing not less than 40 tolas which may be presented by the public. This section came into force 1st April 1927, and on that date the conditions attaching to the acceptance of gold at the Bombay Mint were published. . . . As the rupee sterling exchange did not reach the upper gold point in the course of the year no gold was tendered at the Mint." Yet India was a substantial gold importer during the year.

[16] *Ibid.*, p. 5.

[17] Cf. Ch. 18, The One-Way American Banking System in its Relation to the International Distribution of Gold, and Ch. 19, Changes in the Flow of Gold.

"The unusual occurrence of a frosty weather at the beginning of the year destroyed a considerable part of the winter crops. This was followed by communal riots in Bombay of such a violent character that drastic steps were needed to re-establish order and a curfew order had to be passed. Over a hundred persons were killed and for ten days the city was in a state of panic. The monsoon broke seasonably, but there was an excess of rain in some parts and drought in others. Sind and Assam suffered from floods which rendered thousands homeless and did incalculable harm to crops. Kathiawar and the United Provinces experienced drought in the autumn. Later, a plague of locusts destroyed the already scanty crops in Sind and the Punjab. The strike fever continued throughout the year all over the country. The worst sufferer was Bombay, where the cotton mills were idle for 210 days during the year and the number of workmen on strike was 125,400."

In addition, India, in common with all raw material producing countries, began to experience very severe declines in the prices of her principal export commodities. These tendencies were all accentuated in 1930 and the beginning of 1931, as is indicated in the following summary statement by the Controller of the Currency in his report for the fiscal year April–March 1931 (p. 3):

"Economic conditions in India were affected throughout the year by the doubts and uncertainties attending the efforts to settle the country's political future. Although the findings of the Royal Commission appointed to report on the constitutional problem were not published until the third week of June 1930, the Indian National Congress inaugurated an elaborate civil disobedience campaign early in the year, the effect of which was very pronounced not only on internal trade but also on outside markets where developments in India were being closely watched. The feeling of nervousness and insecurity which prevailed after the close of the Lahore Congress in December 1929 re-appeared, business was paralysed for a time, particularly in Western India, and disturbances occurred in many parts of the country. The monsoon which broke at about the normal time was excellent and gave on the whole very good harvests with the result that India was placed

in the paradoxical position of having large quantities of surplus exportable crops which could not be exported except at a heavy loss owing to the prevailing depression and lack of demand. This was particularly true in the case of the jute and wheat crops."

After 1929, therefore, India's power to purchase the precious metals was progressively reduced because currently accumulating savings were severely contracted. At the same time the price of silver began to fall, owing to a wide variety of circumstances including famine in China in 1929 and political disturbance there in 1930, a reduced monetary demand for silver by many countries, and sales of silver from melted down rupees by the Indian government. The price of gold remaining stable, silver became cheaper and cheaper in India as compared to gold. As in 1920–21, when a similar change in the ratio between the metals took place, an inducement was offered to the Indian masses to buy silver instead of gold, and even to sell gold to buy silver.[18] An increased demand for silver instead of gold in 1929–30 and a diversion of some of the savings of the Indian cultivator "which would have been invested ordinarily in the purchase of gold . . . into cheap silver" in 1930–31 are consequently noted in the Reports of the Controller of the Currency.

A smaller proportion, therefore, of a reduced demand for the two precious metals combined went into the purchase of gold. Gold imports declined substantially in both value and quantity from 1929 to 1931, while silver imports increased greatly in quantity, and in 1930–31 even in value, as shown

Imports of the Precious Metals into India, 1925–26 to 1930–31, fiscal years (millions of rupees)[19]

	1925-26	*1926-27*	*1927-28*	*1928-29*	*1929-30*	*1930-31*
Gold	348	194	181	211	142	127
Silver	171	198	138	97	86	100

[18] Cf. Brown, *op. cit.*, pp. 85–8, for an account of the 1920–21 situation. At that time the main reason for the change in the ratio was a rise in the price of gold.

[19] *Annual Report of the Controller of the Currency for 1930–31*, pp. 52, 54, tables.

in the accompanying table. These annual figures do not, however, tell the full story of the changes in Indian demand for gold, for in 1930–31 the inflow was swollen by purchases for speculative and political purposes and at the same time a back flow from 'up-country' began to develop which finally resulted in India's becoming a net exporter of gold. The conflict of these two forces is described by the Controller of the Currency as follows:

"It will be observed that as much as 11½ crores worth of gold bullion and sovereigns combined was imported between April and September, that is to say, about 87 per cent. of the total imports of the year arrived during this period. In particular, the huge amount of Rs. 3⅔ crores was imported in the month of August alone. The explanation probably is that it was during this period that the Congress boycott campaign was at its height. There is a natural inclination to buy gold for hoarding in times of political uncertainty and this was stimulated in the present instance by propaganda from certain quarters urging the cultivators to buy gold instead of piece-goods and other imports which were on the boycott list. The result was that India imported more gold and sovereigns in the early part of the year than the demand could absorb and the price of the metal in Bombay fell from Rs. 21–11–3 in April to Rs. 21–3–6 at the close of the year. In the absence of any improvement in demand, bullion dealers were unable to hold on to their stocks and were eventually forced to realise by tender to the Bombay Mint at the Government buying rate. This movement which began on the 7th March 1931 continued until the close of the year by which time 972,216 tolas of gold had been received in the Mint." [20]

In January 1931 India was actually a net exporter of gold, and in June 1931 a regular export movement was begun. It originated in a small way in the receipt by bullion dealers in Bombay of 'distress gold' from 'up-country.' [21] Therefore

[20] *Ibid.*, pp. 9–10. The increases in Indian official gold holdings in 1929 and in the first half of 1931 (Table 67) are accounted for by purchases to build up the gold standard reserve in 1929 and by these very unusual gold sales to the Mint in 1931.

[21] Samuel Montagu & Co., *Annual Bullion Letter, 1931*, p. 8.

when England abandoned the gold standard in September 1931, the stage was fully set for a dramatic reversal in India's traditional role as an absorber of gold from the West. Since the rupee remained at 1 s. 6 d. and the price of gold in London rose, the conditions necessary for a stable gold price in India were then destroyed. The price of gold in rupees began to rise in proportion to the decline of sterling in New York. All the strong motives impelling the Indian cultivator to part with gold continued to operate, including the relative cheapness of silver.[22] To these was now added the powerful motive of a substantial profit on past savings. The operation of this motive in bringing gold out of hoards in India is admirably described in the quotation from the *Times of India* of October 10, 1931, given in the *1931 Annual Bullion Letter* of Samuel Montagu and Company (pp. 8–9):

"The shipments of gold to London by the last two mail boats have been large enough to excite comment amongst the general public. Many must be interested to know where this gold comes from and in what form it arrives in Bombay. The continuous imports of gold year by year into India have been always considered by western economists as a fact somewhat outside normal economic phenomena and explainable only by reference to the peculiarities of oriental psychology. At the 1 s. 6 d. gold ratio the price of gold in the bazaars was lower than the present price by Rs. 2 or Rs. 3. The imports of the last few years, therefore, were brought in at this low rate. Now that the rate has advanced substantially—being quoted on Tuesday morning in the bazaar at one time as high as Rs. 26–12 per tola fine—it is only natural that the small holders, who must be legion, should want to realise a profit on their small hoarded savings in the form of gold. In view of the fact that a very large number of up-country dealers do business in Bombay through many different agents, it is very difficult to discover the source of the arrivals, but it is reported in the bazaar that probably the majority of arrivals are derived from

[22] The decline in sterling in New York, of course, was a common force acting on the rupee price of both gold and silver. Though it may have some influence on the ratio in India the relatively low rupee price of silver continued to reflect the fundamental world demand and supply forces for that metal.

Madras, Rangoon and the Deccan in particular, and the South generally. However, it seems probable that most other parts of India must also be contributing their share.

It is naturally the easiest thing for the up-country dealer, who is also in many cases a bullion dealer and shroff, to melt his clients' gold trinkets and so make a convenient homogeneous ingot for disposal in the bazaars of the large ports like Calcutta and Bombay. When these ingots, large and small, arrive in Bombay, they are handled mostly by the bigger shroffs and wholesale bullion dealers, who send them into the Mint at Bombay to be refined, assayed and moulded into convenient bars imprinted with the name of the mint and a number. These bars are then exported.

Owing to the arrivals from up-country being very large since the advance in the price, the market has kept well under parity on the basis of the new London-New York rate. This, of course, tends to increase the profit for the exporter of gold. Hence the great export activity at present."

During 1929, 1930, and the first part of 1931 India's customary favorable merchandise balance of trade was declining, and during the latter part of this period there was a certain amount of capital flight owing to disturbed political conditions. Under these circumstances the reduced import of gold was very helpful to the currency authorities in their efforts to support the rupee. Gold must not, however, be thought of as a 'balancing item' in the Indian balance of payments, as that term is ordinarily applied to gold standard countries. The phenomenon of large amounts of imported gold being offered to the mints of a country whose exchange was close to 'gold export point' and was being supported by fresh foreign borrowings is in itself sufficient evidence of this fact. Yet the change in the Indian attitude toward gold was in harmony with the main lines of international gold distribution during this whole period.

The Influence of World-wide Deflationary Forces on the Gold and Foreign Exchange Reserves of Central Banks and Governments

In our discussion of the gold exchange standard as a gold economy measure in Chapter 20 figures were presented to show the tendency toward a concentration of foreign exchange holdings of European central banks in the hands of the central banks of a few creditor countries that existed from 1928 to 1930. This tendency was part of a general decline in the proportion of the world's 'reserve funds' held by the central banks and governments of debtor countries and a general increase in the proportion held by the central banks and governments of creditor countries which was a direct consequence of the development of world-wide deflationary forces. It is convenient to refer to these changes in the size of the holdings of gold and foreign exchange reserves by central banks and governments as a movement of these reserves from debtor to creditor countries. The use of such an expression is justifiable only as a short method of describing the final result of a process that was far from being a simple transfer of reserves from one group of central banks and governments to another. The whole movement was modified by the direction of the flow of newly produced gold into the world's monetary and banking systems, a flow that was greatly influenced by the declining rate at which India was importing gold. It was also modified during the latter part of the period by the beginning of gold hoarding, and at all times by the withdrawal of certain foreign exchange holdings completely from use as 'reserve funds.' Moreover, the channels through which the general changes in the size and distribution of gold and foreign exchange reserves were actually worked out were very complex.

A general picture of the movement of gold and foreign exchange 'reserves' from 1929 to mid-1931 is given for 32 countries in Table 67, which shows net changes in millions of

TABLE 67

Gold and Foreign Exchange Reserves of Central Banks and Governments, Net Changes, 1929-1931 (millions of Swiss francs)

	1929			*1930*			*First Half of 1931*		
	Gold	Foreign exchange	Total	Gold	Foreign exchange	Total	Gold	Foreign exchange	Total
United Kingdom	−181		−181	+42		+42	+385		+385
United States [1]	+741		+741	+1,601		+1,601	+1,882		+1,882
France [2]	+1,986	−1,371	+615	+2,425	+29	+2,454	+581	+2	+583
Total, 3 Center Countries	+2,546	−1,371	+1,175	+4,068	+29	+4,097	+2,848	+2	+2,850
Netherlands	+27	−1	+26	−44	+56	+12	+148	−38	+110
Switzerland	+62	+99	+161	+118	−2	+116	+127	+69	+196
Belgium	+196	+8	+204	+142	+283	+425	+45	−69	−24
Total, 6 Creditor Countries	+2,831	−1,265	+1,566	+4,284	+366	+4,650	+3,168	−36	+3,132
Italy	+38	−237	−199	+29	−225	−196	+19	−110	−91
Germany	−251	+351	+100	−84	−59	−143	−981	−574	−1,555
Sweden	+12	+69	+81	−6	+174	+168	−3	−133	−136
Czechoslovakia	+15	−36	−21	+44	+27	+71	−1	−81	−82
Austria	0	−41	−41	+33	+105	+138	0	−198	−198
Hungary	−34	−13	−47	−1	−11	−12	−46	−52	−98
Bulgaria	+2	−61	−59	+2	−13	−11	+2	−11	−9
Greece	+6	−81	−75	−9	+1	−8	−1	−36	−37
Poland	+46	−109	−63	−80	−66	−146	+3	−37	−34
Lithuania	0	+17	+17	+2	+4	+6	0	−10	−10
Latvia	0	−23	−23	0	−13	−13	0	−14	−14
Finland	−1	−9	−10	0	+33	+33	0	−10	−10
Denmark	−1	−33	−34	0	+13	+13	0	−59	−59
Norway	0	+24	+24	−1	−25	−26	0	−26	−26
Danzig		−1	−1		+4	+4		−12	−12
Yugoslavia	+4	+37	+41	+4	−148	−144	+42	−35	+7
Portugal	0	+7	+7	0	−39	−39	0	−10	−10
Roumania	+29	+209	+238	+3	−155	−152	−14	+17	+3
Spain	+7		+7	−318		−318	+178	+106	+284
Canada [3]	−188		−188	+168		+168	−119		−119
Australia	−101	−224	−325	−72	−63	−135	0	+61	+61
India [4]	+21		+21	0		0	+119		+119
Argentina [5]	−899		−899	−113		−113	−322		−322
Chile	+2	−47	−45	−1	−64	−65	0	−71	−71
Brazil [6]	−249	+79	−170	−692	−28	−720	−77	−137	−214
Japan	+27		+27	−636		−636	+65		+65
Total, 26 Debtor and Periphery Countries	−1,515	−122	−1,637	−1,728	−548	−2,276	−1,136	−1,432	−2,568
Grand Total	+1,316	−1,387	−71	+2,556	−182	+2,374	+2,032	−1,468	+564

SOURCES: For all European countries, the United States, and Japan: Blessing, *B.I.S. Doc. C. B60;* for other countries: *Federal Reserve Bulletin,* Feb. 1930, p. 74; April 1930, p. 171; May 1931, p. 278; Sept. 1931, p. 524; Oct. 1931, p. 578; Dec. 1931, p. 675; Feb. 1932, pp. 111 and 117

All conversions made at par of exchange; for countries whose exchanges depreciated after 1929 this may involve an error if the foreign exchange in their central bank balance sheets was carried at market.

Second Half of 1931			*1929-1930*			*1929 to Mid-1931*			*1929-1938*		
Gold	Foreign exchange	Total	Gold	Foreign exchange	Total	Gold	Foreign exchange	Total	Gold	Foreign exchange	Total
−1,063		−1,063	−139		−139	+246		+246	−817		−817
−2,571		−2,571	+2,342		+2,342	+4,224		+4,224	+1,653		+1,653
+2,448	−1,134	+1,314	+4,411	−1,342	+3,069	+4,992	−1,340	+3,652	+7,440	−2,474	+4,966
−1,186	−1,134	−2,320	+6,614	−1,342	+5,272	+9,462	−1,340	+8,122	+8,276	−2,474	+5,802
+812	−306	+506	−17	+55	+38	+131	+17	+148	+943	−289	+654
+1,507	−316	+1,191	+180	+97	+277	+307	+166	+473	+1,814	−150	+1,664
+803	−630	+173	+338	+291	+629	+383	+222	+605	+1,186	−408	+778
+1,936	−2,386	−450	+7,115	−899	+6,216	+10,283	−935	+9,348	+12,219	−3,321	+8,898
+70	−478	−408	+67	+462	−395	+86	−572	−486	+156	−1,050	−894
−539	−157	−696	−335	+292	−43	−1,316	−282	−1,598	−1,855	−439	−2,294
−45	−341	−386	+6	+243	+249	+3	+110	+113	−42	−231	−273
+17	−132	−115	+59	−9	+50	+58	−90	−32	+75	−222	−147
−18	−231	−249	+33	+64	+97	+33	−134	−101	+15	−365	−350
−9	+12	+3	−35	−24	−59	−81	−76	−157	−90	−64	−154
+1	−9	−8	+4	−74	−70	+6	−85	−79	+7	−94	−87
+25	−61	−36	−3	−80	−83	−4	−116	−120	+21	−177	−156
+19	−79	−60	−34	−175	−209	−31	−212	−243	−12	−291	−303
+6	−18	−12	+2	+21	+23	+2	+11	+13	+8	−7	+1
+8	−9	−1	0	−36	−36	0	−50	−50	+8	−59	−51
+1	−59	−58	−1	+24	+23	−1	+14	+13	0	−45	−45
−39	−56	−95	−1	−20	−21	−1	−79	−80	−40	−135	−175
+12	−13	−1	−1	−1	−2	−1	−27	−28	+11	−40	−29
+22	−8	+14		+3	+3		−9	−9	+22	−17	+5
+20	−46	−26	+8	−111	−103	+50	−146	−96	+70	−192	−122
−2	+71	+69	0	−32	−32	0	−42	−42	−2	+29	+27
+26	−61	−35	+32	+54	+86	+18	+71	+89	+44	+10	+54
−179	+175	−4	−311		−311	−133	+106	−27	−312	+281	−31
−47		−47	−20		−20	−139		−139	−186		−186
−120	+137	+17	−173	−287	−460	−173	−226	−399	−293	−89	−382
+57		+57	+21		+21	+140		+140	+197		+197
−503		−503	−1,012		−1,012	−1,334		−1,334	−1,837		−1,837
+3	−39	−36	+1	−111	−110	+1	−181	−181	+4	−221	−217
	+46	+46	−941	+51	−890	−1,018	−86	−1,104	−1,018	−40	−1,058
−986		−986	−609		−609	−544		−544	−1,530		−1,530
−2,200	−1,356	−3,556	−3,243	−670	−3,913	−4,379	−2,102	−6,481	−6,579	−3,458	−10,037
−264	−3,742	−4,006	+3,872	−1,569	+2,303	+5,904	−3,037	+2,867	+5,640	−6,779	−1,139

[1] Federal Reserve Banks and Treasury. [2] Total Gold Stock.
[3] Government Reserve against Dominion Notes and Savings Bank Deposits and Gold Deposits of Chartered Banks in the Central Reserve.
[4] Currency and Gold Standard Reserves of the Government.
[5] Government Conversion Fund and Bank of the Nation. All other figures for Central Banks only.
[6] Bank of Brazil and Government Stabilization Fund.

Swiss francs, in the gold and foreign exchange reserves of central banks and, in several important countries, of both central banks and governments. All conversions have been made at par of exchange. These figures are of course incomplete, for they do not include the unpublished reserves of many central banks, and the list of countries is far from being all-inclusive. They, nevertheless, have a revealing story to tell concerning the strains to which the international gold standard system was subjected under the impact of the crisis of 1929 and its aftermath.

The main features of this story are as follows:

1929. The internal strains within the central nucleus resulting from the end of de facto cooperation between Great Britain, France, and the United States as international money markets appear in Great Britain's loss of reserve and the gain in total reserve by France and the United States, and in the large French conversion of foreign exchange reserves into gold.[23] In 1929 the three center countries together gained 2,546 million Swiss francs in gold and lost 1,371 million in foreign exchange reserves, making a gain of 1,175 million in total reserves.[24] This pull over the world's reserve funds was shared by the smaller creditor powers and is shown by the strengthening of the gold reserves of the Netherlands, Switzerland, Belgium, and Sweden, and of the foreign exchange reserves of the last three of these countries.

The general loss of reserves by debtor countries, which was proceeding simultaneously, is shown by the rest of the table, and is especially noteworthy in the two countries most directly affected by the decline in raw material prices, Argentina and Australia. There were, however, exceptions to the rule of two kinds. First, Germany had a net gain in total reserve that was

[23] Cf. Ch. 20, The Foreign Exchange Portfolio of the Bank of France in 1929.

[24] Throughout this summary account of Table 67 the references to 'countries' individually or by groups are, of course, references to central banks and governments, as indicated in the notes to the table, not to the whole movement of gold and balances of the country. The references to India, for example, are misleading unless this is borne in mind.

largely due to a return flow of foreign funds after the most critical period in the international negotiations over the Young Plan had been safely passed.[25] Second, there was a gain in total reserves by four European countries—Yugoslavia, Portugal, Roumania, and Spain, and by Japan, which together composed the group that had not yet completed the 'unfinished business' of returning to gold.

It is noteworthy that the 32 countries together actually lost reserves during 1929, but that this loss was due wholly to the decline in the foreign exchange holdings of the Bank of France. The increase in total reserves of the creditor countries, including Sweden,[26] exceeded by only a trifling amount the loss of total reserves by the debtor countries, but if the gold reserves alone are considered, the gain of the creditor countries exceeded the loss of the debtor countries by over 1,300 million Swiss francs.

1930. In 1930, with the full strength of world-wide deflationary forces in operation, the underlying pattern is the same. But it is a pattern modified by the strenuous efforts of many central banks to strengthen their position and by the influence of the revival of foreign lending by the United States and Great Britain during the first half of the year.

The striking differences in the position of France, Great Britain, and the United States that characterized 1929 were repeated. While England gained a very small amount of gold, both the United States and France added greatly to their stocks. There was no further realization of foreign exchange reserves by the Bank of France, yet the increase in French gold holdings was 439 million Swiss francs greater, and the increase in total French reserves 1,839 million Swiss francs greater than in 1929. The increase in American gold holdings

[25] Cf. Ch. 19, Bank Rate and the Defense of Sterling, and Ch. 25, The Gold and Foreign Exchange Reserves of the Reichsbank.

[26] In the subtotals Sweden is not included among the creditor countries because one of the objects of the table is to group the countries whose power to attract gold persisted throughout 1931. Sweden was not one of these.

was 860 million Swiss francs greater than in 1929. This was more than double the increase in 1929, while the increase in total French reserves was four times that of 1929. As in 1929 the smaller creditor powers in Europe continued as a group to add to both their gold and their foreign exchange reserves, though in this group the Netherlands did not share in the large increases shown by Belgium, Sweden, and Switzerland. The creditor countries as a whole (including Sweden) gained 4,278 million Swiss francs in gold and 540 million in foreign exchange reserves as compared to a gain of 2,843 million in gold and a loss of 1,196 million in foreign exchange reserves in 1929. The gain of this group in total reserves was 3,171 million greater than in 1929.

At the same time the debtor countries as a group were losing 1,722 million Swiss francs in gold and 722 million in foreign exchange reserves, a loss in total reserves of 2,444 million. This was 726 million greater than the loss in total reserves in 1929 and was differently distributed. The effects of international loans floated by Germany and Austria are evident in the small size of Germany's gold loss and in the actual increase recorded for Austria, while the influence of the continued access of Argentina and Canada to the New York capital market can be seen in the reduced losses of reserves by Argentina and by the actual gain by Canada. The strenuous efforts made by European central banks to strengthen their positions is reflected in additions to the gold and foreign exchange holdings of Czechoslovakia, Finland, and Denmark. Brazil lost gold heavily, and Poland, Italy, and all four countries that in 1929 had not yet returned to gold were heavy losers of gold or foreign exchange or both. Of all European countries, Spain suffered the largest gold losses, chiefly because of acute internal political difficulties. During this year also Japan joined the gold losing countries. Indeed, the Japanese loss of 639 million Swiss francs accounted for over one-third of the gold loss of all the debtor countries together.

In 1930 the countries that had not returned to gold before the beginning of the crisis behaved much like other debtor countries, but since they again displayed a group characteristic in 1931, they may still be set out as a separate element in the whole picture. The countries whose exchanges were suffering depreciation in London and New York were also beginning to show group characteristics. The representatives of this group in Table 67 are Argentina, Chile, and Australia. The decline in the losses of reserves by Argentina and Australia was of course influenced by the course of their exchanges as well as by their continued borrowing.

The 32 countries together gained in total reserves 2,374 million Swiss francs in 1930 in contrast to the small loss of 1929. Gold holdings increased a billion and a quarter Swiss francs more than in 1929 and, in the absence of further liquidation of foreign balances by the Bank of France, foreign exchange reserves declined one billion 200 million less than in 1929. Creditor countries as a group gained in total reserves about twice as much as debtor countries lost.

1929 and 1930. For the two years together the general character of the changes appears more clearly than for either 1929 or 1930 separately. This may be seen by arranging the several countries according to the size of the changes in their total reserves (Table 68 A). To bring out the predominant role of a few countries in the whole movement a division is made between countries gaining or losing more and those gaining or losing less than 200 million Swiss francs during the two years. Such an arrangement of countries does not portray adequately the geographical spread of pressures threatening the preservation of the gold standard as an international institution, for equal changes have of course entirely different meanings in countries of unequal size and importance. Nor does it necessarily indicate the severity of the strains imposed, for the changes in reserves are the net result of the pressures experienced and the means employed to counteract them. It

TABLE 68

Countries Gaining and Losing Reserves

A 1929-1930 (millions of Swiss francs)

COUNTRIES GAINING OVER 200 MILLION IN RESERVES		COUNTRIES LOSING OVER 200 MILLION IN RESERVES	
France	3,069	Argentina	−1,012
United States	2,342	Brazil	−890
Belgium	629	Japan	−609
Switzerland	277	Australia	−460
Sweden	249	Italy	−395
		Spain	−311
		Poland	−209
Total, 5 countries	6,566	Total, 7 countries	−3,886

COUNTRIES GAINING LESS THAN 200 MILLION IN RESERVES		COUNTRIES LOSING LESS THAN 200 MILLION IN RESERVES	
Austria	97	United Kingdom	−139
Roumania	86	Chile	−110
Czechoslovakia	50	Yugoslavia	−103
Netherlands	38	Greece	−83
Lithuania	23	Bulgaria	−70
Finland	23	Hungary	−59
India	21	Germany	−43
Danzig	3	Latvia	−36
		Portugal	−32
		Denmark	−21
		Canada	−20
		Norway	−2
Total, 8 countries	341	Total, 12 countries	−718
Total, 13 countries gaining reserves	6,907	Total, 19 countries losing reserves	−4,604
Net gain, 32 countries	2,303		

B 1929–JUNE 1931 (millions of Swiss francs)

COUNTRIES GAINING OVER 200 MILLION IN RESERVES	GOLD	FOREIGN EXCHANGE	TOTAL
United States	4,224		4,224
France	4,992	−1,340	3,652
Belgium	383	222	605
Switzerland	307	166	473
United Kingdom	246		246
Total, 5 countries	10,152	−952	9,200

COUNTRIES GAINING LESS THAN 200 MILLION IN RESERVES	GOLD	FOREIGN EXCHANGE	TOTAL
Netherlands	131	17	148
India	140		140
Sweden	3	110	113
Roumania	18	71	89
Lithuania	2	11	13
Finland	1	14	13
Total, 6 countries	293	223	516
COUNTRIES LOSING OVER 200 MILLION IN RESERVES			
Germany	−1,316	−282	−1,598
Argentina	−1,334		−1,334
Brazil	−1,018	−86	−1,104
Japan	−544		−544
Italy	86	−572	−486
Australia	−173	−226	−399
Poland	−31	−212	−243
Total, 7 countries	−4,330	−1,378	−5,708
COUNTRIES LOSING LESS THAN 200 MILLION IN RESERVES			
Chile	1	−182	−181
Hungary	−81	−76	−157
Canada	−139		−139
Greece	−4	−116	−120
Austria	33	−134	−101
Yugoslavia	50	−146	−96
Denmark	−1	−79	−80
Bulgaria	6	−85	−79
Latvia	0	−50	−50
Portugal	0	−42	−42
Czechoslovakia	58	−90	−32
Norway	−1	−27	−28
Spain	−133	106	−27
Danzig		−9	−9
Total, 14 countries	−211	−930	−1,141
Total, 11 countries gaining reserves	10,445	−729	9,716
Total, 21 countries losing reserves	−4,541	−2,308	−6,849
Net gain, 32 countries	5,904	−3,037	2,867

Compiled from Table 67

does, however, clearly disclose two facts of major importance in the history of the gold standard during these two years: (1) there was a persistent 'shift' of reserves from debtor to creditor countries; (2) neither the United Kingdom nor Germany participated in this shift on a substantial scale.

First Half of 1931. The figures for the first half of 1931 indicate a still further accentuation of the whole process of concentration of reserves, and, for the first time since the beginning of the depression, a large participation by Great Britain and Germany in the general movement. The gains of the creditor countries in these six months were 69 per cent of the amount gained during the full year 1930. The losses of the debtor countries were 100 per cent of their losses during the full year 1930. Of the three center countries the United States became the chief magnet for gold. American gold holdings increased more in six months than in the entire year 1930, while French gold holdings grew at a rate only half as great as in 1930. The United Kingdom also gained gold substantially, its increase of 385 million Swiss francs being not very far from the French increase of 581 million. The Netherlands, Switzerland, and Belgium continued to gain gold, but Belgium lost in total reserves. The efforts of the smaller European central banks to improve their positions seem to have been inadequate. With the exception of Roumania, Yugoslavia, and Spain, their reserves, especially in foreign exchange, declined. In many countries gold reserves were becoming immobilized, while the small group of countries that had not returned to gold by 1929 was still trying to reach the goal of de jure stabilization and was building up reserves. This was true also of Japan which returned to gold in 1930 and during the first six months of 1931 showed an actual increase in gold in place of the large loss of 1930. The three ABC countries and Canada continued to lose reserves, but Australia, which had readjusted its exchange, was a small net gainer. The outstanding change within the debtor group,

however, was the loss of both gold and foreign exchange by Germany. The German losses were sufficiently large to account for the entire increase in the rate at which the debtor countries as a group were losing gold during the first six months of 1931 as compared with 1930.

1929 to Mid-1931. When the figures for the two and a half years ending on June 30, 1931 are arranged according to the size of changes in total reserves (Table 68 B), the underlying forces are even more clearly suggested than they were by the 1929–30 totals.

The foregoing examination of the behavior of the reserve funds of these 32 countries from the beginning of the depression until the eve of the confidence crisis of 1931 reveals certain progressive changes in the character of the concentration movement:

1) a progressive increase in the rate at which debtor countries as a whole were losing, and creditor countries as a whole were gaining reserves;

2) a progressive tendency for an increasing proportion of the loss of reserves by debtor countries to take the form of a loss in foreign exchange reserves;

3) a tendency for gold reserves in the hands of the central banks and governments of the 32 countries together to grow at an increasing rate.

The figures suggest also a fourfold grouping of countries which provides a key to the interpretation of the history of the international gold standard during these years:

1) the group of countries which, under the pressure of loss of reserves, abandoned, or seriously modified the form of their adherence to the gold standard;

2) the group of countries whose position in the depression period was dominated by circumstances peculiar to themselves; in particular, Italy whose adaptation to the situation was a test of a controlled economy, and Germany whose adaptation to the situation was inextricably related to the reparation problem and who therefore also had, to a certain extent, a controlled economy;

3) the group of countries that were still attempting to return to gold during the depression;
4) the center countries as a group.

The rest of our discussion of the disintegration of the gold standard system will be carried out largely in terms of this fourfold grouping of countries.

CHAPTER 24

The Disintegration of the International Gold Standard System at the Periphery

The forces responsible for the movement of gold and foreign exchange reserves from the central banks of debtor to those of creditor countries after 1928 also caused the exchanges of a few debtor countries to depreciate in dollars and sterling, or, if the expression is preferred, 'in gold' (Table 69 and Chart 54). This was an outward and visible sign of the disintegration of the international gold standard system at the periphery.

Meaning of the Phrase

This phrase is here employed, however, to connote something more than the mere deviation of exchange rates from par. It includes also modifications in practice in many countries that constituted a clear departure from the accepted canons of behavior implicit in the idea of the return to gold as generally understood during the Restoration period, and carries certain deeper implications that touch the substance as well as the form of the international gold standard system.[1] There can be no periphery without a center. The economic adjustments in the countries whose exchanges were allowed to depreciate during the early phases of the depression were achieved because of, and their permanence was predicated upon the continued existence of a large group of stable exchange rate countries with reference to which they were depreciated. As long as the mutual economic relations of the center countries are sufficiently adjusted to the system of ex-

[1] Cf. Ch. 2, The Gold Standard, Form and Substance.

change rates subsisting between them to make that system of rates stable, a real standard of reference exists for the periphery countries. If the central group of stable exchanges breaks up, then the terms of the problem of the periphery countries are altered, but the center is not destroyed. Instead of being a stable system of rates it becomes an unstable system of rates, but still a system binding the major currencies of the world together (cf. Ch. 33 and 34). The center countries, by the very fact of their economic dominance in the world, can never shift to the periphery, and the periphery countries have to consider the sum total of their relations to this central system of rates in determining their currency policy.

The phrase, 'the disintegration of the gold standard system at the periphery,' therefore, carries the further implication that generalizations made concerning the economic effects of leaving the gold standard and depreciation 'in gold' on the basis of the experience of the periphery countries cannot be applied indiscriminately to all countries. It is the *pons asinorum* of elementary instruction in banking that what is true of one bank in a system of banks is not true of all banks. What one bank can do depends partly upon its size and influence, and partly upon what other banks are doing. It is of the essence of clear thinking on international gold standard problems to recognize that all generalizations concerning the role of gold standard arrangements in a given country depend first upon its position in the world economy, and second upon certain assumptions, more often implied than expressed, concerning the relations of other countries to the gold standard. The international gold standard as a practical and working institution cannot be understood in terms of any abstract formula. For any *single* country there is *no* general answer to the question of whether adherence to the international gold standard is a deflationary, a stabilizing, or an inflationary policy. The answer must always be that it depends upon the circumstances.

The Depreciated Exchanges

Australia and New Zealand

The circumstances that determined the currency history of Australia during the earlier years of the depression have a triple interest for the student of the international gold standard: first, because Australia shared the difficulties felt by all raw material producing, debtor countries, and experienced them earlier, more acutely, and in simpler form than almost any other country; second, because of the peculiar relations of the Australian pound to the pound sterling, amounting, as in the case of South Africa, to an identification of the two currencies in the public mind; third, because Australia, during these years, developed a deliberate policy of taking advantage of her position on the periphery of the gold standard to bring about a redistribution among various economic groups within her borders of the losses of real income caused by the depression.

It is an outstanding characteristic of Australian economic history that periods of crisis and depression have been closely associated with periods in which the inflow of British capital investment in the Commonwealth has either been cut off or sharply diminished.[2] This was true of the severe crisis of 1920–21, which was followed, after an interval, by a period of prosperity lasting from 1925 to 1929, based on "high export prices, a growing volume of exports and a fairly regular, but excessive inflow of capital." [3]

[2] Cf. Gordon Wood, *Borrowing and Business in Australia* (London, Oxford University Press, 1930), passim.

[3] Douglas Copland, *Australia in the World Crisis, 1929–1933* (Macmillan, 1934), p. 11. In these Alfred Marshall Lectures, delivered in Cambridge University in October and November 1933, Dr. Copland combines in high degree theoretical insight with mature and balanced judgment gained in practical experience. Heavy drafts are made upon this source in this section.

Dr. Wood states that the crisis of 1920–21 was followed by a period of depression lasting "with brief interludes" until 1929 (*op. cit.*, p. 175), but Dr. Copland states that the country was undoubtedly prosperous from 1925 to 1929. Whether 1925–29 may be considered a brief interlude in the period 1922–29 is a question the writer cannot attempt to decide.

This prosperity did not, however, rest on very firm foundations, and it was partly undermined by deflationary forces directly associated with the joint return to gold of Australia and Great Britain. Export prices fell sharply between 1925 and 1926, reflecting the rise of the external value of the Australian pound,[4] and the terms of trade, which had been moving in favor of Australia until 1925, began to move against her, though they were still favorable in 1928.[5] From 1922 to 1928 capital imports averaged just under £30 million per annum, but Australian long term borrowing in London was very uneven. It was sharply interrupted in 1923, 1925, and 1927 by a series of events, elaborately treated elsewhere in these studies, that were directly connected with the return to and the maintenance of the gold standard by Great Britain.[6] During each interruption in long term borrowing the gap was substantially made good by short term accommodation in accordance with the British practice of shifting from the long to the short term shoulder in time of stringency. So customary, indeed, had this practice become in the case of Australia that Australian Treasury officials were wont to use the very striking phrase 'arrears of borrowing.'[7] Nevertheless, the irregularity in long term capital inflow did have a depressing effect upon Australian business, which was accentuated by the reflection, in higher rates in Australia, of the relatively high interest rates prevailing in London as part of the defense of sterling.

These inheritances from the return to gold were still

[4] Wood, *op. cit.*, p. 218.

[5] Copland, *op. cit.*, p. 15 and table, p. 14; cf. Gordon Wood, *op. cit.*, pp. 190–1. Dr. Copland's figures, on 1911 as a base and for calendar years, show a steady improvement from 1920 to 1924 and 1925, while Dr. Wood's figures, on 1914 as a base and for trade years, show a sharp adverse movement in 1924 followed by an improvement in 1925 and 1926. Variations in the terms of trade, Dr. Copland points out in dealing with the extremely adverse position of the depression years, are not a measure of changes in real income in Australia, but are a main cause of such changes (*op. cit.*, p. 43).

[6] Wood, *op. cit.*, table and chart on pp. 186 and 187.

[7] Copland, *op. cit.*, p. 11.

present on the eve of the world depression; in addition, the internal organization of the Australian economy was rigid and brittle. The wage system was rigid and industry was organized on a semi-monopolistic basis.[8] A high protective tariff system was in force and government expenditures for social services were on a high level. Finally among the inelastic elements in the Australian economy must be included a strong belief in the supreme importance of parity with sterling.[9] All these constituted foci of resistance to the forms of economic adjustment desirable in Australia on account of her extremely vulnerable position in the face of falling export prices and a decline in her import of capital from abroad, and all were supported by powerful interests. Australia, however, had equipped herself between 1924 and 1929 with three instruments of economic control which proved capable of giving her an unexpected degree of flexibility in meeting the impact of such forces—the Loan Council, the Commonwealth Bank, and the Court of Arbitration.[10]

The Loan Council was first conceived of as a defensive measure taken by the various governments in Australia in the face of increasingly severe scrutiny of Australian borrowing in London after 1925. By an agreement between the Commonwealth and the States arrived at on December 12, 1927, and legally sanctioned by the Financial Agreement (Validation) Act of 1929, the Commonwealth took over all the public debts of the States, subject to arrangements for their service by the States. The Commonwealth also agreed to make annual contributions from its revenue toward payments on the State debts, and sinking funds were established. The management of the public debt of both Commonwealth and States and the determination of future borrowing policy was then entrusted to a special body known as the Loan Council. This

[8] Wood, *op. cit.*, pp. 214–23. The cost of living index rose in Australia after 1925.

[9] Copland, *op. cit.*, p. 75.

[10] Cf. *ibid.*, Ch. IV, The Flexibility of Institutions, passim.

body consisted of one representative of the Commonwealth and one of each State. Each government, Commonwealth or State, had to submit to this Council the amount it wished to borrow for each financial year. The Council was given power to decide whether the total could be raised on reasonable terms and conditions, and if not, to fix the amount to be borrowed and to allocate it to the Commonwealth or States.[11] The Loan Council thus established became a powerful instrument by which Australian public bodies could deal as a unit with the English financial powers. It proved to be a highly constructive agency for solving Australian foreign exchange problems during the world crisis, and in time became the directing authority of Australian financial policy.

Under a new charter granted in 1924 the Commonwealth Bank entered the crisis with an issue and banking department on the plan of the Bank of England, a savings bank, and a rural credit department. It was obliged to hold a legal reserve of 25 per cent in gold against its note issue and could issue notes against Australian and British government securities and approved short term bills. In cooperation with the Loan Council the Commonwealth Bank gradually acquired during the crisis all the essential characteristics of a central bank. The steps in this evolution will be indicated briefly in our account of Australian currency history during the first years of the depression.[12]

This centralized control over financial policy was paralleled by the control of wages by the Court of Arbitration. The Court was the main wage fixing authority in the Common-

[11] Wood, *op. cit.*, p. 222, note.

[12] This evolution overshadowed and finally sidetracked efforts to establish a new central banking institution, largely under government control, in Australia. On April 5, 1930 the government introduced a Reserve Bank Bill modeled on the South African Reserve Bank legislation (*The Economist*, April 5, 1930, p. 767). This legislation took various forms as the conflict between inflationary and deflationary ideas proceeded (*ibid.*, July 12, 1930, p. 75; Aug. 9, 1930, p. 275; Dec. 6, 1930, p. 1056).

wealth, for "by a decision of the High Court in 1926 Commonwealth awards in any industry took precedence over State awards." [13] The Court was instructed by Parliament to take into account economic considerations in determining its awards, and unless the law governing its constitution were altered the Court was independent of the government of the day.

This was also true of the Loan Council and the Commonwealth Bank, and since, when a Labour Government was victorious in the Commonwealth elections of October 1929 the Senate remained in the hands of the opposition, this independence was preserved throughout the depression. Final decisions on basic economic policy could therefore be taken by the Council, the Bank, and the Court that ran counter to the views of the dominant party and the ministers.

The position of Australia as a gold standard country during the early years of the depression can, in its essentials, be stated very briefly. The decline in the price of wool and wheat, a short wheat crop in 1930, and a domestic situation that interposed serious obstacles to cutting down imports caused an increasingly adverse merchandise trade balance. The simultaneous shutting down of capital imports from Great Britain turned this into a very acute balance of payments problem and brought on a foreign exchange crisis. The two factors combined resulted in large losses of real income within the country, unemployment, and budget deficits. Because of the great relative importance of goods export and capital import in sustaining the national income the incidence of the depression was very unequally distributed within Australia. Consequently, currency policy and internal policy clashed on many issues which had to be compromised. Within each field, moreover, were serious conflicts. In the development of currency policy at least four elements are clearly distinguishable:

[13] Copland, *op. cit.*, p. 88.

1) a vigorous and unsuccessful resistance on the part of the banks and the government to the depreciation of the Australian pound in London;
2) a series of changes in the formal relationship of the Australian pound to gold that were directly related to this resistance;
3) a breakdown in the system of arbitrage between Australia and New Zealand that was also part of this resistance;
4) a final transition to a pure form of sterling exchange standard based upon administrative policy rather than upon law.

The main issues of domestic policy were rooted in an acute conflict between inflationary and deflationary schools of thought, ending in a middle of the road policy which used elements of both. On the deflationary side it included compulsory wage and interest reductions and on the inflationary side the expansion of central bank credit and planned currency depreciation. The interaction of these forces can be best seen in a brief chronological summary of events.

By August 1929 long term borrowing by Australia in London ended, partly for reasons connected with Australian credit and partly because of the general situation in the London capital market. Accommodation was secured in London by the sale of two issues of treasury bills of £5 million each, supplemented early in the depression by overdraft money obtained at a London bank. The prices of wool, metals, and wheat were already falling; in consequence, Australia had to draw upon her existing funds in London to support the exchange. These funds had been very substantial from 1922 to 1928, standing in the latter year at £47 million.[14] At the same time the gold reserves of the Australian banking system were £48 million. The immediate difficulty could therefore be met by drawing on previously accumulated balances and by shipping gold. The London funds of the Commonwealth Bank

[14] *Ibid.*, p. 112, note. A chart showing the fluctuations in these funds is presented on p. 113, as estimated according to the method used by Roland Wilson in his *Capital Imports and the Terms of Trade* (Melbourne University Press, 1931), but no table is given. Mr. Wilson's tables show only the cumulative net changes from year to year.

were reduced £10 million in the second half of 1929.[15] From June 30, 1929 to June 30, 1930 total Australian banking funds abroad fell £26½ million.[16] As Dr. Copland points out, Australia acted in fact in accordance with the theoretical principle that a country with large foreign indebtedness should accumulate large reserves in good times with which to meet her fixed foreign obligations in bad times.

These resources, however, quickly proved inadequate to meet the situation. At the time of the break in the New York Stock Exchange in October 1929 the new Labour Government was faced with a serious exchange problem. The Australian pound was steadily, if gradually, declining in London. Gold was moving out. Reserves in London were being depleted. The government was therefore prompted to take steps that really put an end to the functioning of the gold standard in Australia on traditional lines. In December 1929 an act was passed that gave power to the Treasurer to authorize the Commonwealth Bank to require returns of all gold held privately and to requisition it, if necessary, in exchange for Australian notes. This act also gave power to the Treasurer, upon recommendation of the Commonwealth Bank, to prohibit the export of gold. The first of these provisions was modeled upon section 11 of the English Currency and Bank Notes Act of 1928. There was, however, an important difference between the English and the Australian laws, for a statement by the Treasurer clearly indicated that the power to requisition residing in the Commonwealth Bank could be used to prevent the export of gold, because gold obtained in exchange for notes could be requisitioned immediately.[17] The Act in fact suspended the right of private banks to export gold when it was profitable to do so and concentrated power over all gold in Australia in the Commonwealth Bank. In the words of that Bank's Chairman this was done to safe-

[15] Copland, *op. cit.*, chart of Commonwealth Bank London funds, p. 110.
[16] Wilson, *op. cit.*, p. 36, table.
[17] *The Economist*, Dec. 7, 1929, p. 1079; Jan. 11, 1930, p. 73.

guard the gold standard.[18] It was the same kind of 'safeguard' employed by Great Britain herself in preserving her own gold standard during the war.[19]

Deprived of the right to obtain gold for remittance to London, the private banks looked to the Commonwealth Bank to provide the necessary sterling exchange to meet current needs. With continued declines in the yield of exports and in the absence of any restriction on imports, it became clear that radical measures must be taken if the Australian pound was not to depreciate further. The necessity of avoiding exchange depreciation was still an unquestioned dogma of sound finance in Australia, particularly, as Dr. Copland says, in the view of the banking institutions directed from London.[20] Accordingly, a double line of policy was pursued. First, the Loan Council took steps to reduce government borrowing to one-half its former level in order to eliminate the need for further borrowing abroad, a clearly deflationary policy that sharpened the political controversy between the advocates of 'sound' or orthodox finance and the advocates of inflationary measures. Second, on January 23, 1930 an agreement was reached whereby gold held by the private banks was to be put at the disposal of the Commonwealth Bank to meet general needs, and the available foreign exchange in London was to be rationed. This was deemed necessary because the banks were already quoting the Australian pound at a 2½ per cent discount, and an outside or 'black' market in which a greater discount was quoted, had already appeared.[21] Under these agreements the Commonwealth Bank shipped £7 million in gold to London on February 7, 1930, bringing the total shipped since July 1929 to £17 million. Gold continued to be

[18] *Ibid.*, cf. the Report of the Commonwealth Bank for the second half of 1929 in which it is contended that these measures by no means took Australia off the gold standard.

[19] Cf. Ch. 2, The International Gold Standard as a Code of Practice during the War, and Ch. 3, Measures of Support.

[20] Copland, *op. cit.*, p. 73.

[21] *The Economist*, March 29, 1930, p. 708.

shipped; nevertheless, even the official exchange rate continued to fall (Table 69).

These measures—the exercise of its full powers over the public debt by the Loan Council, the centralization of gold reserves, the transfer of the function of gold export from private to official hands, the artificial pegging of the sterling rate, the beginning of the rationing of foreign exchange supplies—were the weapons forged by Australia in her effort to meet the impact of the depression and to preserve the outward semblance of adherence to gold. Control of imports was a logical next step [22] and was soon attempted by means of a general increase early in 1930 of the already high import duties and the prohibition of some luxury imports.

One basic rule governing the behavior of the foreign exchanges under the gold standard was also broken during this period. New Zealand was able to borrow in London after Australian accommodation was cut off, and her export trade had not suffered in the same degree as that of Australia. Yet the New Zealand pound was dragged down with the Australian pound by the action of the banks that controlled the market. In the spring of 1930, however, a gap began to appear between the Australian and New Zealand pounds in London. The rate between Australia and New Zealand was nevertheless maintained at par.[23] In the name of defending the gold standard in Australia, the functioning of exchange arbitrage was suspended between the two Dominions.

Though drastic, these measures were proving inadequate to meet the underlying difficulties of Australia. These were admirably summed up in a despatch to *The Economist* from Australia in June 1930 in which the following points were made:

1) Net borrowings abroad had been reduced from about £30 million per year to practically zero.

[22] Cf. the integration of exchange controls with measures of direct control over imports during the war; Ch. 3, Measures of Support.

[23] *The Economist,* Dec. 27, 1930, p. 1224.

TABLE 69

Exchange Rates of Certain Debtor Countries, 1929-September 1931
Monthly Averages as Percentages of Par in London and New York

	STERLING RATES [1]		DOLLAR RATES [2]				DOLLAR RATES	
	Australia	New Zealand	Argentina	Brazil	Venezuela	Uruguay	Spain [3]	Peru [4]
1929								
Jan.			99.257			99.348		
Feb.			99.257			99.210		
March			99.041			98.256		
April			99.002			95.834		
May			99.002			94.470		
June			98.751			93.495		
July	99.4437	99.750	98.845	99.138	100.414	94.346	75.165	
Aug.	99.250	99.500	98.869	99.155	100.051	95.312	75.989	
Sept.	99.000	99.250	98.818	99.138	99.792	94.581	76.450	
Oct.	98.875	99.125	98.466	99.255	99.740	94.463	75.150	
Nov.	98.750	99.000	97.345	98.202	99.740	93.592	72.481	
Dec.	98.5625	98.844	96.394	94.372	99.948	91.680	71.409	
1930								
Jan.	98.375	98.375	94.666	92.638	99.740	89.904	67.896	
Feb.	97.875	97.969	89.687	93.252	99.740	86.024	65.777	
March	96.375	97.300	88.758	96.162	99.689	86.069	63.797	
April	93.875	95.781	91.867	97.993	99.119	89.827	64.673	
May	93.875	95.375	90.396	98.946	99.119	89.160	63.357	100.000
June	93.875	95.375	87.558	95.301	98.310	86.224	60.875	95.625
July	93.875	95.375	85.044	90.928	98.445	82.617	59.708	94.230
Aug.	93.875	95.375	85.494	83.252	97.564	80.193	56.352	89.950
Sept.	93.875	95.375	84.767	84.322	95.854	79.649	55.569	86.025
Oct.	93.021	95.375	80.900		95.854	76.628	53.595	78.147
Nov.	92.166	95.375	80.967		95.854	77.279	58.528	77.607
Dec.	92.166	95.375	78.308	80.367	95.854	72.513	55.678	75.745

1931								
Jan.	82.139	93.733	72.245	75.852	95.854	65.887	53.865	74.182
Feb.	76.923	91.220	74.565	71.571	93.968	66.792	52.771	69.687
March	76.923	91.220	80.886	65.961	93.264	70.935	55.590	69.657
April	76.923	91.220	79.251	60.752	88.072	65.479	54.264	70.865
May	76.923	91.220	73.291	55.811	85.145	59.398	51.813	69.900
June	76.923	91.220	72.814	62.700	88.937	56.599	50.124	69.825
July	76.923	91.220	72.433	60.142	90.051	52.470	48.253	69.932
Aug.	76.923	91.220	66.927	53.252	89.336	44.492	45.575	69.870
Sept.	76.923	91.220						

[1] T/T Selling Rate. London on Australia and New Zealand, average of weekly quotations published by *The Economist.* After October 11, 1930, the Australian rate is the reciprocal of the published quotation which was expressed in terms of £100 sterling after that date.

[2] Calculated from rates published in the *Federal Reserve Bulletin.*

[3] Par is taken as pre-war par, 19.30 cents per peseta for Spain.

[4] Par is taken as 40 cents per sol, the rate of de facto stabilization of the Peruvian pound.

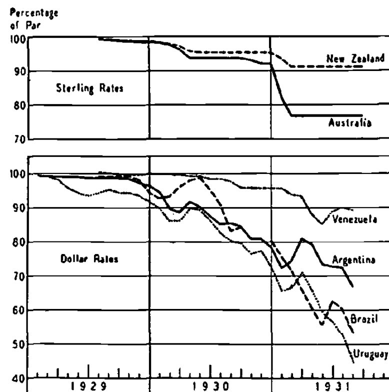


CHART 54

Exchange Rates of Certain Debtor Countries, 1929–September 1931
Monthly Averages as Percentages of Par in London and New York

2) Heavy declines in the price of wool, wheat, meat, dairy products, and minerals (Australia's chief exports) had reduced the proceeds of exports about £40 million.
3) There was a loss in income of between £30 and £80 million owing to the reduced expenditure at home of those whose incomes from abroad were reduced in these two ways.

Hence, Australian national income was reduced about one-fifth.

4) Prices were falling, especially export prices which had reached about two-thirds of the import price level.
5) The number of people in the export industries was declining, but the protected domestic industries were expanding.

Hence, there was growing unemployment, uneconomical domestic expenditure, and economic unbalance.

6) The normal balance of payments was violently disturbed, and balances of Australian banks in London were not accumulating.[24]

Finding its measures to meet the situation inadequate, and still conceiving of the problem in terms of an effort to maintain the Australian exchange in London, the Australian government made an official appeal for advice and help from Great Britain. A conference was arranged between the Bank of England, the Australian government, and Australian bankers, and Sir Otto Niemeyer was invited to Australia to perform the now familiar functions of the money doctor. Acting in this capacity Sir Otto did not hesitate to impress upon the Australian authorities the evils of further currency depreciation and the necessity for further drastic public economies.

[24] *Ibid.*, July 26, 1930, p. 166. Dr. Copland's analysis of the basic economic problem of Australia (*op. cit.*, pp. 180–1) shows that under these conditions the expansion of the protected industries and of sheltered occupations could not be lasting.

Australian gold and merchandise imports and exports in 1928–29 and 1929–30 (years ending June 30) were (*The Economist*, Aug. 30, 1930, p. 407):

	1928-29	*1929-30*
Imports	£143,647,881	£131,134,269
Merchandise	143,299,604	130,840,475
Gold	348,277	293,794
Exports	144,850,452	124,848,549
Merchandise	141,866,297	97,980,010
Gold	2,984,155	26,868,539

Throughout 1930 much emphasis was placed on the necessity of reducing production costs, and this also was the burden of Sir Otto Niemeyer's advice. This advice was considered by the upholders of orthodox finance to contain a series of "unpalatable but salutary home truths." At the time of his visit Australia was facing early maturities of £18 million of treasury bill and overdraft debt in London, and as *The Economist* suavely remarked, the Australian government was 'helped' in making up its mind to accept Sir Otto's advice by the hard fact that it had treasury bills maturing in London that could not be renewed.

The result of these consultations was a further rounding out of policies already in force. On August 21 a new agreement was reached between the States and the Commonwealth which proclaimed a settled policy of balancing budgets, and it was agreed that the Loan Council should raise no more overseas loans until the existing short term debt in London was completely dealt with. Sir Otto Niemeyer, the Commonwealth Treasurer, and the bankers agreed also that Australian foreign exchange reserves should be pooled in order to give the Commonwealth a prior claim on available funds to meet their London obligations. The Australian banks agreed to find annually £36 million in sterling exchange to be paid to the Commonwealth Bank in London against payment of a like amount by the Federal Government into a special account to be opened in the Commonwealth Bank in Australia. At the same time the Bank of England agreed to help in providing for maturing loans in 1930. The first earnest of this help was the placing of new six month treasury bills in London to meet £5 million in bills maturing on September 2. £14 million of the £18 million short term debt due in August was repaid. Since there were no large maturities of long term Australian loans in London in 1931 and 1932, it was felt that the crisis had been surmounted and that Australia had obtained a genuine financial breathing spell.[25]

[25] *Ibid.*, Sept. 20, 1930, p. 530.

These measures constituted a subordination of the needs of the Australian export trade and of the public works and social programs of the Labour Governments in Australia to the maintenance of Australian credit abroad and to the views of her creditors on currency matters. Dr. Copland has presented a strong case to show that a policy of no exchange depreciation and deflation along the lines urged by Sir Otto Niemeyer could not, under the circumstances, have been carried out to the bitter end without a breakdown of the social order.[26] There was strong political opposition within Australia to any deflationary program. In October 1930 the forces within the government opposed to such a program 'imposed' by foreign creditors were strengthened by the election of Mr. Lang as Premier of New South Wales on a platform of opposition to retrenchment and to a balanced budget. Nevertheless, the Commonwealth Treasurer adhered to the policy of not adding to the outstanding short term debt of £37 million in London, and, in the face of falling revenues due to the now rapid decline in imports, the government successfully refunded its internal debt.

The foreign exchange position, however, was not materially helped. The Australian banks, following at a distance the lead of the open or 'black' market to which they were steadily losing business and which was the true measure of the value of the Australian pound in London, were forced to raise their rates. At the end of the year their selling rate was £ A 109 for £100 sterling, but in the outside market the Australian pound was at a discount of from 15 to 18 per cent.[27] Finally on January 7, 1931 the Bank of New South Wales broke away from the bankers' agreement, quoting £ A 115. 10 s. for £100 sterling, and the other banks had to follow. For four successive weeks the premium on London was raised until the official rate quoted by the banks on January 31 was 130 Australian pounds for 100 pounds sterling. This decline in the

[26] Copland, *op. cit.*, pp. 36–8. [27] *Ibid.*, p. 109.

Australian pound brought about a heavy liquidation of Australian securities in London, and in Australia the battle over inflation was renewed with increasing fervor. In January the Court of Arbitration decreed a general 10 per cent reduction in wages, the first genuinely deflationary step taken in Australia. On the other hand, a Gold Bounty bill had just been passed providing for a bonus of £1 per ounce for production in excess of the average of 1928–30, to be paid out in wages. Ostensibly this was to help unemployment in the gold mining industry. Unquestionably, however, its basic purpose was to help solve the foreign exchange problem and to help defend the gold standard, which, in spite of the already existing discount of 23 per cent in the exchange and the various modifications in gold standard practice noted above, was still believed to prevail in Australia. That was certainly the view of Mr. Lang who in February urged "the abandonment of the gold standard," and said that New South Wales would pay no more interest on its overseas debt. This act of repudiation was prevented from having serious effects upon Australian credit in London, for the Federal Government assumed service of the New South Wales debt under the Financial Agreement (Validation) Act of 1929. But though the Federal Government earnestly fought the extreme position of Mr. Lang, it had inflationary proposals of its own. The Federal Treasurer sponsored a plan to return to the 1929 price level, and the Federal Government proposed to reorganize the currency on a fiduciary basis and to requisition the gold of the Commonwealth Bank for the purpose of meeting its own obligations in London, and pressed forward its plans to reorganize the Commonwealth Bank on lines bringing it more largely under political control.

This political battle ended in the spring of 1931 with a temporary victory for the anti-inflationary forces. On April 2 Sir Ronald Gibson, Chairman of the Commonwealth Bank, wrote the Chairman of the Loan Council that the Bank could not provide further assistance to the governments, and that it

would limit its advances to £25 million in Australia and £25 million abroad. The latter figure had already been reached and the margin still available in Australia would be exhausted in two months. The seriousness of the budget problems raised by this letter led to the appointment by the Loan Council of a sub-committee consisting of five under-treasurers and four economists known as the Copland Committee to recommend plans for achieving balanced budgets by 1934. A month earlier, March 6, the Chairman of the Commonwealth Bank had written the Federal Treasurer that the resources of the Commonwealth Bank in London were exhausted and that rather than permit default on Australian obligations the Commonwealth Bank would ship gold. He opposed any "abandonment of the gold standard," seeming to share with Mr. Lang the view that that standard still prevailed in Australia. As a result of this letter Sir Ronald had been summoned to testify before the Senate at Canberra. His testimony was followed by the Senate's rejecting in April the government's proposals to reorganize the currency on fiduciary lines and in May the government's plan to reorganize the Commonwealth Bank. In order to make possible the shipment of gold, Parliament authorized a temporary reduction in the statutory cover against Commonwealth Bank notes from 25 to 15 per cent. £5 million in gold was shipped to London to meet maturing treasury bills and the due date of a further government obligation of £5 million at the Westminster Bank was postponed from June 30 to September 30. A few months before, in April 1931, the government's transfer problem had been eased by the negotiation of a new Anglo-Australian war debt agreement, postponing Australian payments for two years. Another severe crisis seemed to have been overcome by strict adherence to orthodox finance, including in that term appropriate concessions by creditors.

At this juncture, however, a middle of the road policy, departing radically in some respects from the cannons of orthodox finance, was developed which ended the battle between

unequal and inadequate deflation and uncontrolled inflation. The Copland Committee had deliberated and submitted its report which was made the basis for the so-called Premier's Plan adopted by a Conference of Premiers in June. Its essential features were:

1) the division of government expenditure into elements that could not be reduced (unemployment, interest and sinking fund, exchange 'premium') and those which could be adjusted
2) a 20 per cent reduction in all 'adjustable' government expenditure
3) conversion of the internal debt on the basis of a 22½ per cent reduction of interest
4) additional taxation
5) a reduction of bank and savings bank rates of interest on deposits and advances
6) relief in respect of private mortgages.

The refunding proposals under this plan were carried out at first on a voluntary basis with full cooperation between the governments, the Loan Council, and the banks, but in the end they were compulsory. The reduction in private interest was carried out with greater difficulty even with the cooperation of the State governments. This part of the plan rested on the ground that the economic situation had altered the essential basis of loan contracts and that an adjustment to the new conditions was desirable. The reduction in government wages and salaries was in general harmony with the policy of the Court of Arbitration.

These steps were severely deflationary, but have been characterized by Dr. Copland as "constructive deflation," [28] because they were only one side of a total policy having as its aim a new economic equilibrium. The other side of this policy was inflationary. It involved first, an abandonment of the battle against currency depreciation as an evil in itself and a frank recognition of its role in distributing part of the burdens placed upon the export industries to other shoulders

[28] *Ibid.*, p. 136.

by adding to bank deposits and sustaining the domestic price level; second, the adoption of a policy of planned budget deficits in order to expand the domestic purchasing power of certain groups. These deficits were financed by a program of treasury bill issues, underwritten by the Commonwealth Bank with the consent of the Loan Council. Central bank credit extension to government in this way proved, in the view of Dr. Copland, a more effective means of adding to the money incomes of consumers than open market operations of the type usually attempted during depressions.[29]

Toward the end of 1931 bank deposits and advances began to rise in Australia. The decline in wholesale prices was replaced by a slight improvement, and the balance of payments problem began to dissolve under the combined influence of expanded exports, a reduction in dividend remittances, war debt concessions by Great Britain, and a great decline in imports. The exchange crisis was clearly over, and relief from internal deflation achieved.

The steps by which Australia reached this position have been given here in some detail because Australian experience and experiment furnished many precedents later drawn upon by other countries. For example, certain features of the Bruening decrees in Germany in 1931 and the reflation policies of the United States in 1934 had their counterparts in Australia. Australian experience also illustrates the danger of generalizing upon the effects of adherence to the gold standard from the case of a country placed in a particular set of circumstances. For example, on the basis of Australian experience Dr. Copland laid down the dictum, as if it were of universal application, that "in a crisis in which values are collapsing, rigid adherence to the gold standard is the most restrictive of all forms of regulation." [30] To find grounds for distrusting generalizations of this type, it is only necessary to recall that in 1920–21 values were collapsing in the United

[29] *Ibid.*, pp. 145–9, 160–1.

[30] *Ibid.*, p. 177.

States while the gold standard was being rigidly adhered to. No one would maintain that American adherence to the gold standard at this time was in any sense a 'restrictive' policy (cf. Ch. 10). In the interpretation of post-1931 international gold standard history this is a point of cardinal importance, for the wise and successful use of currency depreciation by periphery countries to redistribute internal burdens was the basis of many admonitions to the center countries to do likewise. Finally, the steps by which the essential sterling exchange standard of Australia was forced during the depression to drop off one by one its non-essential golden trappings are of particular interest for our analysis. This process was not completed within the period treated in Book Three, but the final steps may be appropriately described here by two further quotations from Dr. Copland. On December 3, 1931 the Commonwealth Bank took over completely the control of the Australian exchange. Concerning the position then arrived at, Dr. Copland wrote in 1933 (*op. cit.*, p. 111):

". . . Australia for the past two years has been operating a well-regulated sterling exchange standard with local currency at 20% depreciation on sterling. In normal times the operation of this standard requires

(i) That the Commonwealth Bank buys and sells exchange at fixed rates within prescribed limits.

(ii) That the Bank holds a sufficient reserve of gold or foreign liquid assets to enable it to sell exchange freely, pending short period adjustments in the balance of payments.

(iii) That the Bank controls the currency and has the right to issue notes against sterling balances.

(iv) That the Bank has sufficient power and authority to modify internal banking policy to maintain the exchange parity agreed upon.

The Commonwealth Bank has been steadily moving towards the exercise of all these powers."

In May 1932 the last tenuous connections between the Australian pound and gold were broken by an amendment to

the Commonwealth Bank Act. Dr. Copland describes the nature and effects of this Amendment as follows (*ibid.*, pp. 85–6):

"It was provided that the legal reserve could be held in 'English sterling' or in gold. English sterling was defined to include bills at the Bank of England, bills of exchange that will mature in not more than three months payable in United Kingdom currency, and treasury bills of the United Kingdom that will mature in not more than three months. The fiction of convertibility of the note into gold was deleted and nothing substituted for it. The Bank was empowered to transfer its gold reserves to sterling reserves, and any profit accruing on this transaction was to be transferred to a special reserve and to be available 'from time to time as the board determines for the purpose of stabilising exchange or for the purposes of the Note Issue Department.' This legislation is very important in that it implies that sterling and not gold is the legal basis of Australian currency, but it does not fix any special rate at which the Australian note shall be convertible into sterling. Indeed it does not specify that the Australian note shall be convertible into anything at all. The Bank board has thus very wide powers of control over the currency, and is probably more independent in this respect than the Bank of England. In England the Gold Standard (Amendment) Act 1931 relieved the Bank of England for two years from September 18th, 1931, of the obligation to sell gold bullion for notes. In the case of Australia there is nothing in the present legislation requiring the Bank to pay out gold or sterling or any other currency in exchange for notes. The Bank is free to manage the currency according to its discretion for the time being, though the Government may at any time amend the Act, limiting the discretion of the Bank."

Argentina and Uruguay

ARGENTINA

The Argentine economy from 1929 to 1931 was subject to the same fundamental pressures as the Australian, and the Argentine exchange followed a course very similar to that of the Australian pound as quoted in the outside or 'black' market. Like Australia, Argentina was in striking degree dependent

for her prosperity upon the yield of her principal export products—in her case wheat, wool, meat, and linseed. Like Australia she had heavy fixed charges to meet in London, and in less degree, in New York. When the prices of her chief export products began to fall late in 1928, while at the same time the inward flow of foreign capital began to slacken,[31] the Argentine peso came under pressure. In the face of a falling demand in 1929 an unprecedented stock of Argentine wheat accumulated in Liverpool, and in the last quarter of that year both wheat and wool were shipped from Argentina unsold. At the same time payments had to be made for a very large volume of imports bought during the last nine months of 1929.[32] The pressure on the peso, therefore, became increasingly severe, and on December 17, 1929, by a decree closing the Caja de Conversion, Argentina abandoned the shadowy form of gold standard to which she had adhered since August 1927.

It was shown in our account of Argentina's 'return to gold' in Chapter 14 that the meaning of that phrase as applied to her was very equivocal.[33] It will be recalled that not more than one quarter of the gold imported in 1927 and 1928 was purchased by the Caja, the rest being retained by the banks to prevent an undue expansion of the currency. The Caja was not during these years called upon to redeem its notes to provide gold for export, and when, with the weakness of the peso in 1929, gold exports became profitable, notes were not freely presented to the Caja for redemption. During 1929 about 130 million gold pesos in gold were exported to England, the United States, and Germany, but most of them were

[31] In the balance of payments figures of Tornquist capital imports into Argentina from October 1, 1927 to September 30, 1928 were 110 million gold pesos, and from October 1, 1928 to September 30, 1929, only 60 million (H. E. Peters, *The Foreign Debt of the Argentine Republic;* Johns Hopkins Press, 1931, p. 153).

[32] *The Economist,* March 8, 1930, p. 524.

[33] Dr. Peters, indeed, in surveying the entire Argentine currency history, was able to say in 1933 that for the past twenty years Argentina had, practically without interruption, been on a paper standard (*op. cit.*, p. 160).

shipped by the banks from their own holdings. These exports had no deflationary consequences beyond a reduction of the ample reserves of the Banco de la Nacion and an equivalent contraction of bank deposits. There was no need for banks in general to replenish reserves from the circulation, and no multiple contraction of credit, for the deposits of the Banco de la Nacion were not the reserves of other banks. Toward the end of 1929 some notes were presented to the Caja in order to obtain gold for export, but two measures were taken to prevent the deflationary results, which, according to the legal theory of the Argentine gold standard system, should have followed such withdrawals. First, acting in accordance with its traditional policy, the Banco de la Nacion deposited gold with the Caja in exchange for notes,[34] the net result being the same internally as if the gold taken from the Caja had been exported by the Banco de la Nacion in the first place. Second, in accordance with legislation passed at the outbreak of the war [35] but never previously used, the government authorized the Banco de la Nacion to effect rediscounts at the Caja up to a sum not exceeding 200 million paper pesos. This power was not immediately used, nor was it needed to soften internal pressures resulting from a vigorous defense of the gold standard, for no such defense was made. As soon as it became evident that the banks could no longer furnish adequate amounts of gold to support the exchanges, and that further withdrawals would have to be made from the Caja, the Caja was closed. At the first moment when it began to assume reality in Argentine affairs the gold standard was abandoned.

The motives that led to this suspension of the gold stand-

[34] *The Economist* (Nov. 9, 1930, p. 870) mentions such a deposit of 10 million pesos in gold.

[35] Laws promulgated in August and October 1914 provided that the Caja might, subject to government authorization, issue and deliver to the Banco de la Nacion notes in exchange for commercial paper, provided the gold cover for the fiduciary issue did not fall below 40 per cent (*ibid.,* Dec. 21, 1929, p. 1188).

ard without any attempt to defend it are not to be found in any theoretical views as to the advantages of currency depreciation for a country in the position of Argentina such as those which later guided Australia in planning her middle of the road policy. Nor was this action prompted by a deficiency in gold reserves as a proportion of notes and deposits. The mathematical adequacy of Argentine reserves, indeed, was a continual theme of commentators and correspondents in *The Economist* at this time.[36] The unwillingness to defend the gold standard is rather to be explained by the large amount of government floating debt held by the banks. This could not, in the then state of government finances be contracted. At times during 1930 the government was actually falling into arrears in salaries and routine expenditures. Consequently the bank deposits created by the purchase of government debt, representing one-third of total bank credit outstanding, could not be eliminated from the banking system. Hence a severe contraction in the note circulation, working out its effects through bank reserves, would have produced a concentration of credit restriction upon other borrowers. In the words of Dr. Peters, in this "squeezing process" private borrowers would have been "completely excluded" from access to bank credit.[37] For a reason not altogether creditable, therefore, Argentina did not inaugurate the first year of the world depression by a real effort to deflate her whole economy in defense of the gold standard. Since credit could not be contracted because for fiscal reasons the means of payment remained large, prices did not fall and the exchanges declined.

As shown in Table 69 and Chart 54, this decline was uninterrupted during 1930, except for a brief improvement in the spring, partly seasonal and partly due to special factors.

[36] In the Buenos Aires correspondence published in its issue of March 1, 1930 (p. 452), the closing of the Caja was said to be an act considered "dangerous and retrograde" in Europe and America, taken by a government "ignorant of rudimentary economic axioms."

[37] Peters, *op. cit.*, p. 156.

The fundamental forces at work were declining world prices for agricultural products and changes in the physical volume of Argentina's exportable output. In 1930 the effects of falling prices were aggravated by a partial failure of the wheat crop. Foreign currencies were in poor supply in the market and the peso was chronically weak. The financial results of the harvest were bad, even disastrous, in 1930, and the consequent reduced purchasing power was soon reflected in a falling Argentine expenditure for imports.[88] The proceeds of exports, however, were falling earlier and faster than expenditure for imports and a new exchange equilibrium was not reached. Like Australia Argentina was finding difficulty in paying for imports and providing for the service of her foreign debt. Argentina, however, was not as completely cut off from access to new capital imports as Australia and, in addition, was able, like Australia, to provide a certain amount of remittance in the form of gold.

Direct American investment of capital in Argentine enterprises continued for some time after the onset of the depression.[89] Talk of large new long term loans from abroad was the

[88] Cf. *ibid.*, chart opp. p. 69, in which a rapid decline in the value of imports in 'gold pesos' (i.e., in Argentine currency, not 'in gold') is shown for both 1930 and 1931.

[89] Dr. Peters' comments on the British reaction to these direct American investments are an instructive elaboration of a theme first introduced into these studies in our discussion of the Victory of the Principle that the Proceeds of Foreign Loans should be Spent at Home (Ch. 7). Dr. Peters writes (*op. cit.*, p. 154):

"There was a curious reaction to this importation of United States capital, accompanied as it was by an increased volume of inter-American trade. Investments often took the form of purchasing British enterprises long established in the field; even control of the railways was at one time threatened. At this stage the Briton's patriotism was touched, and with a superb disregard for all the laissez-faire philosophy as to capital movements, industriously inculcated into Argentine minds for more than a century, road after road passed resolutions either disqualifying or limiting the holdings of those neither British nor Argentine. The chief objection to United States ownership, apparently, lay in the fact that supplies, which had previously been uniformly obtained from British sources, would probably be purchased by the new management from American producers."

staple of the market during 1930 and even in 1931, and, though the essential conditions for such loans were lacking, the exchange was often strengthened because these hopes led importers and others to postpone remittance abroad in the expectation of better rates. Short term foreign borrowing, largely associated with the temporary revival of foreign lending in New York in the first half of 1930, was also substantial. The main features of this borrowing were a $50 million government six month loan placed in New York in April, a £5 million six month loan placed in London by Baring Brothers in June, and a $16 million loan placed by the municipality of Buenos Aires in New York about the same time. These short term advances caused serious problems of renewal and repayment, but they raised capital imports for the fiscal year 1929–30 (October-September) to 190 million gold pesos. In the following year the amount fell to only 50 million.[40]

In addition to the support given by new loans in 1930, the peso was strengthened by a series of special gold transactions, some involving the extension of new short term credit in London, which revealed in a striking way the essential conflict between the two horns of the Argentine dilemma—how to support the exchange on the one hand and how to avoid domestic deflation on the other. On December 23 £5 million 5¾ per cent one year Argentine treasury bills were discounted in London. The bills were non-renewable and were repayable at the option of the bankers by shipment of gold specie. The proceeds were held in London and the Banco de la Nacion was authorized to exchange them for gold and deposit this gold with the Caja de Conversion against the issue of an equivalent in paper pesos.[41] There was ample precedent for such a procedure, for in pre-war days South American countries frequently sold treasury bills in London to

[40] *Ibid.*, p. 153.

[41] Bank of London and South America, *Monthly Review*, March 1930, p. 136, cf. *The Economist*, March 1, 1930, p. 452. The exact details of this transaction were not, apparently, clear even to the Bank of London and South America which refers to the "none too clear statements published."

strengthen their reserves temporarily. It amounted to the establishment for the time being of a sort of "conversion fund" in London.[42] In January 1930 a decree was issued authorizing the deposit of gold with the Argentine legations abroad against the issue of notes in Argentina, an arrangement that could be used as a means of financing Argentine trade at a cheaper rate of interest than could be obtained at home.[43]

The gold funds established in these two ways in London could be diverted from their original purposes and used to support the exchange through their release to importers or other remitters to London, including the government, against the payment of the equivalent in Argentine notes to the Caja. In the case of gold acquired by the discount of treasury bills this was, of course, subject to the lenders' not exercising too powerful a lien against the actual gold. Such methods of supporting the exchange were the same in their effects in Argentina as if the Caja were opened, except that the amount, timing, and purposes of the gold shipments were subject to government control.

The official closure of the Caja on December 16, 1929 had

[42] The Buenos Aires correspondent of *The Economist*, in describing the discount of these treasury bills, said that the Banco de la Nacion looked upon them as "gold on deposit with the Conversion Office against which it [might] withdraw paper to an approximate amount of 60 million paper pesos (the first installment of an authorized extraction of $200 million)." *Ibid.*

[43] Immediate use of this facility seems to have been made, for the statements of the Caja as of January 30, 1930 show an increase in the paper note issue of 27 million paper pesos against gold brought to the London and Washington legations (Bank of London and South America, *op. cit.*, March 1930, p. 136). Also the Buenos Aires correspondent of *The Economist* in a letter dated June 7, 1930 said: "Possibly owing to the difference between rates ruling here and those prevailing in Europe and in the United States, a certain amount of business is being financed outside this country and the fact that during May £300,000 was deposited to the order of the Argentine Embassy in London the equivalent, some $3,500,000 Argentine paper, being taken from the Conversion office here—seems to bear out this conclusion." *The Economist,* June 28, 1930, p. 1448.

been followed by a sharp and semi-speculative decline in the peso. The seasonal improvement in the spring of 1930 was very slight because of the partial failure of the wheat crop. Gold was therefore released from the legations. As early as May 6, 1930 the Buenos Aires correspondent of *The Economist* spoke of "a growing stringency" in the Argentine money market "due to the fact that gold deposited in the Argentine Legations abroad is being released by payments of the equivalent in paper currency to the Conversion Office—a course which ipso facto removes that amount of currency from circulation." [44] Notwithstanding the new loans and this release of gold, the exchange was weak during the summer. In July, when shipments of the small available supplies of maize and wheat were held up by unseasonable weather, the peso fell sharply, but improving prospects for the next harvest, together with news of damage to the American crop and hopes of still further loans, strengthened it in August.

At this juncture the course of events was interrupted by a political revolution in Argentina that drove President Irigoyen from power. A Provisional Government came into office under General Uriburu and at once embarked upon fiscal reforms and a program of balancing the budget. The American loan falling due on October 1 was successfully renewed and the political overturn served to strengthen rather than weaken the exchange. The financial reforms, however, did not result in deflationary credit contraction. An internal loan offered by the new government was unsuccessful. Only one-fourth was actually sold and the bulk had to be floated by credit extended by the Banco de la Nacion.[45] Thus Argentina arrived, against her will, at a practical counterpart of the inflationary side of the Australian middle of the road policy. The financing of planned government deficits in Australia by direct advances from the Commonwealth Bank was not,

[44] June 14, 1930, p. 1332.

[45] Peters, *op. cit.*, pp. 157–8.

in its practical results, very different from the financing of unplanned deficits in Argentina by the purchase of unsalable government bonds by the Banco de la Nacion.

The September improvement in the exchange did not endure. The peso was weak in October, largely owing to upheavals in Brazil. In November anxiety over the condition of the crops, extraordinarily low prices for grain, and a poor wool market combined to drive it still lower. Prospects for the renewal of short term foreign loans soon to fall due were not bright. Consequently, the policy of gold shipments was carried still further. The Banco de la Nacion was authorized, upon payment of an equivalent sum to the Caja, to export gold from Argentina to meet the service of her foreign debt and gold began to move out for this purpose at the end of October.[46] In addition, in January 1931 an arrangement was put into effect whereby the Banco de la Nacion could replenish its "conversion fund" abroad by drawing on gold in the Caja, as that fund was utilized to support the exchange. This arrangement was described by *The Economist* (June 17, 1930, p. 108):

"On Wednesday (January 14, 1931) it was announced that the Banco de la Nacion has been authorized to issue drafts against its conversion fund of 30,000,000 gold pesos now deposited abroad in its name, and to obtain in exchange for these drafts gold from the conversion office which it can retain or ship abroad as may be required by the state of the foreign exchange market. This is equivalent to the creation of a revolving credit in specie, up to the limit of 30,000,000 gold pesos; in other words it provides a

[46] It was said at the time of the placing of the $50 million loan in New York and the £5 million loan in London that the bankers had obtained practically a direct claim on Argentine gold reserves (*ibid.*, p. 157). Concerning their repayment and refunding in 1931, Dr. Peters writes: "In 1931 both bankers refused renewals and the government was not able to raise the money in the Buenos Aires banks. A compromise was effected in both cases; half of each loan was renewed, and the other half paid partly in gold and partly by subscription from the banks and trust companies of Argentina. At each recurring maturity a part has been repaid and a part refunded." *Ibid.*, pp. 158-9.

means whereby that amount of gold held by the conversion office can be set free to support the exchange in case of need."

These devices, plus the use of gold in the legations abroad, were the Argentine equivalent of the centralization of control over gold exports and the pooling of exchange reserves in London by Australia.

In spite of this support the peso continued to fall until February 1931. The harvest passed into the hands of exporters at very low prices. The depreciation of the exchange and the financing of the government by the banks were beginning to be reflected in increasing deposits, and money was exceptionally easy in Argentina until the time came for the actual export of the major crops. These were exceptionally heavy, and alarm began to be expressed concerning the financing of their movement in the face of a continued contraction of the circulation in order to provide gold for export.

In Table 70 the changes in notes in circulation and bank deposits in Argentina, the course of Argentine prices, and the changes in the amount and value of Argentine export trade from 1928 to 1931, presented by Dr. Peters in various parts of the final chapter in his monograph, are brought together. Annual average exchange rates of the peso on New York expressed as a percentage of par have been added. These form essential parts of the powerful argument developed by him to show that Argentina had reason to be grateful for her currency system of peculiar and antiquated pattern and even to the deficiencies of her government in the conduct of the public finances during the early years of the depression. Her exports were maintained at a high level. Even the sharp contraction, due to the partial failure of the wheat harvest of 1930, left the exports for that year as high as the 1920–26 average, and the 1931 exports were practically equal to the record volume of 1927. By exchange depreciation the fall in the proceeds of these exports in Argentine pesos was prevented from being so disastrous as to break down the entire

financial system of the country.[47] The export industry by no means escaped heavy burdens and loss of income during these years, but the decline in the proceeds of exports in 1930 was only in proportion to the decline in the physical volume, and the large loss in income was mainly due to natural causes. With a much larger output in 1931 the realized exchange depreciation was, in contrast, far from offsetting the effects of the decline in world prices, and the financial yield of the large crop was but little better than that of the smaller one. Still a portion of the burdens that would have fallen upon

TABLE 70

Selected Argentine Financial and Trade Statistics, 1928-1931

	1928	*1929*	*1930*	*1931*
Argentine means of payment [1] (millions of paper pesos)				
Money in hands of public	530.4	782.8	773.0	736.2
Deposits in current account	1,317.6	1,188.6	1,176.0	951.6
Wholesale prices [2] (1926 = 100)				
Argentina	98.5	96.4	92.2	89.0
United States	96.7	95.3	86.4	73.0
Argentine exports [3]				
Thousands of tons	17,029	16,703	11,027	18,477
Millions of Argentine gold pesos	1,055	954	614	641
Millions of U.S. dollars	1,017	908	514	427
Argentine [4] exchange on New York as percentage of par		98.587	86.534	69.153

[1] H. E. Peters, *The Foreign Debt of the Argentine Republic*, p. 173.
[2] *Ibid.*, p. 164. [3] *Ibid.*, p. 152.
[4] Calculated from Table 69, completed for last quarter of 1931 as follows: Sept. 61.873; Oct. 53.894; Nov. 60.987; Dec. 60.655.

the exporters had the exchange been stronger was distributed among other groups. Imports were heavily reduced and the burden of external indebtedness increased, but the example of Australia in forcing a reduction of interest and wage income was not followed. In spite of low prices for exports, especially in 1931, the general price level in Argentina was,

[47] In harmony with Dr. Copland's view concerning Australia, Dr. Peters reached the conclusion that this would have been the inevitable result of the maintenance of exchange parity by Argentina (Peters, *op. cit.*, p. 163).

as compared to other countries, kept relatively stable. Inflation did not depreciate the peso in terms of goods, nor did 'parity with gold' undermine the basis of the country's internal economic balance. Argentina escaped the terrors of the 'money doctors,' maintained her credit and, by muddling through, achieved her own middle of the road internal economic policy.

When Great Britain abandoned the gold standard in September 1931, this chapter in Argentine economic and currency history was ended. After a sharp relapse in October the peso was brought under rigorous exchange control by which it was pegged to the American dollar at a discount of about 40 per cent.

URUGUAY

As shown in Table 69 and Chart 54, the course of the Uruguayan exchange was in its general direction, and even in the details of its fluctuations, closely associated with the behavior of the Argentine peso. The rate first declined substantially below parity in March 1929 under the combined influence of a seasonal decline in exports and of the fall in prices, especially of wool, hides, and cereals. No measures were taken to stem the depreciation, such as the support given the Argentine peso by gold exports. In July the exchange rose, owing to speculative factors, but during the export season it did not show any strength. In December, when the general downward movement had been in progress about nine months, the formal act of abandoning the gold standard was accomplished in harmony with the action of Argentina.[48] From this time on until the summer of 1931, the fluctuations in the Uruguayan exchange were, with few exceptions, those of the Argentine peso. This was not wholly due to similar economic conditions in the two countries, for in Uruguay the force of the depression was mitigated by the greater rela-

[48] Department of Overseas Trade (United Kingdom), *Economic Conditions in Uruguay, 1930;* and League of Nations, Gold Delegation, *Final Report,* p. 9.

tive importance in her economy of cattle raising.[49] A relation somewhat similar to that prevailing between Australia and New Zealand existed between the two countries in 1930 and the spring of 1931.[50] However, both currencies rose sharply in March 1930, when *Uruguay* received a $17 million loan in New York. In the early summer of 1931, when the Argentine peso was once more being supported by gold exports, the Uruguayan exchange continued to fall. In July 1931 it stood at a discount of 48 per cent in New York as compared to a discount of the Argentine peso of 28 per cent. Thereafter the common movement was resumed, both currencies reaching their lowest level in October 1931. When the Argentine peso was finally stabilized at a discount of about 40 per cent in New York, it was soon joined by the Uruguayan peso at a discount of about 54 per cent.[51]

Brazil

The Brazilian milreis suffered a series of shocks far more severe and sudden than those experienced by either of these

[49] Cf. Table 66, showing the relative decline of the world price of wool (40 per cent), wheat (22 per cent), and frozen meat (9 per cent) in 1930. In 1930 the cattle raising industry in Uruguay was in a "flourishing state" (*The Economist,* Dec. 20, 1930, p. 1166).

[50] In his address at the annual meeting of the Bank of London and South America on Dec. 16, 1930, Beaumont Pease said: "Uruguayan exchange rates have had a tendency of late years to follow the trend of those of her neighbor Argentina, even when economic factors hardly seem to justify the movement" (*ibid.,* p. 1186).

[51] Meanwhile, the Paraguayan peso had moved with the Argentine peso, being really part of the Argentine currency system. In the June to December 1930 issues of the Bank of London and South America *Monthly Review* the following note concerning the Paraguayan currency appears:

"Transactions with foreign countries are usually made on the basis of the 'peso oro' (Argentine gold dollar), or in the currency of the country with which the transaction is made. There are no official exchange quotations for foreign currencies in Asuncion but the rates are received daily by telegraph from Buenos Aires, and bills are liquidated on the basis of these rates and are payable in Argentine paper or Paraguayan paper at the rates of $1 Argentine paper to $0.44 Argentine gold and $42.61 Paraguayan paper to the $1.00 gold."

currencies from 1929 to 1931, owing to the extreme dependence of the Brazilian economy upon a single commodity and to the greater degree of political instability in the country. In October 1929, at the time of the crash in the New York Stock Exchange, the whole Brazilian economy was thrown into a severe crisis by the collapse of the Coffee Defense System. In the face of three successive large crops the Coffee Defense Institute of the State of Sao Paulo had succeeded in maintaining the price of coffee at artificially high levels, but only at the cost of accumulating very large stocks. When the break came prices were cut in half. To meet this crisis a £2 million seven month credit was obtained from London bankers long associated with Brazilian underwriting, and the Banco do Brasil, acting under instructions from the President of the Republic, pursued an active policy of making advances to growers and holders of coffee and of discounting freely for the banks.[52] The amount of coffee permitted by the control to enter Santos was increased and exports rose sharply. The fall in price, however, was so rapid that their value declined and the milreis began to depreciate.

At this moment of crisis it became evident that the connection between the Brazilian currency and the international gold standard established by the de facto stabilization at the end of 1926 was even more purely ornamental and lacking in substance than that of Argentina. The 1926 stabilization had provided Brazil with three forms of note circulation, existing, in the words of the Annual Report of the Banco do Brasil for 1930 "within watertight compartments"—the issues of the Treasury, the Caixa do Estabilizaçao, and the Banco do Brasil. The Caixa, or Stabilization Office, issued notes against gold and was intended to give gold in exchange for notes upon the model of the Argentine Caja. During 1927–28 Brazil had been an importer of gold, largely as a result of foreign borrowing. The exchange had been easily supported

[52] Banco do Brasil, Annual Report for 1929 (*Federal Reserve Bulletin,* July 1930, p. 443).

during these years and for the first three quarters of 1929 by the intervention of the Banco do Brasil in the market, and gold was at no time withdrawn from the Stabilization Office. Consequently in October 1929 the Caixa and the Banco do Brasil were in a strong position to defend the gold standard had they so desired. The gold held by the two agencies was about £30 million sterling and the foreign exchange of the Banco do Brasil was about £6.5 million sterling.[53] Yet no such defense was at first attempted. The Rio de Janeiro correspondent of *The Economist* indeed stated that official intimations had been given that withdrawal of gold from the Caixa would be considered unpatriotic and pointed out that access to this gold had been rendered difficult because a very large proportion of the outstanding gold notes of the Caixa had been accumulated by the Banco do Brasil.[54] No gold was exported in the last months of 1929, and the Banco do Brasil even ceased its own intervention in the market in November and December. At the close of the year the milreis stood at a 5 per cent discount.

In January 1930 this policy of preserving gold and foreign exchange reserves for the sake of appearances, and to give an outward show of strength to Brazilian finance, was abandoned because of the increasing weakness of the exchange. The Banco do Brasil began to ship gold to New York and, encouraged by this example, other banks followed suit. These shipments were substantial enough to restore the milreis almost to parity in April and May. The milreis was further strengthened, and the internal financial position improved by the placing in May of a large Coffee Realization Loan in New York, London, and on the continent by the State of Sao Paulo. This loan was amply secured and bore a high return. Its repayment was to be effected by shipments spread over

[53] The *Federal Reserve Bulletin* for December 1929 gave the figure as $150 million of gold held by the two agencies in October, while the item 'Correspondents Abroad' of the Banco do Brasil was 326 million milreis.
[54] *The Economist*, Feb. 15, 1930, p. 355.

ten years of the coffee stocks held by the control authorities. In spite of these attractions and although it was in part a refunding of the short term advances previously made by the issuing bankers according to the established British tradition, the loan was placed with difficulty and the London share of £8 million was largely left with the underwriters. It was one of the very few issues that was able to break through the unofficial embargo on foreign loans at that time very rigidly in force in London.

The proceeds of this loan, when they became available, proved wholly inadequate to prevent further declines in the milreis. Following the presidential elections of March 1930 political unrest in Brazil had become acute. The government was pursuing, on the whole, an inflationary policy, going heavily into debt to the Banco do Brasil. From May through July gold shipments were practically suspended, and though they were resumed under the urgent necessity of meeting foreign obligations in August and September, the milreis experienced a second and greater depreciation. On October 3 actual revolution broke out in several important States, and official quotations for the milreis, which then stood at about a 15 per cent discount, were suspended for nearly two months. During the revolution, on October 11, the government took over the liability of the Banco do Brasil for its own note issue and its redemption and conversion funds, together with a portion of the Bank's gold reserves.[55] In return the government received cancellation of its debt to the Bank and a deposit credit which was at once utilized to meet its urgent needs.

When, on October 24, the revolutionary party was successful in the capital and a new regime under President Vargas came into power, Brazil had practically completed a transition to what was in effect, if not in form, a single government note issue and a pure paper standard. Very large shipments

[55] It was entitled to do so under agreements entered into in 1923; Banco do Brasil, Annual Report for 1930.

of gold had been made during the revolution itself, and these shipments were continued under the new government until the gold reserves of the Caixa and the Banco do Brasil were exhausted. At the same time the foreign exchange holdings of the Banco do Brasil fell from the equivalent of 36 million American dollars to under 5 million. In spite of the use of gold and foreign exchange reserves the milreis continued to depreciate as soon at quotations were resumed, and it was abundantly clear at the close of 1930 that a thoroughgoing reform for Brazilian finance was necessary. In this emergency the Brazilian government invited Sir Otto Niemeyer, just returned from Australia, to come to Brazil in his familiar role of money doctor.[56]

The first official notice of the results of his mission was given in July 1931, when it was announced that plans for administrative reforms in the handling of government funds had been submitted to the President. Further proposals for a new central bank were foreshadowed. Shortly thereafter Sir Otto's Report was published. In it he applied to Brazil all the major principles of post-war currency stabilization—

[56] The course of events as described in the text may be read on the face of the figures of the Brazilian note circulation as given in Sir Otto Niemeyer's *Report to the Brazilian Government,* July 1931, Annex IX. For selected months during 1927–31 they were:

	NOTES						
	Treasury	Bank of Brazil	Stabilization Office	Bank of Brazil holdings	Active circulation	GOLD £000,000	BANK OF BRAZIL DISCOUNTS & ADVANCES (thousands of contos)
	(thousands of contos)						
1927							
March	1,977	592		176	2,393	10.0	941
June	1,977	592	10	276	2,303	10.2	1,077
Dec.	1,977	592	436	270	2,735	20.7	984
1929							
March	1,952	592	851	678	2,707	30.9	1,074
Sept.	1,952	592	857	709	2,691	31.1	1,240
Dec.	1,951	592	848	690	2,702	30.9	1,395
1930							
March	1,951	592	651	643	2,551	26.0	1,368
Aug.	1,951	592	168	415	2,296	14.1	1,345
Sept.	1,951	592	132	338	2,338	13.3	1,376
Nov.	2,543	170	129	265	2,577	4.1	1,255
Dec.	2,543	170	129	323	2,519		1,262
1931							
May	2,543	170	129	394	2,448		1,526

balancing the budget, settlement of past debts, an independent central bank, stabilization of the currency, and the attraction of foreign capital. To these were added a recommendation that the federal government should exercise control over the foreign borrowings of the states and municipalities, a step analagous to the establishment of the Loan Council in Australia, and recommendations against further government responsibility for coffee control and in favor of a greater diversification of Brazilian production. But, in addressing this advice to a country with an exchange standing at a discount of about 37 per cent in New York and London,[57] he did not repeat his admonitions to the Australian authorities against all depreciation of the exchange, but advocated the choice of a new rate of stabilization near the current market rates.

Conditions in the world's central money markets were extremely adverse for the attraction of foreign resources to replenish the foreign exchange reserves of the Banco do Brasil or of a new central bank, and the path of internal monetary reform was far from smooth. While the preliminary steps in the new program were being taken the milreis continued its decline. In September 1931 it stood at a discount of over 50 per cent in New York, but after a preliminary stabilization from October 1931 to March 1932 at a discount of 48 per cent, it joined the group of dollar countries in the summer of 1932 at approximately the discount prevailing at the time of the Niemeyer Report.

Other Depreciated Currencies

Of the other South American countries that had previously returned to the gold standard Venezuela alone experienced a depreciating exchange in 1930 and the first part of 1931. The Venezuelan exchange is therefore included in Table 69 and Chart 54. Exchange depreciation occurred later and was

[57] The milreis improved rather sharply in June 1931; cf. Table 69.

more moderate than in Argentina and Brazil largely because Venezuela's chief export product, petroleum, was among the world commodities that declined least in price in 1930 (Table 66). Exchange depreciation began in the summer of 1930 and gold exports were prohibited. The three principal reasons for the fall in the exchange were the decline in the price of coffee, the curtailment of oil production with a consequent loss of revenue to the government in taxes levied on foreign companies, and the decrease in the number of foreign employees in the oil fields. These all cut down the demand for Venezuelan exchange, but at the same time imports were not greatly reduced. Toward the end of 1931 an acute shortage of foreign bills was experienced, and the banks entered into an agreement to peg the exchange and to ration the supply of foreign currencies that came into the market.[58]

The Peruvian pound and the Spanish peseta were also

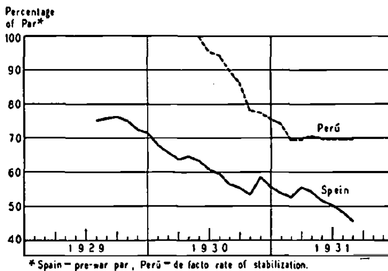


CHART 55
Exchange Rates of Spain and Peru on New York, 1929–September 1931
Monthly Averages as Percentages of Par

depreciating during this period. Because Peru and Spain were members of the small group of countries still struggling to return to gold in 1929, their position in the gold standard system will be briefly touched upon later, but in order to complete the picture of the breaches in the international gold standard as a system of exchange rates during the last years of the Experimentation period, these exchanges have been included in Table 69 and are presented separately in Chart 55.

[58] Department of Overseas Trade (United Kingdom), *Economic Conditions in Venezuela,* Aug. 1932, pp. 11, 12.

The International Shifting of Economic Burdens

With the possible exception of Spain, the depreciation of the exchanges of these various countries had the effect of shifting economic burdens from certain groups of dominant importance in the life of the community and subject in exceptional degree to the pressure of falling prices to other groups.[59] As a whole these currency depreciations involved also an international shifting of economic burdens. The fundamental cause of the great decline in raw material prices was a lack of economic balance on a world scale. Relative to demand there was over-production of many staples sold in world markets. The economic remedy was a restriction of supply on a world scale pending the growth of effective demand adequate to absorb the total world output at remunerative prices. Currency depreciation, by relieving the export industry of certain countries from the worst pressures of falling prices, retarded the pace of reduction in output in those countries. It has been noted in the case of Australia, Argentina, and Brazil that export *volume* increased with currency depreciation. Therefore the pressure for reductions in the supply of similar products grown in other countries was doubly severe. The power of raw material producers in these competing countries to purchase the products of industry was reduced further than it would otherwise have been because a disproportionate part of the total burden of the world deflation in raw material industry was shifted to them by exchange depreciation elsewhere. The pressure in these countries for production control and government aid to farmers by government purchase and storage was to that extent increased, while in countries with large agricultural production, but not normally exporters on a large scale, pressure for high agricultural production became intense. In addition, the internal shifting of burdens in the countries with depreciated ex-

[59] The exceptionally careful analysis of this process in Australia by Dr. Copland is a model that can, *mutatis mutandi,* be applied to all.

changes was reflected in a reduction of their imports, which imposed an additional loss of markets upon the industrial producers of the world, and finally the position of the investors and savers in the creditor countries was endangered by the burdens placed by exchange depreciation upon their debtors. Exchange depreciation by periphery countries therefore served to diffuse the real losses of the depression internationally as well as internally. The 'sea of economic forces' was compelling the world to seek a new economic balance. For the world as a whole there was no escape from the losses incident to structural maladjustment growing out of war and to the carrying forward of unsolved economic problems by inflationary finance. The difficulties of the raw material producers would in any event have had severe repercussions throughout the world economy. Exchange depreciation at the periphery simply effected a somewhat different international distribution of these losses.

In the single centered pre-war international gold standard system the beginnings of serious disturbance in the underlying balance of the world's exchanges of goods and services were reflected in the credit worthiness of prospective borrowers in London. Unwise and reckless lending was often partly responsible for the changed situation, and recognition of the change was doubtless often unduly delayed. But when the situation became clear, the direction and amount of the international flow of credit was altered, and in the main, 'gold standard adjustments' were forced upon debtor countries before their economic difficulties had become so acute as to endanger the basis of their economic life. There was truth in the saying that before the war gold standard adjustments took place in debtor countries and were enforced by the dominant influence of British finance. Only in exceptional cases, when they were extremely severe, were they shifted in part to other countries by temporary abandonment of the gold standard and exchange depreciation.

Our entire analysis of the post-war experiment of attempting to operate an international gold standard with a decen-

tralized financial system in an unbalanced world economy supplies the reasons why the temptation to embrace this avenue of escape was present in an unprecedented number of countries simultaneously, and with unprecedented strength, in the early years of the depression. Yet in the very nature of the case it could not, either before the war or after, be a remedy open to all countries. It was clearly not appropriate to countries dependent largely upon imports for the conduct of their essential industries, and, as already stated, for any single periphery country its success depended upon the continued existence of a large group of stable exchange rate countries. Since it was essentially a device for *shifting* rather than for *avoiding* losses it could not be of universal application.

Signs of Strain Elsewhere

The list of severely depreciated exchanges in 1929, 1930, and the first part of 1931 is short, but the international gold standard facade was subject to serious stress in many other countries. In some, traditional practices long associated with gold standard orthodoxy were abandoned, in others the orthodox defenses in time of crisis were used with success, and in still others the gold standard was defended along lines made familiar during the war. Without attempting to differentiate abstractly between them according to the form of their adherence to the gold standard, the signs of strain observable in a few of the more important of these countries will be briefly mentioned. In conjunction with the preceding comments on countries that frankly abandoned the gold standard, this will establish, by illustration, the full scope of the meaning we have assigned to the phrase, the Disintegration of the Gold Standard System at the Periphery.

Canada

The foreign exchange problems of Canada during the early years of the depression were fundamentally different from those of all other raw material producing debtor countries

because of her continued access to American capital markets. Until the summer of 1931 Canada's ability to borrow abroad provided support to her exchange and rendered the task of maintaining the gold standard relatively easy. Yet after January 1929 Canada was not in any true sense a gold standard country, partly because of certain features of her intricate relationship to American finance and partly because of the particular set of monetary and banking arrangements prevailing when she returned to gold.

At the outbreak of the World War Canada left the gold standard and provided herself with the means of internal credit expansion under the terms of the Finance Act of 1914. This Act provided that the government might, by proclamation, suspend the redemption of Dominion notes in gold and might advance Dominion notes to the banks upon pledge of satisfactory collateral. For the first time Canadian banks were put in a position where they could increase their cash reserves from internal sources other than Canada's own production of gold. The Finance Act of 1923 provided that after three years the right of the Minister of Finance to refuse redemption of Dominion notes in gold was to lapse, and by the expiration of this right by limitation on July 1, 1926 Canada returned to the gold standard. The Finance Act of 1923 also made the right of the Department of Finance to issue notes to the banks permanent and further defined the type of security they might pledge.[60]

Canada, therefore, returned to the gold standard with two types of note issue, indistinguishable in form but very different in nature. A part of the Dominion note issue was governed by the pre-war regulations and, except for a certain fiduciary element, the Department of Finance was required to hold a 100 per cent gold reserve against it. Another part was issued to the banks through the pledge of securities known in Canadian parlance as 'rediscounting.' Against such

[60] C. A. Curtis, 'The Canadian Monetary Situation,' *Journal of Political Economy,* June 1932, Vol. 40, p. 318. This section draws heavily on this source.

notes no gold reserve had to be held. All Dominion notes, however issued, were redeemable in gold at the Department of Finance, and in addition the notes obtained through rediscounting could be retired through the repayment by the banks of the advances made to them; that is, the notes could be presented and the pledged security released. For these advances a rate of interest was charged by the Department of Finance but no attempt was made to use this rate as an instrument of credit control.[61]

In 1928, owing chiefly to the higher level of interest rates in the United States and the large movement of Canadian funds to America to share in the speculative boom, Canadian gold exports substantially exceeded new gold production in the Dominion.[62] This unusual gold drain which persisted, subject to seasonal variations, throughout the year, was heavily reinforced by an unusually large seasonal loss at the very end of 1928 and during January 1929. Under Canada's new monetary system this gold export had two consequences which would not have been possible before the war. First, there was no contraction of the credit base. The exported gold was, it is true, obtained by the withdrawal of notes from the cash reserves of the banks and their presentation for redemption at the Department of Finance, but the banks at once made good the contraction of their own reserves by obtaining new notes from the Department by rediscounts. The banks even added to their reserves by this method sufficiently to provide the basis for an expansion in the credit superstructure to finance Canadian participation in the speculative boom. Second, by reducing the gold holdings of the Department of Finance to about one-half of their 1926 level, the gold exports resulted in an actual deficit in the legally required Department gold reserves of the order

[61] *Ibid.*, p. 326.

[62] *Federal Reserve Bulletin*, Jan. 1930, p. 4. It is pointed out that Canadian exports of gold were usually larger than her imports by an amount approximating Canada's own output of about $40 million.

of $25 million.[63] No matter how large the gold export, such a result would not have been possible under the pre-war system. As Professor Curtis says, the Dominion note was then practically a gold certificate.[64]

Faced with this situation the Department of Finance, without any legal steps having been taken, quietly suspended the redeemability of the Dominion note in gold, and with the cooperation of the banks, this became an effective form of gold export embargo. Gold exports ceased in January 1929.

During the first three quarters of 1929 Canada experienced a continued drain of funds to New York, and in addition was suffering the economic effects of falling wheat prices. The harvest was light and passed in large part into the hands of various wheat pools and other strong holders who withheld considerable portions of it from export in the hope of higher prices. For 1929 Canada had, as a result, an excess of merchandise imports of $91 million as compared with a merchandise export surplus of $152 million in 1928. Deprived of the support of gold exports the Canadian exchange, which throughout 1928 had remained at or within the gold points, went below gold export point to New York. In February the Canadian dollar was weak, New York funds moving from about ¼ to ½ per cent premium, and from March to June the premium was just under 1 per cent. There was some improvement in July, but the essential weakness of the Canadian dollar prevented the usual seasonal inflow of gold in the autumn. With the culmination of the American boom the premium on New York funds reached a level of just over 1 per cent. Immediately after the New York Stock Exchange crash Canada withdrew funds employed in the New York

[63] For a calculation of this deficit as of November 30, 1929 cf. *The Economist*, Jan. 18, 1930, p. 116. Since a gold export embargo prevailed throughout 1929, this probably represents approximately the position at the beginning of the year.

[64] *Op. cit.*, p. 315. Some of the notes issued through rediscounts must have been redeemed in gold.

market on a large scale, as evidenced by a decline in the 'call loans abroad' of the Canadian banks. This did not, however, at once strengthen the Canadian exchange, for there was an offsetting and stronger movement of funds the other way because of the liquidation of American owned securities by holders who had Wall Street obligations to meet. This was compressed into a very short period—late October and early November. At this time the dollar was very strong, the New York premium reaching 3 per cent on October 30. By the end of the year it had again fallen to 1 per cent, and by late spring 1930 the premium had disappeared.[65] Though the merchandise balance of trade continued to be heavily adverse, the Canadian exchange was still supported by substantial capital imports from the United States. A normal seasonal inflow of gold took place in the summer which, in conjunction with a substantial repayment of rediscounts by the banks, made good the deficit in the legal gold reserves of the Department of Finance.[66] Canada seemed to have returned to the gold standard after a temporary deviation from it.[67]

It was not a temporary deviation, however, for in January 1931, and again from June to September, the Canadian exchange stood at a discount, which, while moderate, was still sufficient to have called forth gold exports had the gold export embargo not continued in practical effect. In the summer and autumn of 1931, with the development of the crisis in Europe and the general deepening of the depression, Canada began to have difficulty in borrowing in New York,

[65] The figures in the text are taken from the daily quotations published in *The Gazette*, Montreal.

[66] In other words the process by which this deficit was created was exactly reversed; cf. Curtis, *op. cit.*, charts, pp. 323, 325.

[67] Cf. B. H. Beckhart, 'Canada's Experience with the Temporary Suspension of the Gold Standard,' *The Annalist*, April 25, 1930, p. 907. Professor Curtis points to this article and to the fact that *The Statist* on October 5, 1929 removed Canada from its gold exchange index to show that Canada's abandonment of the gold standard was recognized outside the country, although her adherence to it was stoutly affirmed in Canada. *Op. cit.*, p. 321.

and American funds employed and invested in Canada began to be withdrawn. The great importance of these capital items in the Canadian balance of payments was strongly emphasized at this time, for the exchange continued to be weak in spite of a substantial reduction in the merchandise import surplus which fell from $103 million in 1930 to $13 million in 1931. When England abandoned the gold standard in September 1931, Canada's borrowing in New York was made even more difficult and funds were withdrawn from Canada on a larger scale. These capital movements became an all important influence upon the exchange. For the first time the Canadian dollar went to a discount of really substantial proportions in New York. The pretense of adherence to the gold standard had to be frankly abandoned, and an official embargo on gold exports was proclaimed on October 19, 1931.

Canada's experience affords an excellent example of the influence of institutional arrangements upon the outward aspect of the gold standard. Had Canada been possessed of a highly flexible central banking system capable of 'economizing gold' and conducting offsetting discount and open market operations, she could undoubtedly have avoided recourse to a gold export embargo. Gold could have been exported in sufficient amounts to correct the small discount in the rate that prevailed from time to time between January 1929 and September 1931 without imposing credit contraction upon the Canadian banks. It would have been possible to say that the gold standard in Canada had been preserved "in its full integrity" (cf. Ch. 2, note 1). Yet this would not have been due, any more than was actually the case, to the setting in motion of corrective forces. The amenities would have been more perfectly preserved, but the economic policy of Canada, her position in the world's system of exchange rates, and her financial adjustment under the first impact of the world depression would still have been as they actually were, determined by far more fundamental forces than the form of her adherence to gold.

Chile

Unlike the exchanges of Australia and New Zealand, Argentina and Uruguay, Brazil, Venezuela, Peru and Spain, the Chilean exchange did not depreciate prior to England's abandonment of the gold standard. In September 1931 the average rate of the Chilean peso on New York was 12.04 cents, just under its parity of 12.17 cents. Chile, unlike Canada, was a country with a central bank of the most modern type. The Banco Central de Chile, established in accordance with the recommendations of the Kemmerer Commission, had begun operations in January 1926, and through its instrumentality Chile energetically defended her position as a gold exchange standard country. It was not without a note of triumph that F. W. Fetter, who had accompanied the Kemmerer Commission to Chile, was able to write in the summer of 1931: "In 1930 and 1931, amidst wide-spread currency depreciation in South America, Chile, thanks to an ample gold reserve [68] and the willingness of the authorities of the central bank to use this reserve for redemption purposes, has stayed on the gold standard." [69] The character of this defense of the gold standard and its costs, however, give ample cause for reflection concerning the appropriateness of such a defense for a country in the position of Chile, and ample justification for the inclusion of her experience under the general caption, Disintegration of the Gold Standard System at the Periphery.

During the prosperity that followed Chile's return to gold the new central bank intervened from time to time in the foreign exchange market to prevent the peso from going "too near" the gold export point, and obtained the means for do-

[68] The foreign exchange reserves of the central bank were regularly referred to in Chile as "gold reserves"; the Banco Central de Chile said in its Annual Report for 1930: "The Bank continued its policy of keeping in its own vaults only a small part of its gold reserves, and of depositing the greater part with some of the largest and most important banks in London and New York" (*Federal Reserve Bulletin,* Nov. 1931, p. 624).

[69] *Monetary Inflation in Chile* (Princeton University Press, 1931), p. 182.

ing so and for strengthening its 'gold reserve' by purchasing from the government foreign exchange obtained by foreign borrowings.[70] In 1928 these borrowings became the basis of a long term public works program which introduced peculiar difficulties into the Chilean situation, described by *The Economist* (Aug. 29, 1931, p. 398):

"In 1928 the Government inaugurated a plan of public works which was carefully prepared and based on the development of its natural resources as well as on the capacity to meet the annual service requirements on the loans contracted to finance the plan. An average annual increase of revenue of 5 per cent. was allowed for, and the Chilean Minister of Finance estimated that ordinary expenditure would not increase by more than 2 per cent. per annum. With this margin it was considered safe for the Government to borrow in order to carry out the construction programme. The advent of the world slump, however, upset the whole scheme, and the Government made matters worse by borrowing (largely from American houses) on short-term through 1930 and into 1931 to finance this public works programme in the hope that it would be able to resume its long-term borrowing before the end of 1931."

This recourse of the government to the short term international money markets took place at a time when the general economic position of Chile was becoming extremely depressed. About 82 per cent of Chilean exports consisted of copper and nitrate. Between 1929 and 1930 the price of copper fell one-fourth (Table 66), and by 1930 Chile was facing a nitrate crisis comparable in severity to that of 1921. This crisis was responsible for a complete centralization of control over Chilean nitrate, deeply involved the national budget, severely strained the international price maintenance agreements existing in this commodity, and threatened to bring on a price war. During 1929 stocks had been accumulating in Chile far in excess of normal requirements. The Nitrate Producers Association consequently brought about a cur-

[70] Banco Central de Chile, Annual Report for 1928 (*Federal Reserve Bulletin*, June 1929, p. 393).

tailment of production in 1930 of about a million tons, but demand was falling so rapidly that stocks were not reduced.[71] During this crisis, upon the initiative of American financial interests, the Nitrate Producers Association was transformed into a single syndicate for prices and sales, the Compania de Salitre de Chile, known as *Cosach,* controlling 95 per cent of Chilean production. To further this scheme the Chilean government transferred large nitrate deposits to the new company, agreed to make certain annual cash payments to it, partly to provide service for its foreign obligations, and removed the substantial export duty on nitrate. In return it took a 50 per cent interest in the company's capital stock. The price fixing agreements with European nitrogen producers in force in 1929 were renewed for 1930, and under these controls nitrate prices did not fall substantially. Exports, however, did fall heavily, greatly aggravating Chile's foreign exchange problems, and stocks accumulated on a very large scale.

Price maintenance in the nitrate industry was seriously threatened early in 1931 when, in retaliation for a prohibitive import duty on Chilean nitrate imposed by Germany, *Cosach* refused to renew its international marketing agreements and threatened to sell its products when and how it chose. That this was not an empty threat is shown by the 13 per cent decline in nitrate prices in Chile from 1930 to 1931. In addition, the financing of *Cosach* by contemplated foreign loans was seriously impeded by the adverse conditions in the central money markets, which were now practically closed to the Chilean government.

While the affairs of the nitrate industry were in these straits, the decline in the price of agricultural products was arousing discontent among farmers and on January 1, 1931 Chile embarked upon the policy of assisting agricultural exports by

[71] Banco Central de Chile, Annual Report for 1930 (*ibid.,* Nov. 1931, p. 624). As agriculture is the best customer of the nitrate industry, the decline in demand was unavoidable.

the payment of bounties through the agency of an Agricultural Export Board.

Under these circumstances the government's short term borrowings abroad were far from sufficient to prevent the peso from going to gold export point, and the Banco Central de Chile began to lose foreign exchange. "From January 1, 1930, to July 10, 1931, the total 'gold holdings' of the Bank fell from 446,351,253 pesos (about $54,300,000) to 221,050,651 pesos (about $26,900,000), a reduction of over 50%." [72] At the same time the government had accumulated an external floating debt which, on April 1, 1931, was $59,914,000. This floating debt, together with the difficulties of meeting fixed charges of about $40 million per annum on long term external debt, at a time when the merchandise trade balance was becoming actually adverse, clearly brought both Chilean public credit abroad and the Chilean gold standard to the verge of breakdown. In July 1931 Chile passed into a regime of exchange control under the guidance of the Committee for the Control of International Exchange Operations; service on the Chilean public debt was no longer remitted abroad but was deposited in a special account with the Banco Central de Chile.

At this point in Chilean currency history mounting economic distress within the country finally culminated in a political revolution which, on July 26, 1931, brought a new government into power. This new government completed the Chilean default by declaring a complete moratorium on her foreign debt in August, and announced that it would attempt to restore the balance of international payments by exchange control, customs tariffs, and other similar measures. The motives leading to the moratorium on Chile's foreign debt are described by Mr. Fetter as follows:

"Chile's recent action in July and August, 1931, in declaring a moratorium on her foreign debts, seems to have been inspired in

[72] Fetter, *op. cit.*, p. 182; cf. Table 67. Actual gold was not exported and consequently became an increasing proportion of total reserves.

part by the feeling that in view of the great decline in the prices of her leading exports, exchange to meet the service on her large foreign debt, much of which had been recklessly incurred during recent years to finance ambitious programs of internal improvements, could be secured only by a drastic policy of deflation that might have serious economic consequences, or by the use of the gold reserve of the central bank and the consequent endangering of the gold standard." [73]

The defense of the gold standard by such means invites serious reflection as to what may have been the purpose for which the gold standard existed in Chile. This purpose could not have been to set in motion corrective forces that would establish within the country a new economic balance, for further drastic deflation was clearly not desired. Chile refused, and probably was actually unable to allow, such corrective forces to operate within her borders beyond a certain point. This point fell far short of the achievement of a new economic equilibrium which is at bottom the aim and justification of the international gold standard as an institution designed to facilitate trade and commerce. While Chile rejected the ultimate gold standard remedies for her economic sickness, she rejected also a depreciated exchange as a means of obtaining a new economic balance. She attempted to achieve the economic benefits of a depreciated exchange by other means, by export bounties and by restriction of imports by direct methods rather than through price, while at the same time preserving the outward shell of the gold standard. The purpose of the gold standard in Chile could not have been to help in the maintenance of public credit, for when a direct choice was presented between maintaining public credit and keeping the gold standard, public credit was sacrificed. The conclusion is unavoidable that Chile clung to a symbol of financial and economic 'soundness,' integrity, and strength at the sacrifice of the things symbolized.

[73] *Ibid.*, pp. 184-5, note.

The Agricultural Countries of Eastern Europe

During the earlier years of the depression there was a real possibility that the economic difficulties of the countries just reviewed might be increased by a movement toward European economic solidarity. This movement was of particular interest to the agricultural countries of Eastern Europe which also stood upon the periphery of the international gold standard system. Their geographical advantages enabled them in 1929 and 1930 to increase their exports of cereals and animal foods to Central and Western Europe at the expense of more distant sources of supply. They were eager to add to the advantages of their geographical location the benefits of preferential tariff treatment in Europe, and made sustained efforts toward this end, which are well described by the *World Economic Survey, 1931/2* (p. 284):

"Successive conferences of the agricultural countries of Eastern Europe were held at Warsaw (August 1930), Bucharest (October 1930), Belgrade (November 1930), and Warsaw (November 1930). The eight countries represented at these conferences were concerned primarily with the depressed condition of agriculture and particularly of cereal-growing. They contemplated the institution of national controls for the sale and export of these products, but also asked preferential treatment in regard to them from the importing countries of Western Europe. Such preferential treatment, in certain cases, would have cut across the most-favoured-nation clauses of existing treaties, but was strongly advocated as a temporary measure affecting only a comparatively small volume of produce on the ground that agriculture was the fundamental economic basis of the States concerned."

These proposals were considered by the Economic Committee of the League of Nations in connection with its continued efforts to salvage some of the hopes and projects of the World Economic Conference of 1927, but were rejected in November 1930. Early in 1931 they were again put forward in connection with the ambitious projects initiated by M.

Briand for the economic appeasement of Europe. The further course of the effort to solve the agricultural problem in Eastern Europe by international negotiation under these auspices is described by the *World Economic Survey, 1931/2* (p. 286):

". . . the Commission of Enquiry for European Union . . . held a preliminary meeting in January 1931, and . . . called a meeting at Paris, in the succeeding month, of the cereal exporting and importing countries of Europe, the chief result of which was that the importing countries declared themselves ready to reserve an import quota for wheat produced in Europe and to consider similar action in the case of maize and barley, while deferring for a time consideration of rye and oats. A committee was also set up to consider the problem of disposing of the surplus from future harvests. Later meetings of the Commission of Enquiry were occupied largely with the discussion of a pact of economic non-aggression proposed by the Soviet Union, but the Eastern European countries have maintained their request for preferential treatment of their cereals.

In 1931, however, the whole problem was submerged in the financial difficulties and particularly the controls of foreign exchanges necessitated by the severity of the crisis. Discussions continued both in the Economic Committee of the League and in the Commission of Enquiry for European Union. A draft project for an International Agricultural Credit Association was signed by sixteen States in May 1931, but has not been brought into existence. Various proposals for the alleviation of unemployment and for the facilitating of long-term investments have been mooted. Committees have considered the market situation of special products such as hops, tobacco, etc. But the shadow of the depression has been over all such proposals, financial provision has been wanting, and international economic co-operation has proved impossible, while national Governments have been faced with economic insecurity within their own borders."

The hopes of the predominantly agricultural countries of Eastern Europe for substantial benefits from projects of European economic solidarity and international cooperation in

extending agricultural credit were thus unfulfilled. Cut off from regular access to the ordinary sources of long term foreign credit, they found their adherence to the international gold standard increasingly difficult. Yet there were few defections from that standard among them before September 1931. In the main their exchanges were kept stable by reducing imports, foreign borrowings of a very special character, and the use of central bank reserves.

In Table 71 the net changes in gold and foreign exchange reserves of the six Eastern European agricultural countries

TABLE 71

Central Banks of Agricultural Eastern European Countries and of Austria, Gold and Foreign Exchange Reserves, Net Changes, 1929–Mid-1931 (millions of Swiss francs)

	1929			*1930*			*First Half of 1931*			*1929 to Mid-1931*		
	Gold	Foreign exchange	Total	Gold	Foreign exchange	Total	Gold	Foreign exchange	Total	Gold	Foreign exchange	Total
Poland	+46	−109	−63	−80	−66	−146	+3	−37	−34	−31	−212	−243
Austria	0	−41	−41	+33	+105	+138	0	−198	−198	+33	−134	−101
Hungary	−34	−13	−47	−1	−11	−12	−46	−52	−98	−81	−76	−157
Yugoslavia	+4	+37	+41	+4	−148	−144	+42	−35	+7	+50	−146	−96
Roumania	+29	+209	+238	+3	−155	−152	−14	+17	+3	+18	+71	+89
Bulgaria	+2	−61	−59	+2	−13	−11	+2	−11	−9	+6	−85	−79
Greece	+6	−81	−75	−9	+1	−8	−1	−36	−37	−4	−116	−120

SOURCE: Table 67

included in Table 67 and of Austria are set out separately. The movement of reserves in each of the six predominantly agricultural countries is a compound of three elements: (1) an underlying weakness in the exchange leading to a loss in total reserves; (2) a policy of strengthening gold reserves at the expense of foreign exchange reserves in order to produce a greater outward semblance of strength; (3) a stemming of the tide of losses in reserve by some form of foreign borrowing.

These three factors may be briefly illustrated from the experience of Poland, Roumania and Yugoslavia, and Hungary.

POLAND

During 1929 the prices of Polish agricultural products on the farm suffered rapid and disastrous decline, which was not reflected in Polish prices in general. The heavily indebted agricultural population was placed under the severest kind of pressure to meet obligations incurred at exceptionally high interest rates. In order to do so it was forced to sacrifice its products at low prices and even to increase output. In the spring of 1930 a long deferred economic agreement with Germany was signed, but the hoped for alleviation of the agricultural distress did not follow, for the agreement was never ratified by Germany. The agricultural depression continued throughout the whole period and left its imprint upon the foreign trade of the country. The pressure to increase output in 1929 is reflected in actually increased exports, while the decline in agricultural purchasing power is reflected in reduced imports. In 1928 when Poland was still freely importing capital a heavy adverse merchandise balance was possible without serious danger to the gold standard. Even in that year, however, the Bank of Poland was losing foreign exchange reserves. In 1929 the merchandise import surplus was greatly reduced, and in 1930 and the first half of 1931 was replaced by a steadily increasing export surplus. During these years exports were relatively well maintained but imports continued to contract very greatly, not only because of the reduced internal purchasing power but also because capital import was no longer being received in the form of goods. This change in the merchandise balance of trade was not, however, large enough, in the absence of substantial new borrowing, to provide for Polish invisible debits without pressure on the exchange. Consequently the Bank of Poland continued to lose reserves steadily.

In common with other countries of Eastern Europe, and indeed of many other parts of the world, Poland was reluctant to allow the extent of the reserve losses to be dramatized to the public through spectacular losses of gold. She was sub-

ject, like other countries, to a psychological gold export embargo and from the end of 1928, and even before, until September 1930 the Bank of Poland pursued a policy of purchasing gold, thereby accentuating the loss of foreign exchange reserves. The latter declined from 527 million zloty on December 31, 1928 to 418 million at the end of 1929 and 241 million on June 30, 1930. By September 20, 1930 only 176 million zloty remained and a change of policy became necessary. A substantial amount of gold (142 million zloty) was therefore sold and foreign exchange purchased, and the discount rate of the Bank of Poland was raised from 6½ to 7½ per cent and the lombard rate from 7½ to 8½ per cent.

At the moment when these measures were taken Poland was in serious danger of a flight of capital abroad and a flight from the zloty at home. A substantial premium for dollar and sterling currency over the check rate had already appeared, but the action of the central bank and prospects of new foreign borrowing relieved the situation. In November the Pilsudski dictatorship was confirmed in power by an 'election,' and immediately after, negotiations for a new Kreuger Loan were completed. The Polish match monopoly of the Swedish Match Company was extended in return for a new loan of $32.5 million. Though the first installment of this loan was not remitted to Poland for six months, part of the proceeds were set aside to meet previously incurred foreign debts, and the Polish exchange was strengthened. At the same time negotiations were pushed for a large French loan for the construction of a railway from Upper Silesia to Gdynia. This loan, however, was primarily of military and political importance. It was finally placed upon the market in May 1931, but the proceeds being paid largely by the delivery of steel rails it did not greatly help the exchange.

When the financial crisis in Europe became acute Poland was in a relatively favorable position as a gold exchange standard country. Her merchandise balance of trade was by then sufficiently favorable to provide for the payment of her fi-

nancial obligations abroad, though not to take care of a moderate outward movement of private capital which was in progress. Consequently, the Bank of Poland had continued to lose foreign exchange reserves in the first part of 1931, but just at the critical period, May 1931, the proceeds of the Kreuger Loan became available. When President Hoover proposed a one year moratorium on international political debts in June 1930, the Polish balance of payments position was further strengthened,[74] and even more important, further access to the French money market seemed assured.

ROUMANIA AND YUGOSLAVIA

The influence of foreign loans upon the movement of central bank reserves is far more clearly written upon the face of the figures in Table 71 in the case of Roumania and Yugoslavia than in the case of Poland. Both countries were aided in meeting their basically similar economic problems by the circumstance that their return to gold was still unfinished business at the end of 1928. Both countries reached the beginning of the depression with currencies that had for some time been stabilized de facto only, and both received large stabilization loans during the depression. Both were able also to attract private capital from abroad for employment in their industry and in internal development. In Yugoslavia the attraction of private capital to industry was important in 1929 and the stabilization loan in 1931, while in Roumania the stabilization loan was important in 1929 and the attraction of capital for internal development followed in 1931.

The Roumanian stabilization was the last successful operation of this kind in the long series characteristic of the postwar restoration of the gold standard. The de jure stabilization of the leu, which had been stabilized de facto since March 1927, was carried out in February 1929 with the aid of credits to the Bank of Roumania amounting to $25 million extended

[74] Poland was relieved of payments for plebiscite costs and relief debts (*The Economist*, Reparation and War Debts Supplement, Jan. 23, 1932, p. 7).

by a consortium of 13 central banks, including the Federal Reserve Bank of New York, and with the aid of a loan of $101 million placed by private bankers for the Roumanian government.[75] The strengthening of the foreign exchange reserves of the Bank of Roumania in 1929 was a direct consequence of these fresh foreign resources. During that year the Bank intervened in the market to make foreign exchange available to the government to meet obligations abroad and to prevent the leu from reaching gold export point.[76] During 1930 Roumania continued to receive large foreign remittances from the proceeds of the stabilization loans and part of these were set aside in special government funds to meet foreign obligations. They therefore did not appear fully in the balance sheet of the Bank of Roumania. At the same time declining imports were moving the Roumanian merchandise balance of trade toward an increasing export surplus. Nevertheless the underlying weakness of the leu may be read in the loss of foreign exchange reserves by the Bank in 1930. As in the case of Poland, a Roumanian psychological gold export embargo continued in force and actual gold was not exported, yet at the close of the year serious doubts were entertained concerning the permanence of the Roumanian stabilization. Early in 1931 these doubts were temporarily set at rest by the placing of a loan in the French market by the Roumanian Monopoly Institute. This loan, which was guaranteed by the government and was partly for military purposes, checked the loss of reserves by the Bank of Roumania, as shown in Table 71.

In contrast to Roumania, Yugoslavia was able to attract foreign capital in 1929 in the form of large French and American investment in her mines, and Swedish, Swiss, Hungarian,

[75] *Federal Reserve Bulletin,* March 1929, p. 201.

[76] Bank of Roumania, Annual Report for 1929 (*Federal Reserve Bulletin,* Sept. 1930, p. 551). These operations are mentioned in this report in a passage that has as its main purport the assertion that the forces of supply and demand were allowed to operate without any interference in the Roumanian exchange market. The logic of this passage has escaped the writer.

and Belgian investment in her industry. Combined with an excellent harvest which produced a favorable merchandise trade balance, this enabled the central bank to strengthen its reserves in 1929. In 1930, however, the situation developed along the lines already indicated in the case of Poland and Roumania. The expectation of a de jure currency stabilization, however, remained a factor psychologically favorable to the dinar. On May 8, 1931 this expectation was realized. The de jure stabilization differed from the others which had preceded it in that it was carried out under French auspices without British or American participation. A stabilization loan of 1,025 million French francs was placed by a continental banking syndicate led by the Union Parisienne,[77] and the fall in the reserves of the Yugoslav central bank was checked. In addition, the Bank was able to give a semblance of additional strength to the gold standard as a domestic institution in Yugoslavia by the now familiar operation of revaluing its gold assets in dinars.

HUNGARY

The importance of access to long term credit in France in the defense of the gold standard in Eastern Europe is illustrated by the experience of Hungary, which did not have this advantage as fully as the other countries. During the entire two and a half years from 1929 to the middle of 1931 the Hungarian central bank was losing reserves, but this loss was less in 1930 than in 1929 and the first half of 1931. The reasons were stated in the 1930 Report of the National Bank of Hungary: "Owing to a considerable improvement in the foreign trade balance and a continued large scale offer of foreign short-term credits, Hungary's international payments were more nearly in balance than in previous years. This situation is reflected in the gold and foreign exchange reserve of the National Bank, which showed unusually slight fluctuations during the year." [78]

[77] *The Economist,* June 6, 1931, p. 1220.
[78] *Federal Reserve Bulletin,* May 1931, p. 268.

These favorable circumstances were reversed early in 1931. Under the Hague Agreements of 1930 a new international long term loan for Hungary had been promised to complete the financial reconstruction of the country begun under the auspices of the League of Nations with the flotation of the International Loan of 1924. The condition of the central money markets made this impossible, and negotiations for placing abroad £5 million in treasury bills to meet immediate budget needs could not be completed before Hungary became involved in a major financial crisis.[79] Following the failure of the Credit Anstalt in Vienna, foreign credits were rapidly withdrawn from Hungary, and in July a temporary closure of the banks and the stock exchange was forced. In that month Hungary passed into a regime of foreign exchange control.

With the exception of Hungary none of the agricultural countries of Eastern Europe instituted legal measures of foreign exchange control before September 1931.[80] In spite of a considerable amount of window dressing and the political elements involved in the foreign loans that helped to support the exchanges of Poland, Roumania, and Yugoslavia, the Eastern European sector of the periphery of the international gold standard was defended in general by orthodox means. For various reasons the possibility of shifting their economic burdens internationally and redistributing them internally by a policy of moderate and controlled exchange depreciation on the Australian model was not open to these countries. The psychological prerequisites of such a policy were wholly absent. The budget problems of the various governments were bound up with continued credits from sources that would have regarded such a policy as 'fundamentally unsound.' The whole financial and economic background was one of a barely completed struggle to return to normal and to escape the evils of a fluctuating exchange. The effort of these countries

[79] These bills were finally placed, chiefly in France in August 1931.

[80] B.I.S., *Foreign Exchange Regulations,* 1st Issue.

to shift part of their burdens to their agricultural competitors by preferential tariffs was unavailing. They were, on the contrary, forced to bear somewhat more than their full share of the real costs of the depression. The resulting economic prostration undermined the basis of ordinary banking credits extended to them, and the restriction of their imports severely injured industries in other countries looking to them as markets. These two international repercussions of Eastern European troubles were concentrated in their fullest force upon the pre-war center of their economic life, Vienna.

Austria

While the quality and safety of many advances made by Vienna banks to Eastern European customers were rapidly deteriorating, the Austrian economy was itself suffering severely from the depression. A general stagnation of business, in contrast to a predominantly agricultural crisis, was the basic characteristic of the Austrian position, which is described clearly in the Annual Report of the National Bank of Austria for 1930 (*Federal Reserve Bulletin,* May 1931, p. 262):

"An artificially created state such as Austria, not yet securely established along economic lines, could not fail to be seriously affected by the crisis. The fact that certain consequences of the crisis are less pronounced in Austria than elsewhere should deceive no one. For example, it is true that the percentage increase in unemployment during 1930 was less in Austria than in many other countries such as England and Germany, but this was because the level of industrial employment in Austria had already declined in preceding years, and therefore the number of unemployed was at that time relatively greater. While economic reports on the past year show, in a number of other countries, a sharp decline in stock-exchange quotations and suspensions of payment by great credit institutions, Austria has been spared such experiences because the Vienna stock exchange had not yet recovered from the collapse of 1924–25, and the Austrian banking system had already undergone a sharp contraction between 1925

and 1929. It is also easy to explain why business losses resulting from a fall in the price of raw materials should have assumed smaller proportions than elsewhere in a country like Austria, where production of raw materials—except for lumber—is of little importance and where business enterprises are unable for lack of capital to maintain large stocks. In fact, the price decline and the decrease in the volume of foreign trade have not been altogether unfavorable to this country, which is dependent on large imports of raw materials and in which a predominant place is held by those industries which turn out finished products. . . . On the other hand, the price decline had an unfavorable effect on certain Austrian exports, such as lumber and paper. Austrian exports of finished products, however, exert a decisive influence in the matter of values, and the decline in prices of these products was by no means so great as in those of raw materials. Invisible exports, however, which form an important element in the balance of payments, showed a rather sharp decline."

During 1929 the high interest rates prevailing in the financial centers, and, after the New York Stock Exchange break, the increasing decline in the opportunities for profitable employment in Austria, led to an outflow of short term foreign funds. This was, however, not sufficient to alter the substantial dependence of the Austrian banks on the remainder. Together with the shutting down of the inflow of long term foreign capital it weakened the Austrian exchange and led to a decline in the foreign exchange reserves of the National Bank. The most conspicuous feature of the decline in long term capital import was the delay in placing a large government loan that had been under negotiation since 1927 and was to have been employed for railway development and postal administration. These projects were, in anticipation, partly financed by short term domestic credits obtained by the government. From both a foreign exchange and a budget point of view the flotation of this loan was vital for Austria in 1930. In the spring of that year the last political obstacles were removed by the Hague Agreements, and the first tranche of the loan was floated in the international markets in July.

The loan was for $61 million instead of a planned amount of $102 million, and a second tranche was expected to complete the government program. For the time being, however, the first tranche was sufficient to enable the National Bank to add to its reserves as shown in our table and to allow the government to repay the short term debts incurred in anticipation of it.

In 1931 the whole posture of Austrian, and indeed of European, affairs was radically altered. At the close of 1930 the accounts of the Credit Anstalt showed a deficit of 140 million schillings, and the directors appealed to the National Bank and to the government for help. This was the culmination of a situation that had long been maturing, and was closely associated with the great political issue of Austro-German Anschluss. The Credit Anstalt was primarily a holding company for the industrial undertakings of the Rothschild interests which had been built up before the war when the Austro-Hungarian Empire was one customs union. The destruction of this large free trade area after the war limited the sales opportunities of these enterprises, but as long as inflation prevailed they were able to maintain their profits. As early as 1927, however, the future of the Credit Anstalt had been unfavorably discussed and in 1928 the Austrian government had been warned that it would ultimately have to take over the institution. With the deepening of the great depression, Austria brought pressure upon Germany to proceed with plans for a Customs Union as an essential step to save the Credit Anstalt, and the premature announcement of these plans preceded by only a few months the actual outbreak of the crisis.

A program for the reorganization of the Credit Anstalt was announced simultaneously with the public disclosure that it was in difficulties. This did not preserve public confidence, however, or prevent a panic. Runs started on the Credit Anstalt which was forced to discount heavily with the National Bank. Foreigners lost faith in the safety of their funds in Austria and a flight of capital began. Within the

next few months the National Bank lost most of its large stock of foreign exchange. In Austria this crisis led to the negotiation of standstill agreements with foreign creditors, and in October, to the inauguration of foreign exchange control. In Europe it was the signal for a financial crisis which finally broke up the central nucleus of the international gold standard and opened the period of Disintegration. In this crisis the action of the center countries was not united, and their attempts at cooperation in meeting it were greatly complicated by the Anschluss proposal. This proposal, as well as the economic difficulties of the Eastern European agricultural countries and the immediate repercussions of the Credit Anstalt failure were all intimately related to the fate of the international gold standard in Germany.

CHAPTER 25

The Transformation of the Gold Standard in Germany

The adherence of Germany to the international gold standard had been consolidated between 1924 and 1928 in a way that gave an outward appearance of strength, solidity, and normality to the German currency. Yet the foundations on which the German gold standard system rested were not strong, solid, or 'normal.' They were, indeed, the result of a very special application of the post-war principles of stabilization which concealed, rather than repaired, essential weaknesses.[1] Beginning in 1929 these foundations were so undermined that by July 1931 the whole structure had to be shored up by the scaffolding of exchange control.

The Acid Test of the Stabilization Principle of attracting Foreign Capital as applied to Germany

When the creditor powers and Germany agreed at Geneva in September 1928 to seek a 'final' settlement of reparation, the German budget was being met with difficulty. German business, however, was enjoying a prosperity that seemed so firmly based that the operation of the 'prosperity index' under the Dawes Plan threatened to add to the approaching maximum annuity to be paid under that Plan. This seemed likely to intensify the budget problem and possibly to cause a breakdown in transfers. Hence there was a community of interest on the part of government and business in favor of a definite reparation settlement which reinforced the desire of all Germans to see the end of foreign financial and economic controls in Germany and an early evacuation of the

[1] Cf. Ch. 16, passim, and Ch. 21, An Unsolved Reparation Problem.

Rhineland. Business was eager to avoid the difficulties that might accompany a reparation crisis and the government was anxious for relief in its budget problem. Provided that the permanent schedule of payments seemed within Germany's capacity to pay, as seen from the German point of view, Germany was on the whole willing to reach a final settlement, even at the cost of the sacrifice of transfer protection. By the time the Young Plan came before the Reichstag for acceptance the whole situation had changed and Germany had entered into that period of chronic emergency which was the chief characteristic of the last months of Experimentation.

Early in 1929 it began to be apparent that the prosperity of German business during 1927–28 had been largely derived from four sources which were not permanent, but inherently temporary: orders for reparation in kind; orders for technical reconstruction; Russian orders financed by government guaranteed credit; and orders arising from a government promoted housing boom. Reparation payments in kind were declining even under the Dawes Plan, and in the discussions of the New Plan it was proposed first to reduce them still further and then to eliminate them completely. The government credit upon which Russian orders were based could not be extended indefinitely, and the housing boom was approaching its end. Finally it was becoming clear that the process of rationalization had been carried too far. It had increased social costs by creating technological unemployment. It had in some cases increased costs of production by employing expensive foreign capital and forming combines of unwieldy size, and it had, in general, created productive capacity beyond the limits of available markets. This situation added to the severity of the general forces of cyclical depression in Germany. The resulting restriction in industrial activity turned the attention of German industry more and more to production for export.

The search for export markets was intensified by the realization that at last there was a probability that reparation

transfers would have to be made in goods. When in 1929 German long term foreign borrowing fell to one-fifth of the 1928 volume, the government and the business community began to look favorably on policies designed to promote exports and check imports. Force was put behind these policies when real reparation transfers began to exert a deflationary effect upon the whole German economy, and when rigorously applied, this involved a reduction in the German standard of living.[2]

The development of a merchandise export surplus by Germany was favored by a decline in domestic demand for industrial products, and also by the reduced cost of imports due to the world decline in raw material prices. More than this, however, was required to provide for the transfer of reparation without further large foreign borrowings. In the words of Dr. Bruening,[3] whose government had to face the problem in 1930, what was required was a thoroughgoing reorganization of German industry to serve more largely the export market, and an attempt on the part of Germany to become self-sufficient in agriculture, except for fodder. To reduce imports without injuring production for export meant the cutting down of agricultural imports, and this necessity intensified the whole movement for extreme agricultural protection in Germany. This movement had its roots in the artificial forcing of agricultural output during the war, and had already been stimulated by the world decline in agricultural prices. The appearance of a real reparation transfer problem, therefore, had as byproducts an intensification of German competition for export markets for industrial products at a time of declining world trade, and a formidable addition to the difficulties of agricultural producers the world over, and of the Eastern European agricultural countries in particular.

As long as the gap in the balance of payments left by de-

[2] Cf. Ch. 16, The Four Major Principles of Post-War Stabilization as applied to Germany, especially the quotation there given from J. W. Angell.

[3] In the course of his Lowell Institute Lectures in Boston in the winter of 1937.

clining capital imports was not completely filled by an excess of merchandise exports, continued reparation payments were bound to exercise a profoundly deflationary effect upon Germany. This was of a character several times referred to in these studies. Reparation payments, from a balance of payments point of view, were imports. These imports had to be paid for, not by German banks as principals, but by their customers. As stated in Chapter 4, payment for such imports reduces bank deposits. Since gold exports and the reduction of bank holdings of foreign exchange do not build up bank deposits as do exports made by customers of banks, the reduction in deposits resulting from reparation payments was bound to be fixed in the German banking system as long as the currency had to be defended by the use of bank reserves. This was a source of direct deflationary pressure quite apart from the indirect one arising from the effect of dwindling reserves upon banking policy. The full impact of these serious economic problems was not felt in Germany all at once, but the gravity of the situation became gradually clear during the discussion of the Young Plan by the experts, and the political negotiations that followed its publication. At the same time two other serious weaknesses in the German position were being revealed.

The first was the danger inherent in the dependence of the German banks upon short term foreign capital, since their own capital was inadequate. Immediately after the inflation it had been scarcely more than the value of their buildings, and additions since that time had not been sufficient to ensure real independence. This situation gave rise to a dilemma. *Additions* to the volume of capital imports were needed for a long time to come to develop the German economy to the point where reparation transfers in goods could finally be made without serious danger to its stability, but *reductions* in the existing amount of imported capital, as German capital was formed to take its place, were necessary to preserve the solvency of the German banking system

against external shocks. At the end of 1928 45 per cent of German bank deposits were foreign deposits.[4] Against these short term foreign liabilities the German banks had acquired long term assets in the form of advances to, and investment in, German enterprise, including many of the combines created during the rationalization period. Short term foreign credits had been mediated to the whole German economy by an abuse of the fundamental banking principle of borrowing short and lending long.[5] In addition, the German banks had outstanding large lines of acceptance credit obtained chiefly in London, which had been employed in part for long term purposes in Germany.[6] They had, to a dangerous extent, become intermediaries between short term foreign lenders and long term domestic borrowers. The failure to remedy this situation in 1927 by extensive refunding of short term credits was one of the most serious post-war financial mistakes. When a moment of deadlock was reached in the negotiation of the Young Plan in the spring of 1929, the German banks were suddenly faced with a demand for payment of these short term foreign obligations, but could not readily call in their long term German assets. They therefore attempted to borrow from the Reichsbank in order to obtain the foreign exchange needed to meet the withdrawal of foreign deposits. This process is clearly described by *The Economist* (Banking Supplement, Oct. 12, 1929, p. 16):

"The most important effect of [the sudden withdrawal of foreign funds from Germany in April 1929] was to bring about a reduction of the total of 'Creditors' or deposits, which had risen continuously—apart from a slight setback in June 1928, for nearly two years. This reduction, amounting during April to nearly 400 millions, was almost entirely due to foreign withdrawals. Instead of meeting these out of their first line reserves of foreign currencies entered under the item 'Balances with Banks,' the banks

[4] Madden and Nadler, *op. cit.*, p. 396.
[5] Cf. Ch. 16, The Principle of Gold Economy.
[6] Cf. Ch. 19, The General Decline in the Quality of Bills.

rediscounted nearly 300 millions of bills and slightly reduced advances, thus maintaining their foreign balances almost intact. This of course, tended to increase the pressure on the exchange, since the Reichsbank was called on for most of the necessary conversions, and had foreign withdrawals become much more serious the banks would doubtless have been obliged to utilize their own reserves to a much greater extent."

The bulk of the German assets of German banks, under the head of 'debtors,' was not reduced at all in April 1929. It was apparent that, quite apart from the effect upon the foreign exchanges and the gold standard, further wholesale withdrawals of foreign deposits would first cut down the foreign exchange reserves of the banks and then force a testing of the liquidity of their assets included under 'advances' and 'debtors.' Such an eventuality was a threat to the solvency of the whole German banking system. As the economic position in Germany and in the world deteriorated further this threat became greater. At the end of 1929 foreign deposits were only 40 per cent of total German deposits and at the end of 1930 they were only 35 per cent.[7]

The second weakness in the German position revealed at this time was fiscal and political. Quite early in the depression it became crystal clear that vitally necessary foreign funds could not be retained unless Germany assumed the economic burdens of a real reparation transfer. Under the circumstances she could not do this without aggravating her fiscal difficulties and intensifying internal political troubles growing out of long continued pressure on the German standard of life.

As early as the end of 1928 the budgets of the Reich and the States were in an unsatisfactory position and at the close of 1929 a genuine budget crisis had developed. The Reich government was burdened with increases in salaries granted to civil servants and with heavy costs for social insurance benefits that had been among the fruits of the prosperity of

[7] Madden and Nadler, *op. cit.*, p. 396.

1926–28. At the same time payments to assist agriculture and the costs of the housing scheme were increasing. The Young Plan as finally presented to the Reichstag for adoption offered temporary budget relief by reducing the first year annuity and offering a large foreign loan, but this was by no means a complete substitute for urgently needed fiscal reforms. The Plan solved the immediate reparation transfer problem, and its adoption seemed likely to ward off the danger of further large withdrawals of foreign funds and to assure the maintenance of vitally necessary German credit abroad. On the other hand it imposed for many years economic burdens which German expert opinion had, by that time, come to regard unanimously as beyond Germany's capacity to bear, and which were opposed with violence by the rising voice of the radical parties in Germany. Finally, the freeing of German soil from foreign occupation guaranteed under the Young Plan was a realization of hopes especially dear to the heart of the aged President von Hindenburg.

Out of these elements the acceptance of the Young Plan by the German Reichstag was compounded. The advantages of the Plan as it left the hands of the Experts may, following Wheeler-Bennett and Latimer, be formulated as follows:

a) For the Creditors

1) It settled the problem.

2) It removed the whole process of payment and transfer from the political sphere, making Germany alone responsible for payment in foreign currencies rather than in reichsmarks.

3) It put the annuities in such a form that they could be commercialized.

b) For Germany

1) It gave definite knowledge of the total due.

2) It reduced the next annuity £35 million.

3) It eliminated the transport tax.

4) It eliminated the prosperity index which would have raised the Dawes annuity £10 million.

5) It made two-thirds of the annuity subject to postponement.

6) It promised help from the B.I.S. in financing German ex-

ports and in making the payments during the last years of the Plan.

7) It ended the Reparation Commission and other forms of control.

8) It assumed that there would be no further costs of occupation.[8]

The last assumption was borne out by the signing at the First Hague Conference of an evacuation agreement, the last agreement signed on behalf of Germany by Herr Stresemann. This conference, however, as a result of a long struggle over the British percentages in the total annuities and in the unconditional part of the annuities, made certain changes in the Plan which added to the German payments. At the Second Hague Conference in January 1930 the Plan, as amended, was incorporated in a series of agreements for ratification by the Powers, and these agreements contained stipulations and assurances concerning German domestic legislation designed to take the place of some elements in the foreign control of German affairs given up in the Plan.

Ratification was obtained from the Reichstag by the Mueller government against intense opposition from all the Nationalist parties and against the general sentiment of business, whose representative in the negotiation of the Plan, Herr Vogler, had, indeed, refused to sign it. Dr. Schacht, though he signed the Plan, issued a manifesto against it as modified at The Hague, and against the government for failing to undertake the necessary fiscal reforms to ensure that all its benefits would not be swallowed up in the deficit. On the latter issue he resigned his office as President of the Reichsbank. A favorable vote was finally secured in the Reichstag on the specific moral pledge by the President of the Reich that fiscal reforms would be immediately undertaken, in particular the reform of unemployment insurance, while on the other hand the Parties agreed to provide liberally for a

[8] John W. Wheeler-Bennett and Hugh Latimer, *Information on the Reparation Settlements* (London, Allen & Unwin, 1930), pp. 102–3.

program of assistance to the sorely tried agricultural interests of eastern Germany (the Osthilfe). It is doubtful whether a single member of the Reichstag who voted for ratification believed the Plan could be fulfilled. Great pressure was brought to bear on the President to withhold his approval, but on March 13 the Plan became law by his signature.

With adoption of the Young Plan a period of chronic emergency began in Germany during which the complex elements in the situation described above finally combined in such a way as to force the imposition of exchange controls and the negotiation of standstill agreements with foreign creditors. This transformation in the gold standard in Germany may be traced by a brief examination of the forces playing upon the gold and foreign exchange reserves of the Reichsbank. This examination will serve also to bind together those parts of our analysis of the impact of world depression on the whole international gold standard system in which the relationship of Germany to other gold standard countries has been touched upon.

The Gold and Foreign Exchange Reserves of the Reichsbank during the Negotiation and Adoption of the Young Plan, September 1928 to March 1930

During the three months immediately following the decision to seek a final reparation settlement, capital was flowing into Germany and the Reichsbank was able to strengthen its reserves. It will be recalled that at this time, instead of strengthening its foreign exchange reserves, the Reichsbank allowed gold to flow in, chiefly from Great Britain,[9] on an orthodox private arbitrage basis and that, as a consequence, the next unfavorable conjuncture in the international position of Germany was bound to be reflected in a reduction of Reichsbank gold reserves.[10] Such a conjuncture began to develop with the decline of American lending to Germany late in

[9] Cf. Ch. 19, Bank Rate and the Defense of Sterling.

[10] Cf. Ch. 16, The Modification of the Principle of Gold Economy, 1928.

1928 and early in 1929, and the strong attraction even of German domestic funds to New York for speculative employment there. It culminated in a mass withdrawal of foreign credits when a schedule of payments was presented to Germany by the Committee of Experts and was rejected by Dr. Schacht. These withdrawals included a very large recall of French funds.[11] The disclosure of the dangers to which the German banking system was exposed by such withdrawals was an effective form of pressure upon Germany to accept the Young Plan. There are many indications that it was so regarded in Germany. For example, the following statement in the Reichsbank's Annual Report for 1929 is open to no other interpretation:

"Inasmuch as Germany, as a result of her own lack of capital and her heavy Reparation burdens, is dependent on the assistance of foreign capital, grave difficulties arose when foreign aid ceased to be available and foreign funds were withdrawn—*in part deliberately*—or were no longer sent to Germany for investment." [12]

This use of French balances as a weapon in the general European struggle over the surplus of reparation above the sums earmarked for the United States attained its immediate ends. It was effective in influencing Dr. Schacht to recommend to the German government acceptance of the original Young Plan, but from a longer run point of view it marked the first stage in the loss of French international financial power.

As a result of the flight of capital Germany experienced a heavy drain of gold to New York, which, by arrangements already described, was utilized to effect economically a simultaneous strengthening of the gold reserves of the Bank of France and the central banks of other creditor powers. As

[11] *The Economist*, Banking Supplement, Oct. 12, 1929, p. 15, stated: "The apparent deadlock reached by the conference of experts in Paris, and the action of foreign banks (mainly French and Belgian) in making large withdrawals of funds, brought about an exchange crisis [in Germany]."

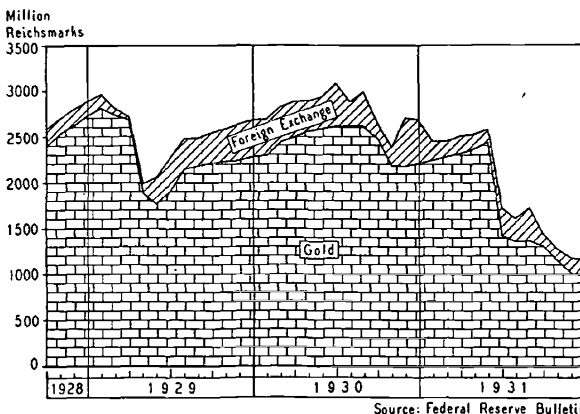
[12] *Federal Reserve Bulletin*, May 1930, p. 298 (our italics).

shown in Chart 56, the losses in Reichsbank reserves at this time were almost wholly in gold.

Faced with a sudden demand for accommodation from the commercial banks for the purchase of gold for export, the Reichsbank raised its discount rate from 6½ to 7½ per cent on April 25, 1929, but in order to make this rate effective it

CHART 56

Reichsbank, Gold Holdings and Foreign Exchange Reserves September 1928–December 1931



was obliged to return to the policy of credit rationing which it had used from April 1924 to December 1925. Had the situation persisted, this policy would have forced the banks either to bring foreign exchange to the Reichsbank or to utilize their own foreign exchange reserves to effect remittance abroad. With the final signature of the Young Plan on June 7, 1929, however, credit rationing was no longer necessary. A return flow of short term capital temporarily solved both the foreign exchange and domestic credit problems. It continued during the last six months of 1929, but was not paralleled by fresh imports of long term capital. From June to December 1929 new long term issues placed abroad amounted to less than 50 million reichsmarks. During

the first four months of 1930 Germany was able to borrow abroad on long term to the extent of 348 million reichsmarks, the equivalent of her entire long term capital import of 1929, but there was no genuine revival of the foreign market for German loans. In the spring of 1930, moreover, Germany did not further increase her short term foreign indebtedness, though she was able to retain the new short term funds attracted in the last half of 1929.[13] She could do so, however, only at the cost of maintaining high interest rates in Germany, as is brought out in the Annual Report of the Reichsbank for 1930 (*Federal Reserve Bulletin,* Aug. 1931, p. 452): "The position of the Reichsbank improved considerably [in the spring of 1930] so that it was able to follow the discount rate reductions of the more important central banks, and gradually reduce the difference between the rates abroad and its own discount rate. The bank, however, was obliged to proceed in this matter with great caution because of the large volume of foreign short term indebtedness, and was unwilling to risk the danger of an excessive outflow of foreign funds by too great or too rapid discount rate reductions". . . .

This revived, though reduced, capital import coincided with the growth of a substantial favorable balance of merchandise trade as a result of the economic forces already described.[14]

[13] Final Report of the Agent General for Reparation Payments (*ibid.,* Nov. 1930, pp. 713–4).

[14] German merchandise imports and exports (millions of reichsmarks) from January 1929 to March 1930 were (*ibid.,* p. 732):

1929	IMPORTS	EXPORTS	NET
Jan.	1,317	1,101	−216
Feb.	1,015	971	−44
March	1,023	982	−41
April	1,254	1,227	−27
May	1,131	1,172	+41
June	1,077	1,077	0
July	1,226	1,099	−127
Aug.	1,073	1,189	+116
Sept.	1,038	1,200	+162
Oct.	1,107	1,247	+140
Nov.	1,161	1,154	−7
Dec.	1,020	1,063	+43
1930			
Jan.	1,305	1,092	−213
Feb.	982	1,026	+44
March	884	1,104	+220

Consequently during the final struggle over the ratification of the Young Plan in Germany the Reichsbank was able to strengthen its reserves. On this occasion, the Spartan gold standard principles enunciated by Dr. Schacht in 1926 were not strictly adhered to. The foreign exchange reserves were first built up in May 1929 while gold was still being lost (Chart 56). Immediately after the signing of the plan in June, however, Germany reappeared as a purchaser of gold in London, was even able to draw gold from Argentina, and continued to be a moderate buyer in London for the rest of 1929. At the end of the year total reserves were 198 million reichsmarks less than at the end of 1928, but the foreign exchange reserves were 249 million reichsmarks greater. The change in the composition of the reserve was partly due to the Reichsbank's wish, as indicated in its 1929 Report, not to force an increase in the discount rate in London by exercising its full power to take gold, and partly to its wish to avoid shocks to confidence that might arise in the future if the sudden losses in the earlier part of the year were repeated. The latter motive may be inferred from the changes in the composition of the reserve during the next sixteen months (Chart 56). The repercussions on the Reichsbank's position and policy of the struggle over the Young Plan explain why, in contrast to central banks of other debtor countries which, in 1929, were giving up foreign exchange in preference to gold, the Reichsbank lost gold and gained foreign exchange during that year (Table 67). In February 1930, after the successful conclusion of the Second Hague Conference, the Reichsbank's gold purchases became substantial, and by the end of March the losses in total reserve of the spring of 1929 were fully made up.

The Gold and Foreign Exchange Reserves of the Reichsbank during the Period of Chronic Emergency, March 1930 to May 1931

The ratification of the Young Plan by the Reichstag was followed by the overthrow of the Mueller government on

March 27, 1930, ostensibly on the issue of postponing a solution of the unemployment insurance problem. A new government of the center was formed under Dr. Bruening. It was faced on taking office with an accumulated deficit of 1,284 million reichsmarks and an expected further deficit of 700 million for 1930–31, and plunged immediately into a struggle over financial reform. Early in April the new government obtained Reichstag approval for measures of increased taxation and for an agricultural program designed to increase the price of rye by the imposition of duties on fodder barley and the prohibition of the import of corn. These measures bore the marks of political compromise. The new taxes were not sufficient to prevent the early threat of a renewed budget deficit, and the agricultural program, while helping the rye growers of eastern Germany, complicated the problems of the farmers raising swine for export. During the next few months the economic situation grew steadily worse. The government devoted itself to the working out of an elaborate agricultural program in the East, the promotion of the export trade, and the solution of the budget problem by the reform of unemployment insurance, reduction of government salaries, and new taxes. These measures encountered violent opposition, and on July 18 Dr. Bruening dissolved the Reichstag. This he was able to do because foreign capital was once more being withdrawn and the banks were consequently in a position to help the government by taking up treasury bills. A few days later he put his entire financial program into effect by the promulgation of one all embracing decree, providing for new taxation, reduction in government salaries, a scheme for agricultural relief in the East, a reform of unemployment and health insurance, and an extension of the powers of government to deal with the abuses of cartel agreements. This decree was put into effect subject to its ratification by the new Reichstag to be elected in September.

During this period of acute political and economic difficulty a steady and uninterrupted decline in share prices be-

gan on the Berlin Bourse.[15] Its profound effect upon the liquidity of the German banks is described in the Banking Supplement of *The Economist* for May 1931:

"The extent of the losses which the German banks suffered in 1930 cannot, of course, be gauged from their balance sheets, but the very form in which their accounts are presented is evidence that the chief part is played by the depreciation of securities, for the big banks have with one accord introduced a new item: writing down of securities. Profits were appropriated for this purpose to the extent of 21.3 million marks by the Deutsche-Disconto Bank, 10 millions by the Danatbank, 6 millions by the Dresdner Bank, and 4.6 millions by the Commerzbank: It is unlikely that these represent the full extent of the losses, for the banks must have suffered far heavier losses through their close connection with the Stock Exchange. They had to increase their security holdings during 1930, owing to the necessity of making purchases in order to support the market, for the German banks are so closely connected with many industrial undertakings that they cannot be indifferent to the movement of their shares. Besides, apart from the less tangible effects of a fall in Stock Exchange prices, many of their loans are secured against shares so that a depreciation in share values may involve them in losses on their debts."

If the technical position is considered by itself, the moment had clearly arrived in 1930 for effective measures to strengthen the German banking system, but such measures would have raised the cry of inflation and prevented the deflationary policies necessary to get the Young Loan distributed and the Rhineland evacuated.[16]

While the internal situation in Germany was developing in this way, the provisions of the Young Plan were being put into effect. The Bank for International Settlements was organized and on May 17 a trust agreement for the administration of the new reparation arrangements was signed by

[15] Cf. *New York Stock Exchange Bulletin*, June 1935, p. 1, chart showing International Common Stock Prices, 1928–35.

[16] These statements are based on interviews with German authorities.

the Bank and the creditor governments. On that day the B.I.S. took over the funds of the Agent General for Reparation Payments and the Reparation Office in Berlin was closed. Two days later the ABC Reparation Bonds issued under the Dawes Plan were burned. On May 17, 1930, also, Germany passed for the first time legally onto the gold exchange standard. The provisions of Article 31 of the Bank Law obligating the Reichsbank to redeem its notes in gold or foreign exchange were put into effect in accordance with a written pledge given to Owen D. Young, Chairman of the Committee of Experts by Dr. Schacht in a letter dated June 6, 1929.[17] The elaborate system of foreign supervision over the Reichsbank designed to enforce those provisions of the Dawes Plan which bound the Reich to the gold standard[18] were abolished. The Reich, however, did not regain full sovereignty in this all important respect, for it still remained bound to retain the gold standard at the existing parity. Under the Second Hague Agreement of January 20, 1930 the sections of the German Coinage Act of 1924 and of the Reichsbank Law of 1924 that put Germany on the gold standard were to remain unchanged except with the consent of the Bank for International Settlements, or failing that, by action of the Arbitral Tribunal established by the Young Plan.[19] Various other sections of the Bank Law were fixed or amended by these Agreements, in particular Article 25 which limited direct advances by the Reichsbank to the Reich to 100 million reichsmarks and provided that the Reich must be out of debt to the Reichsbank on July 15 of each year, and also limited the direct advances of the Reichs-

[17] *Report of the Committee of Experts on Reparations*, Cmd. 3343, p. 50.

[18] Cf. Ch. 12, The Place of the Dawes Plan in Gold Standard History.

[19] Final Act of the Hague Conference and Agreement with Germany, Annex V and Va; *Agreements concluded at the Hague Conference, January 1930*, Cmd. 3484, pp. 43-4. This Agreement bound the Reich not to change Articles 22 and 31 of the Bank Law and Article 5 of the Coinage Law of 1924. These Articles may be referred to in *Reparation Commission, Official Documents*, XIV, 188, 191, 209.

bank to the Reichspost and the Reich railways to 200 million reichsmarks in all. The government continued to find itself severely hampered in the conduct of its emergency financial measures by these limitations. On June 10 agreement was reached on the issue of the international loan contemplated under the Plan, and on June 12 the Young Loan was placed on the international markets. On June 30 the Rhineland was evacuated.

During these months the Reichsbank continued to strengthen its gold reserves chiefly by private arbitrage operations which brought gold from London. The reichsmark was basically upheld by the continued growth of the commodity export surplus,[20] and was further strengthened by the successful flotation of the Young Loan itself. Of the proceeds of this loan, amounting in all to $302 million, $100 million were paid to the German government for use in Germany. The balance was paid over to the various creditor governments, affording real support for the mark by reducing the transfer burden, and bringing budget relief. On the eve of a definitive solution of the reparation problem by the force majeure of economic and political events which were to sweep aside all the refined calculations of experts and statesmen alike, the first and only step in the commercialization of reparation was taken, and as a consequence in June 1930 the foreign exchange reserves of the Reichsbank were built up and its total reserves stood at the highest point reached since the stabilization of 1924.

The position of the Reichsbank, however, was strong only in appearance. Germany was facing continuing difficulties in retaining short term foreign capital. The Reichsbank, fully aware of this, was reluctant to follow the downward course

[20] German merchandise imports and exports (millions of reichsmarks) for 1929–31 were (Schmidt, *op. cit.*, p. 111):

	1929	*1930*	*1931*
Imports	13,676	10,617	6,955
Exports	13,632	12,175	9,733
Net	−44	+1,558	+2,778

of rates elsewhere, as is shown in Chart 57 and Table 72 in which changes in its rate are compared with those in the Bank of England rate. In view of the stagnant condition of German business, it could not maintain rates high enough to exert a strong pull over foreign funds without losing contact with its own market. On the day of the burning of the

TABLE 72

Reichsbank and Bank of England
Changes in Discount Rates, 1929-1931

REICHSBANK		BANK OF ENGLAND	
1929		*1929*	
Jan. 12	7 to 6½	Feb. 7	4½ to 5½
April 25	6½ " 7½	Sept. 26	5½ " 6½
Nov. 2	7½ " 7	Oct. 31	6½ " 6
		Nov. 21	6 " 5½
		Dec. 12	5½ " 5
1930		*1930*	
Jan. 14	7 " 6½	Feb. 6	5 " 4½
Feb. 5	6½ " 6	March 4	4½ " 4
March 8	6 " 5½	March 20	4 " 3½
March 25	5½ " 5	May 1	3½ " 3
May 20	5 " 4½		
June 21	4½ " 4		
Oct. 9	4 " 5		
1931		*1931*	
June 13	5 " 7	May 14	3 " 2½
July 15	7 " 10	July 23	2½ " 3½
July 31	10 " 15	July 30	3½ " 4½
Aug. 11	15 " 10	Sept. 21	4½ " 6
Sept. 2	10 " 8		
Dec. 10	8 " 7		

SOURCES: Federal Reserve Board, Annual Reports; *Statistical Abstract of U.K.*, *1932*, p. 213

ABC bonds the Reichsbank rate reached 4½ per cent and on June 20 it was reduced to 4 per cent. A differential of 1 per cent as compared to England at this level was not enough to attract foreign funds, or even to retain them in the face of lack of demand in Germany and nervousness induced by the critical struggles over the Bruening financial reforms. In July German banks began to pay back foreign advances for which they had no use. There were withdrawals of foreign

funds and some flight of capital. The Reichsbank had to come to the support of the exchange and suffered substantial losses in foreign exchange reserves. The psychological advantages of the gold exchange standard at this juncture clearly outweighed those of the gold bullion standard. In August, however, the reserves of the Reichsbank were again replenished. It is probable that the receipt of the proceeds of a Kreuger loan, offered in connection with the granting of the

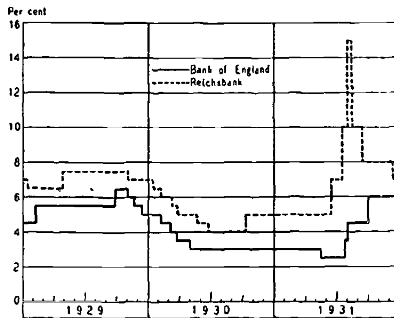


CHART 57
Reichsbank and Bank of England, Discount Rates, 1929-1931

German Match Monopoly to the Swedish Match Company, was of vital importance at this time.[21]

The unexpected and large electoral gains of the Nazi party in the September Reichstag elections profoundly shook the thoroughly unstable financial balance upon which the German gold standard then rested. It was the signal for a second mass withdrawal of foreign credits from Germany, once again predominantly French. There was also general foreign selling of German securities and a flight of German capital, but the foreign acceptance lines of German banks, which were largely British, were not reduced in 1930.[22] The crisis of September had secondary consequences also, for notice of withdrawal of a large amount of three month foreign credits was given.

[21] The Match Monopoly Agreement was ratified by the Reichstag in January 1930, but was subject to the putting into effect of the Young Plan. The proceeds consequently did not reach Germany until the summer of 1930. *The Economist,* Feb. 1, 1930, p. 278.

[22] Madden and Nadler, *op. cit.,* p. 397.

The first impact of the crisis was met by both domestic and foreign measures. The Bruening government was able successfully to float an internal loan, and elaborated further its internal economic program which now included a direct effort to reduce wages and the cost of living somewhat after the manner of the Australian middle of the road policy. The far more elaborate nature of German economic life, however, made the total program infinitely more complex. Agricultural protection was being pushed to still further extremes, well illustrated by the fact that in November 1930 the German *duty* on wheat was twice the world price, and the government was assuming great financial burdens under the Osthilfe program and for work creation projects. Domestic reforms, however drastic, could not meet the immediate foreign exchange crisis and the Bruening government arranged and obtained Reichstag approval for a $125 million two year foreign credit through Lee Higginson and Company.

The immediate crisis ended when the government received the support of the new Reichstag at its first meeting in October and adjourned that body until December 3. Fresh withdrawals of foreign credits ceased, and new credits were offered, especially from Switzerland.[23] Early in December the government again obtained Reichstag approval but only by the narrow margin of 38 votes. In January 1931 the secondary effects of the September crisis were felt, foreign support had again to be sought, and in February a second Lee Higginson credit was obtained. The Reichsbank was able gradually to increase its reserve until June, but this was chiefly because of the import of gold from Russia shipped to Germany as a commodity in payment of Russian debts. Between January and July 247 million reichsmarks ($58 million) of Russian gold were received. Meanwhile, the Bruening government put the next step of its economic program, including price and wage reduction measures, into effect by

[23] E. L. Dulles, *The Bank for International Settlements at Work* (Macmillan, 1932), p. 113.

decree. Both internally and internationally German affairs were passing from a state of chronic emergency to one of acute crisis. With the approach of this new crisis, the whole gold standard problem was once more complicated by the revival of political economics.

Revival of Political Economics

The international cooperation in support of the reichsmark at the time of the September 1930 crisis really inaugurated a new period in German currency history, both because of its nature and the circumstances under which it was carried out. The crisis offered to the Bank for International Settlements its first opportunity to help weather a foreign exchange crisis. The Bank made a direct contribution by increasing to the limit of its ability the investment of its own funds in Germany, but this could not, because of their special nature, be a substantial amount.[24] The Bank also contributed indirectly by encouraging the negotiation of the first Lee Higginson credit in which it could not participate directly because its statutes prohibited loans to governments. General international participation in this credit was invited, but only the United States, Sweden, and the Netherlands participated. Even the urgency of the need could not force this credit through the embargo placed on new foreign lending in London in defense of the pound. Switzerland did not participate on account of a Rhine port dispute with Germany and France did not participate "for political reasons." [25] The elections of September disclosed the strength of the opposition in Germany to the whole idea of further reparation payments, and were followed by declarations of many kinds against the Young Plan, including a series of strongly adverse speeches by Dr. Schacht. All the political emotions that had complicated the German exchange problems of 1920–23 were once more aroused. In Germany it was generally accepted

[24] Cf. *ibid.*, p. 112, for the details bearing on this point.
[25] *Ibid.*, p. 113, note.

that the Young Plan was doomed while it is doubtful whether a single French statesman, except perhaps Briand, shared this conviction. The Governor of the Bank of England and the British Treasury as well as the chief political figures in Great Britain greatly underestimated the depth of the German economic crisis. The struggle between political conflict and economic cooperation was fully revived. The agencies for economic cooperation were more elaborate and technically more efficient, but the note of political conflict was, under the surface, as bitter as in the early 'twenties. The withdrawals of foreign funds in January 1931 appeared to German eyes as a French effort to neutralize the good effects of the first Lee Higginson credit, just as the withdrawals of April 1929 had been regarded as pressure to enforce acceptance of the Young Plan. Suggestions from Germany for a moratorium under the Young Plan appeared to French eyes as merely another German attempt to avoid payment of just obligations but recently reduced by further French concessions. These suggestions, put forward early in 1931, were not pressed until some months later, since, for technical reasons, a moratorium would not have brought immediate relief to the German budget, or immediate support to the reichsmark. This made it possible in February 1931 to arrange the second Lee Higginson credit with French participation. In March, however, secret negotiations for an Austro-German Customs Union with possible later inclusion of Czechoslovakia, the scope of which was intended to be revealed only gradually, became known, and the full program had to be announced. The injection of this fundamental political issue into the situation at this time provided the worst possible political soil in which to cultivate the plant of further international financial collaboration. The effectiveness of this cooperation during the last months of Experimentation was in one sense promoted, but in another and broader sense retarded, by these great political enmities. When viewed on the narrow stage of Eastern European economic life, for ex-

ample, the French financial support given to Poland, Yugoslavia, and Roumania at critical moments in 1931 was an example of constructive international financial collaboration. When viewed upon the broad stage of European political life it was a form of political conflict.[26] Far more serious in their bearing upon the fate of the international gold standard were the hesitations and lack of unity introduced into international action in connection with the Austrian and German currency problems themselves.

[26] For a discussion of the political implications of these loans, cf. John W. Wheeler-Bennett's chapter entitled 'M. Laval in Wonderland' in *The Wreck of Reparations* (London, Allen & Unwin, 1933). Mr. Wheeler-Bennett marshals eleven cases of the political use of French financial power from 1929 to 1931.

CHAPTER 26

The Position of Italy and the Smaller Continental Creditor Countries

To complete our broad outline of the impact of world-wide deflationary forces upon the international gold standard in countries outside the central nucleus, a few words are necessary concerning Italy and the smaller continental creditor countries.

Italy

The position of Italy as a gold standard country at the beginning of the world depression, the methods by which she had attained that position, and the way in which she defended it were all in some respects peculiar to herself. In 1927, largely for the sake of prestige, Italy had stabilized the lira on an overvalued basis, and had subjected her domestic economy to severe deflationary pressure in order to adjust it to the new rates. From August 1926 to December 1927 Italian prices had fallen over 27 per cent—the greatest decline in any country except Denmark and Norway during the period of gradually falling prices immediately preceding the rapid declines of the world depression (Table 62). During the same period Italy had added to her central banking reserves of foreign exchange on such a scale that in December 1927 they were far greater than those of any other central bank in the world except the Bank of France (Table 59 B). These results she had accomplished with the aid of increasingly powerful state influence in economic matters, using, among other means, control over private international capital movements and foreign exchange control.

Having reached an apparently impregnable position, Italy

in 1928 completed the details of her monetary reform and stabilization measures. On February 26, 1928 two Royal Decrees were issued which put her on a form of gold exchange standard. The Bank of Italy was placed under obligation to give gold in exchange for its notes at the rate of 7.919113 grams for every 100 lire, or bills drawn on countries in which bank notes were convertible into gold at a rate of exchange not exceeding an arbitrarily fixed gold export point of 19.10 lire to the American dollar, at the option of the Bank. The Bank of Italy was not obliged to give notes for gold coin or bills drawn on gold standard countries, but the duty was laid upon it to enter the exchange market and buy and sell gold or gold bills so as to prevent the exchange rate from rising above 19.10 lire to the dollar or falling below 18.90 to the dollar. Both upper and lower gold points were thus de facto fixed by decree. Though the Bank could not be forced to increase the Italian note circulation through the exchange by the public of gold or gold bills for notes as of right, it could be forced to do so indirectly whenever it was necessary to issue notes in order to buy gold or exchange to check an undue rise in the value of the lira; that is, to keep the rate on New York from falling below 18.90 lire to the dollar. The Bank, however, was protected in its operations by the continuation of existing controls over private dealings in the exchanges. In June 1928 the relations between the Bank of Italy and the state were given final legal form, including the restriction of temporary lending by the Bank to the state to 450 million lire ($23 million). For reasons already given the use of the treasury bill as a short term instrument of finance giving the government indirect access to the credit of the central bank had been eliminated in Italy (cf. Ch. 14), but that did not mean that the Italian government had deprived itself of means of increasing its floating debt if it so desired. The bulk of the floating debt, small in 1928, was in the form of 'debtor current accounts,' [1] an item that could be readily increased in a fascist state.

[1] Bank of Italy, Annual Report for 1929 (*Federal Reserve Bulletin,* July 1930, p. 431).

In June 1928, also, the Bank of Italy, as previously noted, was given the right to convert its foreign exchange reserves into gold. For a moment Italy, together with France, seemed to exemplify the potential international dangers of the use, in a decentralized gold standard system, of the gold exchange standard as a half-way house. Under the impact of the depression, however, the large potential demand of Italy for gold crumbled away, while that of France continued to be a dominant influence in gold standard history. An instructive contrast was established between the international significance of large central banking foreign exchange reserves held by a creditor country with a strong underlying pull on the exchanges and large central banking foreign exchange reserves held by a country in the position of Italy.

The general scheme of international political payments left Italy free from any transfer problem comparable to that of Germany. Nor was she, like the periphery countries, dependent largely upon the export of a few staple commodities subject to violent price declines. In contrast to the position of such countries the terms of trade moved only slightly against Italy in 1929 and actually improved in 1930 and 1931.[2] Yet after 1928 she found herself in the position of having to defend the lira by the use of her newly acquired central banking reserves because she had neither a strong basic nor a strong surface pull over the exchanges. Italian central bank reserves began to fall substantially in 1928. In 1929 and 1930 Italy was first among European countries in loss of total reserves, and from 1929 to June 1931 her losses were exceeded only by those of Germany in Europe and of Argentina, Brazil, and Japan outside Europe. Aside from the great French conversions of foreign exchange into gold in 1929, the Italian loss of foreign exchange reserves was the greatest in the world from January 1929 through June 1931 (Table 67). Italy,

[2] *World Economic Survey, 1931/2,* p. 162, chart.

however, did not lose gold during these years. In common with some other European central banks, e.g. the Bank of Poland, the Bank of Italy carried out conversions of foreign exchange reserves into gold while total reserves were falling. These were on a small scale and were supplemented by repatriations of gold held in England since the war, made possible under the Anglo-Italian war debt agreements.

The Italian reserve losses of 1928 were the result of a trade deficit which the Bank of Italy in its annual report attributed to a combination of exceptionally heavy imports to make up for deficiencies in Italian harvests and to replenish stocks of raw materials depleted during the deflation of the preceding year, a reduced flow of emigrant remittances owing to the cutting down of emigration and the ending of speculative possibilities by the stabilization of the lira, some export of Italian capital, and increasing foreign debt service payments. It is clear that the remnants of the stabilization process of 1927 still complicated the foreign exchange problem proper in 1928, but within Italy deflationary pressure was relaxed. Prices remained at the level of the end of 1927 until Italy's recession high was reached in March 1929. One of those brief periods of normal conditions which during the post-war period from time to time flashed in the world's economic skies like summer lightning was begun in Italy toward the end of 1928, only to be ended almost immediately by a new deflation. Italian prices fell 8 per cent from March to December 1929; during 1930 they fell a further 20 per cent, and during 1931 another 9 per cent. These declines, especially in 1930, were more rapid than those experienced by most countries outside the group of periphery countries which sought refuge in exchange depreciation.[8] This helped Italy in her efforts to maintain her export trade. At the same time she was able to reduce the cost of her imports by the change in her terms of trade

[8] Italian prices in 1930 and 1931, e.g., fell faster than German, Dutch East Indies, United States, French, Belgian, and British prices (*ibid.*, p. 119, chart).

and to cut down their volume by her own efforts to promote self-sufficiency in agriculture. Consequently, after 1928 the excess of Italian merchandise imports over exports was steadily reduced. In 1929 this was accomplished by a large decline in cereal imports while both exports and other imports were increasing by an approximately equal amount. In 1930 and 1931, when both exports and imports were declining, imports fell faster than exports.[4] Notwithstanding the help given by these changes in her merchandise trade, Italy continued to be in need of capital imports from a balance of payments point of view. The restrictions on foreign exchange dealings and private capital movements put into effect as part of the stabilization process still remained in force through 1929, and though their application was greatly relaxed in practice, they acted as a deterrent to the inflow of capital. It was partly to remove this deterrent, as well as to complete the final steps in the return to gold, that in March 1930 the National Institute of Exchange was abolished, and the prohibition on the export of Italian securities payable in gold or gold currencies was lifted.[5] With this encouragement, in spite of the general contraction of international lending, Italy probably still remained a net importer of capital in 1929 and 1930.[6]

The defense of the gold standard in Italy during the first years of the world depression by a liberal use of central bank

[4] Italian merchandise imports and exports (millions of U.S. dollars) for 1929–31 were:

	1929	*1930*	*1931*
Imports	1,140	912	612
Exports	801	637	528
Net	−339	−275	−84

League of Nations, Memorandum on Trade and Balances of Payments, 1931–1932: Vol. I, *Review of World Trade, 1931–1932* (Geneva, 1932), p. 24.

[5] Bank of Italy, Annual Report for 1929 (*Federal Reserve Bulletin,* July 1930, p. 431).

[6] Ohlin, *op. cit.*, p. 208.

reserves to tide over a period when the balance of payments was being 'corrected' does not justify, except by a very extreme definition of gold standard orthodoxy, the inclusion of Italy's experience under the caption, Disintegration of the Gold Standard System. On the other hand it does not illustrate the operation of corrective forces upon strictly pre-war lines. Behind the decline in Italian prices was a strong deflationary pressure from the central bank,[7] but this thoroughly orthodox procedure was supplemented by the direct action characteristic of the authoritarian state which during 1930 was in some essential respects brought to maturity in Italy. In January 1930, a time of serious industrial troubles, a bill was passed by the House of Deputies enlarging the powers of the Italian Corporations, and in June the capstone of the corporative state was laid by the formation of the National Council of Corporations with powers to legislate on prices, wages, and production. Early in 1930 Mussolini was already demanding economy in municipal and corporate finance, and when a national budget deficit for 1930 threatened, fiscal considerations of an urgent character reinforced the general policy of economy and retrenchment. In the autumn of 1930 the whole force of the fascist political and economic organization was put behind a campaign for lower government salaries, lower rents, and lower wages. This side of Italian economic policy was commented on by the *World Economic Survey, 1931/2* (p. 233) as follows:

"The first important country to embark on a radical scheme of deflation was Italy. In November 1930, salaries and allowances were cut 12 per cent. At the same time an extensive campaign of propaganda was aimed at a general wage reduction of approximately 10 per cent. It has been claimed that the corporate plan of organization of Italy enabled the government more easily to

[7] The correspondent of *The Economist,* writing from Turin on March 13, 1930, spoke of this deflationist policy as being "brutally persisted in" (*The Economist,* March 29, 1930, p. 707). He also suggested the accumulation of "hidden" foreign exchange reserves by the banks.

break through the resistance of individual industries and interests in carrying out its programme of breaking the rigid structure of price and wage costs."

At the same time special care was being taken, as in Germany, to protect agriculture in harmony with the principle of self-sufficiency. In the international dispersion of wheat prices, which was substituted for the world price during the depression, Italian wheat prices remained among the highest in the world.[8]

During the first part of 1931 there were no further striking developments in economic policy in Italy bearing directly on her relation to the international gold standard system. It is a fact of general significance in world gold standard history, however, that Italy entered the final months of the Experimentation period with substitutes for the traditional corrective forces already forged and even partly in effect. Her machinery for exchange control had but recently been dismantled and could be quickly and effectively restored, and the concept was fully established that customary and contractual prices must not be allowed to produce during deflation, or indeed at any time, a dispersion of prices not desired by the state.

The Smaller Continental Creditor Countries

The impact of the world depression upon the debtor countries forced them to seek a new balance in their international relations. It obliged them to promote, whether by currency depreciation or otherwise, a favorable balance of merchandise trade, to exploit to the limit such special means of access to long term international credit as they possessed, to use to the utmost and even seriously to abuse short term foreign credits, and to draw on their central banking reserves. For the creditor countries of the world this meant loss of markets, demands for credit heavily charged with risk, and increases in reserves during a period of declining economic activity.

[8] *Ibid.*, p. 137.

At the outset of the depression Belgium, the Netherlands, Switzerland, Czechoslovakia, and Sweden shared the common characteristic of having a strong pull over the exchanges which put their central banks in a position to add to their total reserves, but with that their similarity ends. Belgium, the Netherlands, and Switzerland retained their pull over the exchanges longer than Czechoslovakia or Sweden, but their problems were far from identical. The position of the Netherlands was complicated by her active and substantial participation in the transactions of a central money market and by her colonial interests, while Switzerland was increasingly embarrassed by the use of her currency as a haven of refuge for foreign capital. Toward the latter part of the period the problems of Czechoslovakia and Sweden became more and more like those of most debtor countries, while Belgium, the Netherlands, and Switzerland were increasingly concerned with the question of undesired expansion of domestic credit due to the attraction of reserves. These differences within the group of smaller continental creditor countries may be briefly brought out by noting the major influences playing upon the central banking reserves of each of the five countries.

Czechoslovakia

At the beginning of the depression the Czechoslovakian currency was still stabilized de facto but not de jure. The foreign exchange restrictions that had been in force as part of this de facto stabilization were removed on December 28, 1928, and during 1929 the final legislative steps were taken to make Czechoslovakia a full-fledged gold exchange standard country. They were pushed with special vigor in order to allow the National Bank of Czechoslovakia to take its place upon the Board of the Bank of International Settlements which was open only to the representatives of gold standard countries.[9]

Though prices were declining during 1929, Czechoslovakia

[9] National Bank of Czechoslovakia, Annual Report for 1929 (*Federal Reserve Bulletin,* Aug. 1930, pp. 506–7).

was able to increase her favorable balance of merchandise trade. She was not severely hit by the forces of depression until the second half of 1930, the end of the period during which inter-European trade was relatively well maintained, and though both exports and imports declined substantially in 1931, she continued to maintain a favorable trade balance.[10] Relatively high money rates prevailed in her markets until the middle of 1930 and there were no large scale withdrawals of foreign funds until the first half of 1931. Since Czechoslovakia was not a heavy debtor on capital account, there was no serious problem of defending the crown. In 1931, however, foreign withdrawals did present such a problem on a moderate scale and, as shown in Table 67, the central bank was called on to give up reserves. The situation is well described in the Annual Report of the National Bank for 1931 (*Federal Reserve Bulletin,* July 1932, p. 434):

"The world-wide economic crisis was felt in Czechoslovakia somewhat later than in neighboring countries, and the economic structure showed considerable powers of resistance. Not until the last quarter of 1930 was there any marked falling off in business, which was followed in the spring of 1931 by favorable developments in the money market, some stabilization of the economic position, and more than seasonal improvement in certain lines. This improvement was checked, however, by the international credit crisis after the suspension of the gold standard in England. Nevertheless, the economic, monetary, and financial position of Czechoslovakia suffered less than that of its neighbors largely as a result of its former monetary and financial policy. Czechoslovakia, even during the rapid expansion of the past five years, resorted in only moderate amount to foreign short-term credit or long-term loans, so that when the liquidation of international credits began in May and June, the balances of Czechoslovak banks abroad were

[10] Czechoslovakian merchandise imports and exports (millions of U.S. dollars) for 1929–31 were (*Review of World Trade, 1931–1932,* p. 24):

	1929	*1930*	*1931*
Imports	590	464	347
Exports	606	517	388
Net	+16	+53	+41

larger than their foreign obligations and the volume of foreign short-term credits to industry was inconsiderable. Czechoslovakia, therefore, had no need to take emergency measures either at the time of the Austrian crisis or during the German crisis in July, although short-term deposits were withdrawn in considerable amounts over a comparatively short period. As, however, the international position, especially in the neighboring countries, continued to get worse, Czechoslovakia found its resources diminished both through the withdrawals of funds and through inability to repatriate from Germany either bankers', industrial, or individual balances. After September 21, owing to uncertainty respecting international credits, Czechoslovakia also had to resort to defensive measures. On September 22 the bank raised its rate, and on October 2 placed restrictions on foreign exchange transactions, which, owing to the deterioration of conditions in the neighboring countries, had gradually to be made more severe. Otherwise, there was no need for exceptional measures such as were put into effect in several other countries. It was not, for example, necessary to close the stock exchange or declare a moratorium."

Sweden

Like Czechoslovakia, Sweden in 1929 had a small favorable merchandise trade balance, but with the deepening of the depression was less successful in maintaining exports relative to imports. Largely owing to the importance of timber and iron ore in her export trade, the trade balance in 1930 and 1931 became progressively adverse. In addition, Sweden was very dependent upon her income from freights which suffered severely in 1931.[11] Sweden throughout received a small net

[11] These items in her balance of payments for 1929–31 were (millions of U.S. dollars):

	1929	*1930*	*1931*
Imports	478	445	358
Exports	486	415	280
Net	+8	−30	−78
Freight Receipts	54	50	37

For exports and imports: *Review of World Trade, 1931–1932,* p. 24; for freight: *Midland Bank Review,* Oct.-Nov. 1932, p. 2. Kronor figures converted at par.

income from capital investment abroad, but this could not offset the declines in the merchandise balance and in freights. These items, rather than capital movements, produced a deficit in the Swedish balance of payments and caused losses in her central banking reserves in 1931.

Belgium

To a larger extent than Sweden and Czechoslovakia, Belgium was throughout the period sensitive to events in the great international centers. In 1929 her money market was seriously affected by the withdrawal of funds for speculative uses in New York; nevertheless the National Bank was able to add to its gold reserves, chiefly by imports from New York. These were actually effected in large part by the triangular transactions with the Reichsbank at the time of the crisis in the Young Plan negotiations, already described. The underlying strength of the belga which made this possible and the technical procedure by which it was accomplished are described by the National Bank in its Annual Report for 1929: [12]

"The bank . . . has never tried to acquire gold, as is sometimes thought. It has merely taken up the volume of gold exchange which has come into the country in excess of the needs of the market. It has done this systematically at a rate corresponding to the gold import point or slightly lower. Being in possession of these foreign bills, and finding that the market was not repurchasing them, the bank converted them into gold. . . . It may be said, therefore, that the greater part of the additional circulation was issued against 100 per cent in gold values.

This influx of foreign exchange came from the surplus in our balance of payments, which throughout the year was influenced by a large volume of exports sold at favorable prices. The loans floated abroad and the purchase of Belgian securities by foreign investors aided this movement, but to a less extent than during previous years. Likewise the participation of foreign markets in capital increases, which have been numerous in Belgium during

[12] *Federal Reserve Bulletin,* May 1930, pp. 294–5; cf. Ch. 20, The Foreign Exchange Portfolio of the Bank of France in 1929.

1929, were by no means negligible. Nevertheless, a certain balance has been struck through the purchase of foreign securities by our own nationals."

The retention of the initiative in gold purchases in the hands of the National Bank was a feature of Belgian policy throughout the period. It enabled the Bank to reduce its foreign exchange reserves to a supplementary role and to make its gold purchases in such a way as not to disturb the international money markets. These two policies were not always compatible, as is indicated in Table 67 by the large growth in foreign exchange holdings in 1930. In that year the Belgian excess of merchandise imports over exports was slightly increased,[13] but this was far more than offset by the fact that Belgian private industry found it profitable, in view of the low interest rates abroad, to borrow outside Belgium.[14] Consequently the Belgian exchange remained at a premium over most gold standard currencies and the central bank remained in a position to increase its reserves. This presented two problems, one domestic, for it involved an increase in the note circulation not justified by domestic economic activity, and one international, for it raised the question whether or not to convert incoming foreign exchange into gold, and if converted, where to buy the gold. During 1930 London was the cheapest market, and in April, July, and December Belgium appeared as a successful bidder for gold there. Throughout the year, however, the Bank was, in its own words, "careful to make its gold purchases abroad without disturbing the

[13] Belgian merchandise imports and exports (millions of U.S. dollars) for 1929–31 were (*Review of World Trade, 1931–1932,* p. 24):

	1929	*1930*	*1931*
Imports	988	861	660
Exports	884	725	643
Net	−104	−136	−17

[14] National Bank of Belgium, Annual Report for 1930 (*Federal Reserve Bulletin,* April 1931, p. 207). The Belgian government refused to allow administrative departments to borrow abroad and removed the tax discrimination in favor of foreign loans which had been part of the stabilization machinery.

international money market."[15] There is evidence of restraint and inter-central bank cooperation in the increase in the foreign exchange reserves of the Bank in spite of its announced policy of reducing the importance of this element in its total reserves. In 1931, however, the policy of converting foreign exchange reserves into gold was resumed and large purchases were made in London in the first quarter. In June gold was imported from Germany and with the spread of the confidence crisis in July Belgium reappeared as an urgently competitive bidder for gold in the London market.

The Netherlands

During 1929 and 1930 the guilder was subject to many of the influences that affected the belga. The greater participation of Dutch funds in the international capital movements of these years, particularly in the active foreign lending of 1930, culminating in substantial Dutch participation in the Young Loan and in the first Lee Higginson credit to Germany, prevented further large accumulation of reserves by the Netherlands Bank. This was welcomed by the Bank as an aid to its internal credit administration, which included at this time earnest but wholly unsuccessful efforts to put gold coin back into circulation. The gold bullion standard, it began to appear, rested, in the Netherlands at least, not only upon central banking practice and the enforcement of 'gold economy,' but also upon the sanction of public habit and convenience. The Netherlands Bank wished also to prevent large international movements in its gold reserves, and to this end it directed its foreign exchange policy until June 1931. It was successful only as far as gold movements between London and Holland were concerned. From the beginning of 1929 to June 1931 all Dutch gold dealings of substantial proportions were with the United States, France, Germany, and the Dutch East Indies. In the first half of 1929 the guilder was sensitive to the strong pull of the dollar and the franc. In February and

[15] *Ibid.*, p. 208.

March the Netherlands Bank's reserves, of both dollars and sterling, were depleted, but in April they were replenished and gold was imported from the United States indirectly through the Reichsbank. In July gold export point on Paris was reached and gold was shipped to France, and in August gold export point on New York was approached and dollar exchange reserves were again parted with "for the protection of our stock of gold," as the Bank expressed it.[16] The gold exports to France were made because the Netherlands Bank did not have an adequate portfolio of French bills, and they led the Bank to build up such a portfolio. When relieved of the pressure from America at the end of 1929 the foreign exchange reserves were again replenished, and since the gold losses had been made good by receipts from Germany and purchases from Java the changes in the reserve position were very slight. The guilder, however, continued to be weak in Paris and in the first two months of 1930 and again in July gold shipments had to be made to France. These were partly offset by the purchase of gold from Germany after the German foreign exchange crisis of September.

During the first four months of 1931 there were no very substantial gold movements to and from the Netherlands. Dutch trade was declining, but the Dutch import surplus was declining also,[17] and in the absence of large new capital exports the Netherlands Bank was able to pursue its foreign exchange policy successfully. In June, with the outbreak of the credit crisis in Germany, large gold imports were received from that country, and with the spread of the confidence crisis to England, the Netherlands appeared for the first time

[16] Netherlands Bank, Annual Report for 1929 (*Federal Reserve Bulletin*, Aug. 1930, p. 504).

[17] Dutch merchandise imports and exports (millions of U.S. dollars) for 1929–31 were (*Review of World Trade, 1931–1932*, p. 24):

	1929	*1930*	*1931*
Imports	1,106	972	761
Exports	800	691	527
Net	−306	−281	−234

during the depression as an urgent buyer of gold in London, taking her place beside Belgium which had been an intermittent, and Switzerland which had been a steady buyer there.

Switzerland

Of the five countries discussed in these paragraphs, Switzerland alone experienced an uninterrupted substantial growth in its central banking reserves. Swiss export trade was severely crippled by the depression and her merchandise import surplus grew throughout the period.[18] Swiss capital was also lent or invested abroad quite freely during the earlier part of the depression. Yet the Swiss franc was consistently at a premium over almost all other gold standard currencies because it was consistently used as a haven for frightened capital, particularly German capital. The problem of unnecessary gold reserve accumulations at the central bank was therefore acute and Switzerland was more anxious than any other gold standard country to restore gold coins to circulation. The legislative groundwork for the restoration of the full orthodox gold standard was laid by legislation passed through its various stages in 1929. This did away with the last traces of bimetallism in the Swiss system and provided for a return to a gold circulation when other countries designated as important did the same.[19] This remained merely a gesture but serious efforts were put forth to cope with the problem of excessive gold reserves, as described by the Swiss National Bank in its Annual Report for 1930 (*Federal Reserve Bulletin,* April 1931, p. 204):

"The gold and foreign exchange policy of the National Bank,

[18] Swiss merchandise imports and exports (millions of U.S. dollars) for 1929–31 were (*Review of World Trade, 1931–1932,* p. 24):

	1929	*1930*	*1931*
Imports	516	488	427
Exports	401	337	258
Net	−115	−151	−169

[19] Swiss National Bank, Annual Report for 1929 (*Federal Reserve Bulletin,* May 1930, p. 305).

which throughout the year aimed to prevent the Swiss franc—already at a premium everywhere—from advancing any further, passed through various stages. When, in March and April, and again in June and July, the Swiss franc again showed a tendency to rise, the bank attempted to intervene by purchasing foreign exchange. When once the gold import point was reached, the bank declared itself ready to buy gold in accordance with its established regulations, specifying, however, that each offer of gold should be subject to a special decision. (It is well known, of course, that the National Bank, unlike most banks of issue, is not legally obligated to buy at a fixed price all gold that is offered to it. It buys gold only according to its requirements; on the other hand, free coinage of gold exists in Switzerland.) When the Bank of England decided to deliver only bars of 'standard' gold—916⅔ fine—the National Bank, along with other banks of issue, decided to accept only bars of fine gold; this resulted in lowering the gold import point of the English pound in relation to Switzerland.

When, as a result of gold purchases aggregating 78,000,000 Swiss francs ($15,054,000) the metallic reserve of the National Bank had reached 639,000,000 francs ($123,327,000), at the end of August, and the notes in circulation were covered to 70 per cent by gold, tenders of gold no longer had any interest for the bank, which, therefore, ceased to accept them. This refusal, however, brought about an equally large inflow of foreign bills of exchange; the resulting decline in foreign exchanges enabled the commercial banks to purchase gold and to have it minted. The National Bank assisted this operation by postponing, in favor of the private banks, the reminting into Swiss coin of its own stock of gold coins of the other countries of the Latin Monetary Union. But about the middle of October, when disturbances in Germany had again created a strong demand for Swiss francs, the bank, in order to check the further advance of the Swiss franc, was compelled to accept foreign exchange in large amounts, part of which was converted into gold deposits in London and New York."

Her strong exchange position brought Switzerland into the world's gold markets as a consistently effective bidder. During the backflow of funds to Europe after the New York

Stock Exchange crisis of 1929 she was able to take gold from New York, and was a steady buyer in London in 1930 and early 1931. On the other hand a regular but moderate stream of gold exports to Germany took place. This was not interrupted by the September 1930 crisis which, as stated above, was weathered by Germany partly with the aid of an inflow of Swiss capital. With the outbreak of the confidence crisis in June 1931 the flight of German capital so strengthened the Swiss exchange that Switzerland began to take gold in London, France, and Germany simultaneously.

A careful study of the monthly gold movements between the Netherlands, Switzerland, and Belgium, and the United States, Great Britain, France, and Germany discloses not only the major forces playing upon the reserves of the smaller creditor powers, but also the general relationships prevailing between the currencies of the center countries. The relative and persistent weakness of sterling, the persistent strength of the French franc, and the intermediate position of the dollar are clearly indicated. The German position is clearly reflected also. Finally the beginnings of a retreat from the gold exchange standard and the end of protection enjoyed by the Bank of England through the adoption of a *devisen politik* rather than a purely passive orthodox gold standard policy by the Netherlands, Switzerland, and Belgium is clearly indicated in the third quarter of 1931. Not only did their position as international creditors distinguish these countries from the debtor countries in the world distribution of gold and foreign exchange reserves during the first years of the depression, but in the figures of their gold trade may be read the story of internal strains within the central nucleus of the world-wide international gold standard system.

CHAPTER 27

The Center Countries

In Table 67 it was shown that the three great creditor countries, the United States, France, and the United Kingdom, participated in very unequal degree in the general movement of gold from debtor to creditor countries. Notwithstanding the change in the direction of flow and the appearance of many cross currents, the fundamental pattern stamped upon the world distribution of gold from 1925 to 1928 [1] still persisted. The London bullion market continued to fulfil the task of distributing new South African gold, for the most part to Europe and India. France continued to be an absorber rather than a distributor of gold, buying in the cheapest market, and the major movements of gold between Canada, the Far East, South America, and the center countries continued to be taken care of by the United States.

I The United States

Three phases may be distinguished in the international gold flow in and out of the United States from October 1929 to September 1931. The first was the four months from October 1929 to January 1930, during which the underlying pattern of world gold distribution was obscured by the effects of the return flow of funds from America to Europe after the New York Stock Exchange crisis. The second was from February 1930 to May 1931, during which an inflow from Canada, the Far East, and South America was completely dominant. The third was from June 1931 to September 1931, a period

[1] Cf. Ch. 18, The One-Way American Banking System in its Relation to the International Distribution of Gold.

marked by preparation for and actual withdrawals of gold, mainly through earmarkings, by European countries in the search for liquidity induced by the confidence crisis and in anticipation of future trouble.

In Table 73 gold movements between the United States and various groups of countries are shown for these three periods and for the last quarter of 1931. The distinctive

TABLE 73

United States, Gold Exports and Imports by Groups of Countries October 1929–December 1931, selected periods

Net imports +, Net exports – (thousands of dollars)

	Oct. 1929– Jan. 1930	*Feb. 1930– May 1931*	*June– Sept. 1931*	*Oct.– Dec. 1931*
All countries	−66,116	+451,432	+161,411	−191,391
England	−20,066	−268	+1,520	+5,267
France	−73,731	−45,977	−24,074	−339,660
Belgium, Holland, Switzerland	−10,007	+39	−4,541	−81,153
Argentina and Brazil	+16,102	+183,726	+44,381	+15,741
Mexico and Colombia	+7,743	+44,307	+17,445	+3,152
Canada	+11,556	+30,659	+36,641	+17,587
Japan and China	+2,120	+197,924	+39,192	+174,518
British India	−13		+4	+8,060
All other countries	+180 [1]	+41,022	+50,843 [2]	+5,097

Compiled from *Federal Reserve Bulletins*, Dec. 1929, p. 778; Jan. 1930, p. 8; Feb. 1930, p. 59; March 1932, p. 168

[1] Includes exports to Germany, $1,489,000; Poland, $5,010,000.

[2] Includes imports from Germany, $34,990,000.

characteristics of the first two periods appear clearly. The third does not stand out as distinctly because of the nature of the transactions involved, but the movements then prepared for dominated the gold flow of the last quarter of the year.

The Return Flow of Foreign Funds, October 1929 to January 1930

The return flow of funds to Europe began before the final break in the New York Stock Exchange and gradually weakened the dollar in the world's exchange markets. In October

the French franc went above gold export point and gold moved from New York to Paris. In November shipments were made to France, Switzerland, Germany, and Poland, and in December to France, Germany, and England. The late appearance of England in this movement was partly due to one of the brief excursions of the Federal Reserve Bank of New York into the realm of *devisen politik* on the European model. During July, August, and September 1929, the New York Reserve Bank had supported the pound by the purchase of about $18 million of sterling bills. Nevertheless, the sterling-dollar rate on the third Tuesday of September was 4.84 21/32, well below gold import point to New York from London. Thereafter the dollar began to weaken steadily, and during November the Federal Reserve Bank of New York was able to dispose of its stock of sterling bills.[2] This did not effectively retard the upward movement of sterling, for on the last Tuesday of December sterling was 4.88 9/32, well above gold export point from New York to London. By January 1930, however, the first force of the return flow of funds was spent and sterling returned to about mint parity in New York. France alone was able to continue her withdrawals of gold into January. At the same time the inward flow of gold from South America and the East, which had been moderate in the last quarter of 1929, was gathering strength. By the end of January the export movement to Europe had run its course and this inward flow became dominant.

From October 1929 to January 1930 the United States lost $75 million in gold and $18 million in central banking foreign exchange holdings. A decline in member bank reserves from $2,322 million on October 4, 1929 to $2,260 million on January 31, 1930 gives superficial ground for supposing the gold losses in this instance to have had their 'normal' effect. There was, however, no simple cause and effect relationship involved. The gold losses were absorbed in a series of central

[2] Cf. B. H. Beckhart, ed., *New York Money Market* (Columbia University Press, 1932), III, 455–60, especially chart, p. 456.

banking operations carried out first to meet the highly abnormal situation created by the crisis of October and then to assist the banking system in meeting the usual seasonal requirements of the year end.

During the first burst of active liquidation on the New York Stock Exchange in October, bank deposits all over the country had suddenly to be drawn upon to meet debts falling due in New York, chiefly in the form of increased payments required to protect call loans inadequately secured at the violently lowered security prices. Holders of securities bought with the aid of borrowed money who could not or did not care to draw down bank deposits for this purpose had to sell their securities and take their losses. This involved finding purchasers who had either to draw down deposits in their turn or find access to new bank credit. Like London in 1914, New York as a central money market in which there was a great concentration of liabilities [3] was calling in its debts. If, like London in 1914, New York had exercised its full powers in this respect without extending new credits, the financial machinery would have broken down as it did in 1914 (cf. Ch. 1). The New York banks, however, had prepared themselves for such a crisis by not participating in the final credit extensions which carried the boom into its last stages. They were able therefore to make loans to purchasers of securities and to buy securities themselves in order to avert the complete demoralization in stock exchange prices that would have been produced by allowing a self-generating liquidation to proceed unchecked. Simultaneously the 'contingent liabilities' of the banks, especially the New York banks, in the form of 'loans for the account of others' became actual. One of the first effects of the break in security prices was to end the era of high interest rates which had attracted non-banking lenders to the call market. These lenders concertedly called

[3] Cf. discussion of the phrase 'concentration of funds' as applied to a central money market in Ch. 7, The Concentration of Funds in New York; cf. also Ch. 18, The Concentration of Liabilities in New York.

their loans and the New York banks were obliged to take them over.[4] To help the banks in assuming these new burdens pending actual liquidation of loans on securities and the deposits created by them, the Federal Reserve banks bought government securities and discounted for the New York banks on a liberal scale. The complicated nature of the double process of contraction and expansion of bank credit involved in the first adjustments after the break may be indicated by an analysis of the figures of the 53 reporting New York City member banks for the single week October 23–29, 1929. The main changes in the combined balance sheet of these banks during that week are given in millions of dollars in the accompanying tabulation.[5]

ASSETS			LIABILITIES	
Total loans		+1,281	Deposits	+1,558
Loans for own A/c to brokers	+992		Due to the Federal Reserve Bank	+131
Other loans to customers	+289			
Investments		+99		
Reserves with the Federal Reserve Bank		+240		
		+1,620		+1,689

During the same week loans on securities to brokers and dealers for out-of-town banks declined $728 million, and loans for the account of others declined $1,359 million. Since loans for own account increased $992 million, the net reduction in loans to brokers was $1,095 million. To bring about this net reduction in brokers loans two partly offsetting operations were in progress:

1) the conversion of loans for the account of others into loans for own account, an operation that increased both the loans of the New York banks and their deposits;

[4] For a technical discussion of the effect upon bank loans and deposits of the rise and decline in loans for the account of others cf. B. M. Anderson, Jr., Brokers Loans and Bank Credit, *Chase Economic Bulletin*, Oct. 31, 1928, and H. L. Reed, *The Federal Reserve System* (McGraw-Hill, 1930), Ap.

[5] The figures are taken from various tables in the *Federal Reserve Bulletin*, Nov. 1929, pp. 751–2, 724.

2) actual liquidation of bank credit in the form of the repayment of brokers loans by the use of bank deposits; i.e., the deposits of new investors and of those called upon to meet margin calls (such operations reduced both the loans and the deposits of the New York banks). These two forces combined in some proportion. The accompanying figures show what the changes in the loans and deposits of these banks would have been if the extreme assumption is made that all the loans for out-of-town banks and for the account of others were taken over by the New York banks.

	LOANS	DEPOSITS
	(millions of dollars)	
Increases due to assumption of loans for out-of-town banks and others	+2,087	+2,087
Reductions due to actual repayment of brokers loans	−1,095	−1,095
Net increase in loans for own A/c of New York banks	+992	+992

The increases in loans and deposits of New York banks, which made it necessary to increase their reserve balances immediately after the crash, were part of a net increase in bank credit taking place in America while total credit extended to brokers was being reduced. The expansion of bank reserves incident to these first adjustments, however, was only temporary, for the forces leading to bank credit liquidation were stronger than those leading to bank credit expansion, great as these were. No steady decline in bank reserves, however, followed. Open market purchases of securities were continued, which facilitated the repayment of the rediscounts made during the crisis. The year-end expansion of the currency was financed by Federal Reserve bank purchases of acceptances and securities. In January the seasonal return flow of currency was unusually large but the corresponding reduction in Federal Reserve bank holdings of securities was unusually small. These operations all combined to facilitate an uninterrupted shift in Federal Reserve credit from the discount to the open market shoulder. Though gold was flowing out, the commercial banking system was once more getting itself free of debt to the central banks with only a

very moderate loss in the cash basis of credit. With a declining demand for bank credit the country over, there was a decline in loans and investments, but this was also moderate. In Table 74 the influences playing upon the American credit base and credit superstructure from October 2, 1929 to December 31, 1929 are shown. The use of year-end figures is unsatisfactory because the seasonal increase in commercial bank float for which no figure for *all banks* is available to the writer disguises the underlying position. Had it not been for this, the credit superstructure would undoubtedly have contracted slightly. For this reason, and in order to include the whole period of gold outflow to Europe, the figures for January 31 would have been preferable, but, as in all these tables, the call dates nearest the desired month have had to be used.

Accumulation of Gold, February 1930 to May 1931

By the end of January 1930 the return flow of foreign funds temporarily attracted by the stock exchange boom ceased to influence the exchanges strongly, though for various reasons foreign short term capital continued to be withdrawn from America. The United States entered a period of steady gold accumulation to which the gold losses of the periphery countries already described, the new production of Colombia, Canada, and Mexico, the gold losses of Japan incident to her struggle to return to gold, and exports from China closely connected with the fall in the price of silver, all contributed. From February 1930 to May 1931 the only important American gold transactions with Europe were with France. In July and August the franc was seasonally strong on account of French income tax payments, but at the same time the gold export point from London to Paris was altered adversely to France for technical reasons (cf. infra, pp. 1008–10), while the dollar was temporarily weak in London. For these reasons French demand for gold, which had been persistent in the London market, was in part diverted to New York, and substantial gold shipments were made to Paris. In April 1931,

TABLE 74

American Credit Base and Credit Superstructure Factors of Change

THE CREDIT BASE

TRANSACTION (millions of dollars)	EFFECT ON MEMBER BANK RESERVE ACCOUNTS	
Decrease in Monetary Gold Stock		−88
Decrease in Money in Circulation outside the Reserve Banks, the Treasury, and All Reporting Banks (estimated)	+22	
Increase in Cash in Vault of All Reporting Banks (estimated)		−68 [1]
Increase in Government Securities held by the Reserve Banks	+365	
Increase in Bills Bought held by the Reserve Banks	+70	
Decrease in Bills Discounted at the Reserve Banks		−298
Decrease in Other Deposits at the Reserve Banks	+14	
Decrease in Unexpended Capital Funds of the Reserve Banks	+14	
	+485	−454
Increase in Member Bank Reserve Accounts due to these Items	+31 [1]	
Actual Decrease in Member Bank Reserve Accounts	−43	

[1] Cf. Table 39, note 1.

when the franc was again seasonally weak, the United States was able to draw back a part of these gold losses to France. As a whole these French transactions made hardly a ripple on the main inward movement.

The gold sent to the United States at this time came partly because of her position as a center country in the international gold standard system. It was one element in a world-wide adjustment between debtor and creditor countries. This was not, as in pre-war days, predominantly an adjustment in debtor countries softened by temporary financing by

TABLE 74

October 2, 1929–December 31, 1929, a Period during which Gold was flowing out and the Federal Reserve System was buying Government Securities

THE CREDIT SUPERSTRUCTURE

TRANSACTION [2] (millions of dollars)	EFFECT ON DEPOSITS (EXCL. INTERBANK DEPOSITS) OF ALL BANKS REPORTING TO THE COMPTROLLER		
Decrease in Monetary Gold Stock			−88
Decrease in Money in Circulation outside the Reserve Banks, the Treasury, and All Reporting Banks (estimated)		+22	
Increase in Commercial Bank Float (incomplete)		+667 [3]	
Increase in Net Indebtedness to Foreign Banks (Member Banks only)			−78
Decrease in Loans plus Investments (adj.) of All Reporting Banks			−442
Loans and Discounts (adj.)	−326		
Investments	−116		
Increase in Government Securities held by the Reserve Banks		+365	
Increase in Bills Bought held by the Reserve Banks		+70	
Increase in Capital Funds of All Reporting Banks (estimated)			−126
		+1,124	−734
Increase in Deposits (adj.) of All Reporting Banks due to these Items		+390	
Actual Increase in Deposits (adj.) of All Reporting Banks		+109	

[2] In this table and in Table 75 the items Treasury Currency and Real Estate owned by All Reporting Banks have been omitted, as the changes in them were of negligible importance.

[3] Cf. Table 39, note 2.

the creditors; for the United States as a large producer of agricultural products for export was herself subject to many of the economic problems of the periphery countries. Within her own borders she exemplified in the highest degree the fundamental economic deadlock of the world depression, the maintenance of agricultural production in the face of declining prices and the maintenance of industrial prices by means of restricted production. From June 1929 to June 1931 the changes in agricultural output in the United States are mainly to be accounted for by climatic conditions. Corn pro-

duction was virtually unchanged, while the wheat, oat, and cotton crops were all larger in 1931 than in 1929. Meanwhile, industrial output had dropped 42 per cent and factory employment 27 per cent. As a direct consequence farm prices had fallen 37.9 per cent at wholesale and 55 per cent on the farm while non-agricultural prices had fallen only 21.2 per cent. The absence of any general deflationary pressure from the banks up to June 1931 helped to prolong this deadlock.[6] Credit was available to assist the farmer in his struggle to maintain production and the industrialist to hold up prices. The prolongation of the price deadlock, however, in a country in which no prosperity is possible without adequate agricultural purchasing power, progressively undermined the solvency of a large section of the banking system.

In order therefore to indicate fully the position of the United States in the gold standard world at the time of the confidence crisis of June 1931, the preceding gold inflow into America has to be considered as an element not only in a balance of payments problem, but also in a domestic banking problem of great, indeed of unprecedented complexity. No country under the pre-war international gold standard system had ever been placed in the position then occupied by the United States.

The American central banking policy that prevailed from February 1930 to May 1931 was already fully developed at the beginning of that period. It was to provide abundant supplies of credit at cheap rates to stimulate business recovery. The discount rate of the Federal Reserve Bank of New York was first reduced from 6 to 5½ per cent on November 1, 1929, and successive reductions brought it down to a record low of 1½ per cent established on May 8, 1931. The government security purchases of the last months of 1929 were continued but on a smaller scale until the middle of 1930. Their role in building up member bank reserves was

[6] For an excellent summary of the situation, cf. L. A. Rufener, *Money and Banking* (Houghton, Mifflin, 1934), pp. 620–7, 636.

supplemented by gold imports and by a continued downward trend of money in circulation. Under these circumstances member banks were able to reduce still further their indebtedness to the Federal Reserve banks and at the same time to increase their reserve balances on a small scale. The role of gold once more, as in 1921–22 and 1928,[7] was to fix permanently in the American credit base reserves created in the first instance by Federal Reserve credit. The power of the American banking system to build an increased credit structure on an increased credit base was, however, temporarily exhausted. At a time when, in the striking and accurate phrase of L. A. Rufener, business men and farmers were actively engaged in "deflating each other," there was no substantial demand for bank accommodation for commercial purposes. Commercial loans declined on a great scale and deposits were correspondingly drawn down. The banks, finding themselves in possession of unutilized lending power represented by surplus reserves, endeavored to find employment for their funds by increasing their secondary reserves and their purchases of securities, especially government securities.

B. H. Beckhart, in the fourth volume of his work on the New York money market (pp. 161–2), has brought out the general economic implications of this particular result of a cheap money policy immediately following a crisis:

"In company with higher-tariff and price-valorization fallacies, the cheap-money fallacy puts in its appearance regularly during periods of business inactivity. Sight is generally lost of the fact that cheap-money policies on the part of central banks may not in themselves bring about that readjustment of retail and wholesale prices, wages and costs, on the basis of which any substantial improvement in business must be founded. Little attention was given to the effects of such policies on the quality of member and nonmember bank portfolios, impaired at that time by frozen real estate, security loans, and depreciated bonds. Whatever effect

[7] Cf. Ch. 10, The Preservation of the Credit Base and the Maintenance of the Credit Superstructure, 1920–22, and Ch. 22, The American Credit Base and Credit Superstructure, June 1928 to October 1929.

TABLE 75

American Credit Base and Credit Superstructure
Factors of Change

THE CREDIT BASE

TRANSACTION (millions of dollars)	EFFECT ON MEMBER BANK RESERVE ACCOUNTS	
Increase in Monetary Gold Stock	+672	
Increase in Money in Circulation outside the Reserve Banks, the Treasury, and All Reporting Banks (estimated)		−55
Decrease in Cash in Vault of All Reporting Banks (estimated)	+98 [1]	
Increase in Government Securities held by the Reserve Banks	+157	
Decrease in Bills Bought held by the Reserve Banks		−287
Decrease in Bills Discounted at the Reserve Banks		−483
Increase in Other Deposits at the Reserve Banks		−64
Decrease in Unexpended Capital Funds of the Reserve Banks	+24	
	+951	−889
Increase in Member Bank Reserve Accounts due to these Items	+62 [1]	
Actual Increase in Member Bank Reserve Accounts	+2	

[1] Cf. Table 39, note 1.

a cheap-money policy might exert on the business situation would be transmitted through increased bond purchases on the part of the banking community, which would place additional purchasing power in the hands of the corporate and governmental borrowers. From the point of view of the credit system, this result (the purchase of bonds by banks, on the basis of expanding bank credit, rather than on the basis of savings) could hardly be counted as salutary. The purchase of such obligations, on the basis of bank credit, would but further impair the liquidity of bank portfolios. Should interest rates later rise or bond prices fall, this condition would but tend to increase the dependence of the banking community on the Federal Reserve banks."

TABLE 75

December 31, 1929–June 30, 1931, a Period during which Gold was flowing in and the Federal Reserve System was not pursuing Active Open Market Operations

THE CREDIT SUPERSTRUCTURE

TRANSACTION[2] (millions of dollars)	EFFECT ON DEPOSITS (EXCL. INTERBANK DEPOSITS) OF ALL BANKS REPORTING TO THE COMPTROLLER		
Increase in Monetary Gold Stock		+672	
Increase in Money in Circulation outside the Reserve Banks, the Treasury, and All Reporting Banks			−55
Decrease in Commercial Bank Float (incomplete)[3]			−1,043
Decrease in Net Indebtedness to Foreign Banks (Member Banks only)		+7	
Decrease in Loans plus Investments (adj.) of All Reporting Banks			−3,092
Loans and Discounts (adj.)	−6,230		
Investments	+3,138		
Increase in Government Securities held by the Reserve Banks		+157	
Decrease in Bills Bought held by the Reserve Banks			−287
Decrease in Capital Funds of All Reporting Banks		+238	
		+1,074	−4,477
Decrease in Deposits (adj.) of All Reporting Banks due to these Items		−3,403	
Actual Decrease in Deposits (adj.) of All Reporting Banks		−3,507	

[2] Cf. Table 74, note 2.
[3] Cf. Table 39, note 2.

During the first half of 1931 the consequences of an easy money policy were more and more clearly exemplified in the banking system. Total deposits continued to decline, but far less than loans and discounts. They were held up by large increases in investments. At the same time the gradual deterioration in the quality of bank assets in the United States led to an alarming increase in bank failures. In 1929 there were 642 failures, in 1930, 1,345, and in 1931, 2,298. Hoarding began on a large scale. The downward trend of money in circulation was reversed, and the role of incoming gold in the American banking system was changed. During the first five months of 1931 it was just enough to offset the increase

in money in circulation. Except for well defined seasonal needs Federal Reserve bank purchases of government securities had practically ceased in mid-1930, so that in the first half of 1931 there was no influence tending to increase member bank reserve accounts. They ceased to rise. Amid ever deepening depression and in spite of the appearance of hoarding, the credit base remained practically unchanged.

The influences playing upon the credit base and credit superstructure from December 31, 1929 to June 30, 1931 are presented in Table 75. Tables 74 and 75 together disclose the processes by which the American commercial banking system came to the eve of the confidence crisis with reserves higher than those existing at the peak of the inflation, with no substantial debt to the Federal Reserve banks and with large unused lending power. They also show that gold movements to and from the United States from October 1929 to May 1931 offered very imperfect illustrations of the textbook maxim that under the gold standard, when gold flows out credit is contracted, and when it flows in credit is expanded. During the latter part of this period, however, gold inflows did contribute powerfully to extreme ease of money in America. They therefore helped to make investment abroad, especially on short term at the relatively high returns still available in debtor countries, attractive to American banks. The importance of export trade, especially to certain great agricultural interests, gave such investment the sanction of patriotic service, and the claims of international financial cooperation in the face of dangers to the whole gold standard system insistently pointed in the same direction. By helping to place behind these broader motives of financial statesmanship the driving force of immediate self-interest, gold imports exerted a strong indirect influence upon a series of adjustments in the international balance of payments of the United States to which they also made a direct contribution.

These adjustments were of the highest importance in the whole history of the international gold standard. Their main

features are indicated in Table 37 and Charts 30–5. Though both exports and imports declined in value the United States continued to have a very substantial export surplus on merchandise account, amounting in 1930 to $782 million. Current invisibles showed on balance a debit of $1,010 million, only slightly less than in 1929, so that in its ordinary interchange of goods and services the United States continued, as it had been since 1923, to be a debtor for the year. This debit of $228 million was far more than offset by a record credit in interest, dividend and war debt account of $857 million and by an inward movement of capital other than new issues. During 1930 Americans bought foreign securities in the international security markets amounting to about $360 million, but foreigners bought about $100 million of American securities and foreign securities previously accumulated in America to the remarkable amount of over $800 million.[8] These dealings in outstanding securities gave a net credit of $555 million, and with the interest and dividend receipts constituted, as in earlier years, America's basic pull over the exchanges (cf. Table 37). A formidable credit balance of $1,184 million, a quarter of a billion dollars greater than that of 1929, had therefore to be met in 1930 by new foreign issues, short term capital exports, and gold imports. Had there been no net import of capital through private trading in securities, the new foreign issues and short term capital exports required to maintain the merchandise export surplus at the level actually recorded without further gold imports would have been of the order of $600 million instead of about $1,200 million. With full realization of the intricate interrelations of all items in the balance of payments the figures are presented in this way in order to stress the peculiar difficulties of the United States as an international financial center. Having in the past lent under special circumstances large sums to other creditor countries, and with a public less

[8] The Balance of International Payments of the United States in 1930, *Trade Information Bulletin, 761*, p. 111.

accustomed to investing in foreign securities than those of Great Britain, the Netherlands, and other European countries, she had difficulty in retaining her foreign investments when they declined in price, and even in depression retained a power to attract capital from abroad to her own securities. Yet capital export on a large scale was necessary if the export surplus to which the American economy had become adjusted was to be retained and an overwhelming attraction for the world's gold was to be avoided. The revival of long term lending in the first half of 1930 was therefore not only of great importance to the American economy, but was also part of a general defense of the international gold standard system. It was supplemented by a steady and large outward movement of short term capital of $484 million, of which about one-third represented increased employment of American short term funds abroad and two-thirds reduced employment of foreign funds at short term in America.[9] This movement was partly due to the differential in interest rates created by the leadership of the United States in the world movement toward cheaper money and the hesitancy with which Germany and other debtor countries followed that leadership. It was due also to the use of American funds to strengthen other currencies against the dollar, partly at foreign and partly at American central bank initiative. The initiative of foreign central banks is indicated by the decline of over $100 million in the contingent liability of the Federal Reserve banks representing foreign central banking funds employed in American acceptances under their guarantee. The initiative of the Federal Reserve banks is shown by their purchase of $35 million of sterling bills in October, November, and December 1930 to support sterling exchange during a period of seasonal weakness.[10] During 1930 the United States, in her own way, followed the British pre-war precedent of shifting her international capital exports from long to short term during a cyclical depression.

[9] *Ibid.*, p. 60.
[10] Beckhart, *op. cit.*, III, 459, and chart, p. 456.

During the first half of 1931 the adjustments in the various items in the American balance of payments were carried beyond the point where they can be described by any pre-war analogies. The outward movement of long term capital was converted into a net inward movement. The import of capital through direct investment and security trading, though less than in 1930, exceeded the capital export through new foreign issues. Though the export of short term capital continued to grow and to impart general strength to other currencies in terms of the dollar, it was, under these circumstances, neither sufficient in amount nor so distributed geographically as to prevent a great reduction in the merchandise export surplus of the country. In particular the purchasing power of countries peculiarly dependent upon new long term American loans was reduced. Exports fell in value more rapidly than imports and a substantial part of the basic pull given to the dollar by the inward flow of interest and dividend payments and private capital movements was offset by a growing debit balance on current transactions resulting from the relatively well maintained volume of invisible imports and the reduced net merchandise exports. The balance was struck by continued gold imports. The figures for the full year 1931, of course, do not reflect this situation, for during the latter part of the year the short term capital export was greatly increased and the gold movement reversed by the withdrawal of foreign funds after Great Britain's abandonment of the gold standard. Preparations were already in progress for these withdrawals from June to September 1931.

Preparing for Trouble, June–September 1931

From June to September 1931 the United States was an active participant in the efforts to stem by international financial cooperation the final disintegration of the international gold standard system as it existed during the Experimentation period. The most dramatic of her contributions was the one year moratorium on inter-governmental debts proposed by Presi-

dent Hoover in June after receiving urgent representations concerning the acute difficulties imposed upon Germany by real reparation transfers during a world depression. In addition the United States participated in a series of international credits arranged to meet various urgent situations arising from the confidence crisis which will be briefly enumerated in Chapter 28. As a result of these credits the foreign bill portfolio of the Federal Reserve banks, which had been reduced to a nominal amount in January 1930, rose to previously unattained proportions after June 1931.[11] Private banking credits added to this emergency export of capital, and at the same time the European exchanges were being further supported by a mobilization of central banking funds in New York and the export of gold through earmarking. In September this was converted into an actual withdrawal of gold from the United States. These earmarkings reflected a growing lack of confidence in the American position itself. Withdrawal of foreign assets held in the United States, motivated by fears for their safety, and intercentral bank cooperation in the extension of American credits to foreigners served the same technical ends as far as exchange rates were concerned until September 1931. But the presence of both motives during the final efforts to save the international gold standard system was further evidence of the conflict between the general international and the particular national interest that made the operation of a decentralized financial system far more difficult than the operation of the gold standard before the war.

The gold withdrawals of October 1931, after Great Britain had abandoned the gold standard, fall outside the Experimentation period, but because of their organic connection with the preparations of June to September the account given of this whole episode in American financial history by Professor Beckhart is quoted here:

[11] Beckhart (*op. cit.*, III, 160, table) gives the monthly totals of this portfolio from May to September 1931 as follows (thousands of dollars): May, 1,074; June, 10,551; July, 34,371; August, 145,215; September, 48,804.

"The sharp reduction in the stock of gold in the United States between September 16 and October 28, 1931, represented a run on the American banking system. Various European nations had lost confidence in the stability of the American financial organization and anticipated the abandonment of the gold standard, and those nations, France, Holland, Belgium, Sweden, and Switzerland, which had balances or short-term investments in the New York money market were withdrawing these in the form of gold.

The outflow of gold was presaged by the rise in foreign bank deposits at the Federal Reserve banks and by the rapid decline in the contingent liability on bills held by the Federal Reserve banks for foreign account.

	ALL FEDERAL RESERVE BANKS		FEDERAL RESERVE BANK OF NEW YORK	
	Contingent Liability on Bills Purchased for Foreign Account	Foreign Bank Deposits	Change in Gold Held Under Earmarked Account for Week Ending	Net Gold Movements for Week Ending
1931				
June				
17	379	5.7	−75.8	+9.8
24	368	20.0	−11.3	+8.7
July				
1	335	35.6	−0.7	+30.2
8	302	39.9	None	+5.6
15	290	56.2	+8.5	+0.1
22	298	58.5	+14.0	+4.2
29	254	100.4	+2.5	+2.1
Aug.				
5	226	132.4	+13.7	+14.6
13	220	180.5	+5.0	+3.0
19	227	168.4	+2.0	+6.5
26	230	182.9	None	+1.2
Sept.				
2	230	178.1	−3.5	+1.2
9	231	207.4	+5.0	+5.4
16	233	197.3	None	+10.9
23	181	162.1	+121.6	+1.6
30	100	95.1	+153.8	−4.7
Oct.				
7	81	152.6	+28.0	−75.1
14	41	231.4	+96.7	−116.8
21	68	160.9	+18.1	−93.8
28	83	157.6	−3.0	−60.6

Foreign bank deposits with the Federal Reserve banks fluctuate ordinarily between 5 and 6 millions of dollars. These represent simply working balances maintained by foreign central banks. An understanding exists that any surplus above this amount is invested immediately in American bankers' acceptances or in United States securities for the account of the foreign central bank. On June 17 the contingent liability on bills purchased for foreign account was some 90 millions of dollars less than the year previous. The reduction had been a gradual one and was in consequence of the decline in rates of interest in the money market. From that time until the first week in August, this amount declined rapidly. The funds received by the central banks from the sale of their acceptance holdings went to swell their deposits with the Reserve banks, along with certain other funds which the central banks had had invested in United States government securities. The Federal Reserve banks took over these bills and this amount together with other bills purchased prevented the increase in foreign bank deposits from affecting the money market. It was not until after September 16 that the withdrawal of foreign funds from the New York money market assumed panic proportions, and within four weeks of that date the contingent liability on bills held for foreign account declined by 192 millions of dollars. Central banks had the funds so invested set aside in the form of earmarked gold, and in addition drew upon their deposit accounts with the Federal Reserve banks to increase further the amount of gold held under earmarked account. Through October a large part of the gold earmarked was exported. Through September and October the monetary stock of gold of the United States declined by 703 millions of dollars, or by 14 per cent." (IV, 163–5)

The underlying trends in the adjustment of the American balance of payments from 1929 to 1931 were thus rudely interrupted by the confidence crisis of the last half of 1931. Their great permanent significance for the whole subsequent history of the international gold standard should not on that account be overlooked. This significance was the continuance and growth of the basic pull of the dollar over the world's exchanges. The period of exceptionally large merchandise ex-

port surpluses was indeed brought to an end, but the special circumstances leading to the remarkable decline in export values were not of a permanent nature. The net debit arising from current invisibles was likely to decline as exports declined, and to revive again as exports increased, for some of its components were sensitive to conditions favorable to exports and some were functionally connected with export trade. A transition to large and growing American import surpluses in the trade and service items was clearly not to be accomplished in a few years. The net inflow of payments for interest and dividends on past debt, though subject to reduction, was clearly not subject to rapid elimination. A net export surplus from these items combined was to be expected as a continuing feature of the American balance of payments, but there was every indication that the capital items would not readily combine to offset it. The forces leading to an inward movement of capital through direct investment and the security markets were very persistent and so also were those tending to discourage the flotation of new foreign loans in America. A regular outflow of short term capital over a period of years was not to be expected, for it is contrary to the nature of such movements which are limited by the inducements offered for the employment of American funds abroad and the actual amount of mobile foreign funds in America. The short term movement, moreover, was subject to rapid reversal with changes in psychological attitudes and new economic and political trends. It was, indeed, from 1929 to 1931 that the foundations were being laid for the later reappearance of America as a great magnet drawing to itself the world's gold (cf. Ch. 33).

II France

While the powers of the United States to attract gold were, during the first years of the depression, still in process of growth and development to full maturity, those of France were at their zenith. French gold demand was one of the most striking features of the whole period between the New York

Stock Exchange crash and the beginning of the confidence crisis in Europe. Its amount and timing were the result of a combination of three major forces: (1) the continued general strength of the franc which enabled a 'correct' gold standard attitude to bring gold to France; (2) the efforts made to develop Paris more fully as an international financial center; (3) the divergent attitudes of the French Treasury and the Bank of France in the treatment of their foreign exchange holdings.

The Continued Strength of the Franc and its Changing Basis

The forces contributing to the strong pull of the franc over the world's exchanges from 1929 to 1931 may be clearly seen by taking Pierre Meynial's estimates of the French balance of payments and combining and arranging them in the general form used in these studies in presenting American balance of payments figures. In M. Meynial's estimates for 1930 and 1931 'invisible capital movements' is a balancing item, not very homogeneous in character and containing the net error involved in all the other items, so that such an arrangement of his figures gives an appearance of exactitude that must be discounted. For 1929 M. Meynial does not include any figure for invisible capital movements, but leaves the statement unbalanced by 5 milliard francs. In his discussion in the *Revue d'Économie Politique,* however, he gives an estimate of the net outward movement of short term capital for 1929 of 1.8 to 2 milliard francs [12] which is used in our table. The figures are all approximations, and the picture presented in Table 76 is to be taken as showing only what it professes to show, the main outlines of the French balance of payments.

As in the case of the American balance of payments, the figures for 1931 reflect very strongly the movement of funds during the confidence crisis of the second half of the year, and

[12] 'La Balance des Comptes,' *Revue d'Économie Politique,* May–June 1930, p. 482.

TABLE 76

The French Balance of Payments Problem, 1929-1934

Payments from foreigners +, Payments to foreigners −

	1929	1930	1931	1932	1933	1934
	(milliards of francs)					
1 Mdse. trade and current invisibles	−0.4	−3.9	−6.4	−5.9	−4.7	−3.8
2 Payments on past financial obligations (gov. payments and int. on capital invested abroad)	+5.2	+4.2	+3.3	+1.2	+1.7	+2.5
3 Net receipts from reparation and war debts	+4.7	+4.9*	+2.6			
A Basic pull over the exchanges (1 + 2 + 3)	+9.5	+5.2	−0.5	−4.7	−3.0	−1.3
4 Movement of long term capital other than new foreign issues placed in France		−3.2*	−2.1	+6.4	+0.2	+0.5
5 Invisible capital movements (short term and error)[1]	−2.0*	+6.8	+25.8	+2.0	−1.5	+2.3
B Capital movements excl. new foreign issues placed in France (4 + 5)	−2.0	+3.6	+23.7	+8.4	−1.3	+2.8
C Adjustment required to be made by new foreign issues and credits, official exchange transactions and gold movements (A + B)	+7.5	+8.8	+23.2	+3.7	−4.3	+1.5
6 New foreign issues placed in France	−1.1	−1.4	−7.3	−3.8	−1.3	
7 Bank of France credit to foreign central bank			−3.8			
8 Net sales of foreign exchange by the treasury and bank of France	+5.1	+4.1	+6.4	+17.8	+3.6	
D New foreign issues and credits and official exchange transactions (6 + 7 + 8)	+4.0	+2.7	−4.7	+14.0	+2.3	
E Adjustment required to be made by gold movements (C + D)	+11.5	+11.5	+18.5	+17.7	−2.0	+1.5
9 Gold imports	−8.5	−11.5	−18.5	−17.7	+2.0	−1.5

Derived from figures of P. Meynial as presented by M. G. Meyers, *Paris as a Financial Center*, p. 143.

* From Meynial's annual articles in *Revue d'Économie Politique*.

[1] Except for 1929 Meynial treats this item as a balancing figure.

it is admissible to assume that during the first half the tendencies disclosed in 1929 and 1930 were continued. These tendencies were:

1) a rapid decline in the basic pull of the franc over the exchanges due chiefly to a reduction in the net credit balance of merchandise trade and current invisibles (with the Hoover Moratorium of 1931 this basic pull was eliminated)
2) a growing inward movement of private capital which fully offset this decline in the basic strength of the franc and produced a steadily increasing credit balance to be offset by new foreign loans and gold movements
3) a steady addition to this credit balance by official sales of foreign exchange and a complete failure of new foreign loans to fill the resulting gap in the balance of payments
4) a persistent gold import due less and less to permanent and more and more to temporary causes.

In 1930, in spite of the adverse movement in the balance of trade, France, by virtue of her international creditor position both from past investment and in the system of post-war debt and reparation payments, had a net credit balance of 5.2 milliard francs in her international transactions before taking account of capital and cash items. Under the stimulus of attractive prices large amounts of French securities placed abroad in earlier years were repatriated. In addition the government repaid a Kreuger Loan of 2 milliard.[13] Had there been no substantial inflow of short term funds into France this would have gone far to offset the underlying strength of the franc. But there was such an inflow. Foreign funds sought safety in the comparative security of the French market. French banks withdrew funds from Germany under circumstances already described, and also from the creditor markets both because of inadequate interest inducement for their employment there and because they wished to strengthen their position at home seasonally and in the face of various banking troubles. These capital movements as a whole therefore added to rather than diminished the basic pull of the franc, leaving a credit balance of the order of 8.8 milliard to be offset by new foreign loans

[13] *Ibid.*, May–June 1931, pp. 516–8.

or increases in French balances abroad, or, failing that, by gold imports. New foreign loans were of only moderate proportions, and official exchange transactions, far from accumulating fresh balances abroad, repatriated such balances on a large scale. Consequently the gold requirement of France was still further increased. These remarkable results were reached in spite of a series of French policies designed to repel the inflow of short term funds, to convert France from a silent into an active partner in the gold standard nucleus, and to impose restraint upon the use of her latent powers to withdraw funds from London and New York.

Writing in October 1930, Albert Aftalion stated that gradually, as some of the international repercussions of the French gold imports developed on a large scale, a fivefold policy was initiated in France to check these imports: (1) to maintain the Bank of France rate at a relatively low level; (2) to relax the burden of taxation upon the income of, and the cost of dealing in, foreign securities; (3) to develop a market for foreign acceptances in Paris; (4) to admit to discount at the Bank of France bills of only seven days' maturity in order to discourage French banks from bringing gold to the Bank of France to finance monthly requirements; (5) to have the Treasury and the Bank of France refrain from selling their holdings of foreign exchange.[14]

These policies make an imposing list, but they were in sum very ineffective. At the time Professor Aftalion wrote they had for the most part passed the peak of their effectiveness. Notwithstanding the intervening great rise and fall of rates in London and New York, the Bank of France had maintained its relatively low rate of 3½ per cent for two years, from January 1928 to January 1930. On January 30, 1930 this rate was reduced to 3 per cent while the Bank of England rate was still 5 per cent and that of the Federal Reserve Bank of New York, 4½ per cent. The Bank of France did not, however, long re-

[14] 'The Causes and Effects of the Movements of Gold into France,' *Selected Documents of the Gold Delegation* (Geneva, League of Nations, 1931), pp. 12–13.

tain its leadership in the downward movement of rates. Concerning the January 1930 and subsequent reductions Margaret Myers writes:

". . . the Bank of France reduced its rate on January 30th, 1930, to 3 per cent. It was motivated not only by the continuing inflow of gold, but also by the desire to ease the market for proposed Government borrowing. In May of the same year the rate was again lowered, bringing it to 2½ per cent., the lowest rate since 1898. In December 1930 the Federal Reserve Bank of New York brought its rate down to 2 per cent, an example which was followed early in January, 1931, by the Bank of France, both actuated by the desire to prevent further drains of gold from the Bank of England.

When, however, the Federal Reserve Bank of New York reduced the rate in May, 1931, to 1½ per cent., and the Bank of England to 2½ per cent., the Bank of France felt that the movement had gone too far, and refused to fall into line, on the ground that a further reduction of the discount rate in Paris would have produced too wide a margin between short-term and long-term rates, and increased the already dangerous tendency to lend at long-term, funds which had been borrowed for short periods." [15]

In this the Bank of France may have been wiser than other central banks, but it is nonetheless true that as a gold repelling instrument the Bank of France rate became weaker as the depression progressed. This was also true of other aspects of the fivefold policy, in particular the effort to develop Paris as an international center for short term financing and to revive new foreign lending.

The Effort to develop Paris as a Market for Short Term International Financing and to revive French Foreign Lending

The combination of the special motive provided by the gold movement to France with the same sort of national self-inter-

[15] *Paris as a Financial Center* (Columbia University Press, 1936), pp. 22–3. This source is heavily drawn upon in the succeeding paragraphs.

est that had produced a strong movement to develop an acceptance market in America in 1914 led to a vigorous attempt to revitalize the Paris acceptance market in 1929 and 1930. The efforts made in earlier years to increase facilities for the acceptance of bills, especially through the government supported Banque Nationale Française du Commerce Exterieur, were supplemented in 1929 by the organization of the Banque Française d'Acceptation. This new venture had the support of both the government and the banks. In the face of declining world trade and of price declines in many of the commodities financed, its acceptances outstanding at the end of its first year of business, December 31, 1930, were 565 million francs. This offset an almost equal decline in the acceptances of other banks and prevented a substantial net decline in total franc acceptances from taking place, but it was the peak of the new effort. In each succeeding year the total was reduced. The Paris market was not brought to an equality even with that of Amsterdam. From a balance of payments point of view, and as a gold repelling measure, the efforts to develop the Paris acceptance were of negligible importance. Several reasons quite independent of the unfavorable economic conditions of the time were responsible for this lack of success in translating into French terms the typically English institution of a great international bill market. There was no proper provision for the fulfilment of the functions of the discount houses of London, though this was attempted by the Compagnie Parisienne de Réescompte. There was no well organized short term money market to handle the floating supply of bills, and foreign sources of bills drawn on Paris were inadequately developed. Even more important, the traditional and customary attitudes taken in England by all parties in the bill market toward one another and toward the market as a whole were not present in Paris. The Banque Française d'Acceptation, for example, could not be perfectly sure that once it had sold bills to the banks it might not be requested to take them back

again, a situation fatal to the firm foundation of a bill market. In neither Paris nor New York could a money market institution indigenous to another soil be made to flourish by a campaign of propaganda.

These unsuccessful efforts to make Paris a great money market for financing international trade and so to reinvest abroad foreign funds accumulating in France were supplemented by equally unsuccessful efforts to revive long term French foreign investments. Concerning this Miss Myers comments (pp. 140–1):

". . . foreign issues were to be moderately encouraged by the reduction of the tax on dividends from 25 to 18 per cent. (in comparison with a 16 per cent. tax on French issues). At the same time, certain technical improvements of the *Bourse* were to be carried out, which would facilitate trading in foreign as well as in domestic securities.

It is doubtful if such feeble efforts could have been successful in any case, but they were completely useless in the face of the unwillingness of the average investor to risk any more money abroad, especially in bonds, and in view of the fact that the law of 1916 [which required the consent of the Minister of Finance before any foreign issue could be placed in Paris] was still in force. The French investor was quite right in his judgment, as the Americans learned later to their cost, but the result of the French failure to lend out their surplus produced an accumulation of gold in France which, perhaps fortunately, brought the world crisis more quickly to a head."

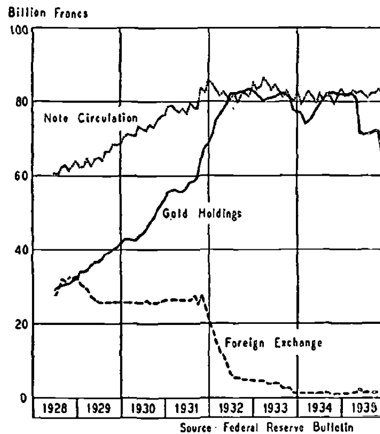
Aside from French participation in the Young Loan and in the various international credits extended during the confidence crisis most foreign loans placed in the French market were either refunding issues or the loans to political allies of France. These were not long continued as French public opinion became increasingly unfavorable to political loans and the Chamber of Deputies took steps to limit the discretion of the Ministers in this matter. From a balance of payments point of view the revival of new foreign investments was a feeble effort to stem the gold inflow.

The Treatment of Treasury and Bank of France Foreign Exchange Holdings

Under the interpretation of the stabilization law which permitted it to hold and replace its stock of foreign exchange acquired before June 1928, the Bank of France was able to avoid any further aggravation of the foreign exchange problem through conversion of its own holdings of devisen. It adhered loyally to this policy as a contribution to inter-central bank cooperation, particularly with the Bank of England, until the confidence crisis had developed alarmingly. From June 1929 to July 1931, as shown in Chart 58, the foreign exchange

CHART 58

Bank of France, Gold Holdings, Foreign Exchange, and Note Circulation, 1929-1935, last week of each month



holdings of the Bank of France did not change substantially. This was not, however, true of the holdings of the Treasury or of private banks.

As long as the Treasury was regularly in receipt of a surplus of income over expenditures, it was able to follow the policy described by Professor Aftalion and even to increase its foreign exchange holdings. These reached a peak of 11.2 milliard francs at the end of August 1930.[16] With the end of the period of budget surpluses and the reappearance of budget

[16] *Ibid.*, p. 84; cf. Ch. 15, The Technical Heritage, for a discussion of the acquisition of foreign exchange by the Treasury.

deficits toward the end of 1930, however, the Treasury was obliged to alter its policy and sell foreign exchange. In this respect it acted independently of the Bank of France, but endeavored to soften the impact of its sales upon other markets. Its policy is described by Miss Myers (*op. cit.*, pp. 83–4):

"The Treasury was not insensible to the adverse effect of its action upon the foreign exchanges . . ., but the budget surplus had disappeared, and the funds had to be brought home from abroad in order to meet domestic expenditures. In order to keep at least a part of these sales out of the open market, it was arranged that the Treasury should transfer foreign balances to French corporations which had foreign debts. The corporations gave to the Treasury annuities running for the same length of time as the original debt, at a higher rate of interest, in this way becoming debtor to the Government instead of to a foreign creditor. The Government thus found itself holding, instead of foreign short funds, domestic long funds which could be discounted at the *Caisse des Dépôts et Consignations.* It was estimated that seven milliards of the Treasury's foreign funds could be disposed of between 1930 and 1933, which would almost entirely avoid sales in the open market. Actually only 1,332 millions were thus exchanged during 1930, and a still smaller amount during 1931. Although the scheme did not attain the usefulness which had been hoped for, it undoubtedly diminished the disturbance which would otherwise have been caused by the Treasury's disposal of its foreign currencies."

Such devices did not prevent Treasury sales of foreign exchange from adding greatly to French gold imports. Like other parts of the fivefold program of gold repulsion, the policy of refraining from official conversions of existing stocks of foreign exchange became less effective as the depression progressed.

The Treasury policy toward its own foreign exchange holdings in 1930 also accentuated a seasonal characteristic imparted to the demand of the French banks for gold abroad by the general nature of French fiscal operations. French revenue flowed in most heavily in the last six months of the year and

during the first six months the government balances with the Bank of France and government cash holdings were drawn down. This was particularly true in the first half of 1930 when the government was still actively reducing the public debt.[17] From January to May 1930 the gold inflow was interrupted, for the government was both refraining from selling foreign exchange and adding to the cash resources of the French banks. But in the latter half of the year revenue was flowing in, reducing the cash holdings of the banks, and the government was selling foreign exchange. French demand for gold abroad was therefore insistent. At the turn of the year 1930–31 the reversal of this seasonal influence was obscured by the fact that the French banks were still strengthening their cash position by what *The Economist* has called "post-Oustric" withdrawals of gold from London. Throughout 1931 they continued to build up cash reserves by this and other means, but the seasonal reduction in French gold demand reasserted itself in April and May.

Fed thus from many sources, the stream of gold continued to flow into France, but it encountered in the organization of the French banking system the traditional great capacity for gold absorption without inflationary results described in our discussion of the technical heritage of the de jure stabilization of 1928. Because of the lack of investment opportunities, particularly the failure of foreign investment to revive, the notes put into circulation by the gold imports and the reduction of government balances found their way largely into the savings bank system. The funds of the Caisse de Dépôts were increasing rapidly in 1930, as they had been for several years, and the 'closed circuit' continued to operate in France.[18]

For these reasons the role of France in the international gold standard system during the first years of the depression was not that of a gold distributor but of a gold absorber. In

[17] Cf. Hawtrey, *The Art of Central Banking* (Longmans, Green, 1932), p. 29.

[18] For the relation of government expenditures to the increase in savings bank deposits in France see Myers, *op. cit.*, pp. 56–7, 79–80.

playing this role her powers were of a different order than those of the United States. They were more spectacular, more easily mobilized and put into action, and could more easily be deployed in the political field, but, from a long run point of view they were neither as strong nor as persistent as those developing simultaneously in America. They were essentially the powers of a country employing the gold exchange standard on a grand scale as a half-way house.

III Great Britain

The analysis of the Experiment of Defending Sterling was carried in previous sections up to the moment of the New York Stock Exchange crisis. Thereafter economic pressures converged upon Great Britain from all quarters of the globe. These have now been considered at their various points of origin, and the foundations for a description of the British reaction to them have been carefully laid. Therefore the continuation of our analysis of the defense of sterling up to the time when the confidence crisis spread from the continent to Great Britain in July 1931 is the coping stone in the arch of our description of the experiment of returning to gold as a whole.

The Impact of the World Depression on the British Balance of Payments

In Chapter 19 the conclusion was reached that from 1925 to 1928 the weakening of Great Britain's basic pull over the exchanges, together with her efforts to maintain her position as an international lender, made it necessary for her to attract foreign balances and sell securities to foreigners in order to counteract chronic weakness in the sterling exchange. This situation existing in relatively prosperous times, combined with the new position of the London bullion market in world gold distribution, undermined the whole basis of the technique by which Great Britain had weathered major world depressions in the past without any question being raised con-

cerning her ability to meet her obligations in gold. The technique of strengthening sterling through a careful and discriminating reduction in the net outward flow of capital by shifting from the long to the short term shoulder [19] depended for its effectiveness on a sufficiently strong underlying position to allow the resulting net inflow of payments to bring gold to England. The problem of meeting a world depression after long years of defending sterling by attracting foreign deposits and investments, while the major burden of distributing gold to South America and the Far East was borne by another country, was new in British history. Its broad outlines are written on the face of the estimates of the British balance of payments from January 1929 to September 1931 (Table 78).

The figures for merchandise trade and current invisibles in this table are those published by the Midland Bank in its Review for November–December 1931. The estimates for invisible current income, especially for the first nine months of 1931 are, as stated by the Midland Bank, only approximations indicating "orders of magnitude," rather than exact figures. To them have been added figures showing part of the private capital movement and gold exports. As an indication of the short term capital movement a figure has been included showing the reduction in the liability of the London market to foreigners on certain short term international transactions during 1929, 1930, and the first four months of 1931. This figure is derived from the estimates of the short term indebtedness of the London market (Table 77) made by the Macmillan Committee for reasons described in their Report (p. 112):

"In view of the large volume of foreign issues which have been floated in recent years in London and of the common belief that, in addition, British investors have made large purchases in the United States, partly of foreign bonds initially issued in New York and partly of American securities, whilst at the same time

[19] Cf. Ch. 19, The Pre-War Technique of Shifting from the Long Term to the Short Term Shoulder in International Lending.

our surplus for new foreign lending has been diminished, it has been surmised that Great Britain must have been financing some part of her new foreign investment on long-term by means of an increase, and perhaps a dangerous increase, in her short-term liabilities to foreign centres. We have accordingly made it our business to collect for the first time as full a summary as possible both of foreign liquid resources in London and of British ac-

TABLE 77

London Money Market, Short Term Foreign Liabilities, 1927-1931
Macmillan figures (millions of pounds)

	END OF YEAR				MARCH
	1927	*1928*	*1929*	*1930*	*1931*
Deposits and sterling bills held in London on foreign account	419	503	451	435	407
Sterling bills accepted on foreign account	140	201	176	161	153
Net liability of London	279	302	275	274	254

SOURCE: Committee on Finance and Industry, Report (1931), Cmd. 3897, p. 112

ceptances on foreign account. . . . We cannot claim that our figures are complete and they could doubtless be improved with further experience; but we believe that they may cover, in quantity, nearly the whole field. The most important item about which we have no information is the total of sterling bills held in their own custody by foreign banks, and it may be that this item is a more fluctuating one than the items for which we have obtained figures. We were prepared to find that these totals might give some support to the fears expressed above, but in fact they are reassuring."

Those famous estimates, far from being reassuring, made a large psychological contribution to the final development of the confidence crisis in Great Britain by dramatizing the fact, not properly understood by the general public, that London's short term investments abroad were far smaller than foreign short term claims in London. The net changes in these London obligations, however, are included in Table 78 merely to show that after 1929 sterling was weakened rather than strengthened by the movement of short term funds. The

table is completed by including the Midland Bank figures for new foreign capital applications, gold figures taken from the *Board of Trade Journal* for 1929 and 1930 and from the monthly figures published in the *Federal Reserve Bulletin* for the first nine months of 1931, and a balancing figure representing other capital movements and error.

TABLE 78

The British Balance of Payments Problem, 1929-1931

Payments from foreigners +, Payments to foreigners −

	1929	*1930*	*1931* (9 months)
	(millions of pounds)		
Mdse. trade	−381	−387	−282
Shipping earnings	+130	+105	+60
Commissions, etc.	+65	+55	+35
Government receipts	+24	+21	+10
Sundry other receipts	+15	+15	+10
Income from investments	+270	+235	+100
Total credits on current account	+504	+431	+215
Mdse. trade and current invisibles[1] (The Problem)	+123	+44	−67
Reduction of short term liability (deposits and sterling bills) to foreigners[2]	−27	−1	−20[3]
New capital issues[4]	−94	−108	−46
Other capital movements and error	−17	+70	+112
Total capital movements and error	−138	−39	+46
Gold[5]	+15	−5	+21
Gold, capital, and error (The Adjustment)	−123	−44	+67

[1] *Midland Bank Review*, Nov.–Dec. 1931, p. 2.

[2] Committee on Finance and Industry, Report (1931), Cmd. 3897, p. 112.

[3] 1931 figure for 4 months only.

[4] Midland Bank figures.

[5] *Statistical Abstract of U.K., 1931*, p. 389, for 1929 and 1930; *Federal Reserve Bulletin*, Nov. 1931, p. 630, for first 9 months of 1931.

The most striking feature of Table 78 is the decline and disappearance of the surplus available for foreign investment as a result of merchandise trade and current invisible income. During 1929 and 1930 Great Britain had to keep the net outward movement of capital within very narrow bounds and to

supplement her 'gold income' from various special sources in order to prevent large drains from the Bank of England gold reserves. In the first nine months of 1931 she was actually faced with a deficit which had to be covered by borrowing or drawing upon her past capital investments abroad.

The rigidity of the British system of industrial production and the difficulty in reducing costs combined in a complex way with the catastrophic fall in raw material prices to sap the underlying pull of sterling over the exchanges and to create acute financial problems connected with gold and capital movements. The decline in raw material prices reduced the world's purchasing power for British goods and the rigidity of her costs prevented Great Britain from competing effectively in the shrinking market for exports. Consequently British exports declined very sharply in volume. On the other hand the decline in prices enabled Great Britain to import on very favorable terms. There was a remarkable movement in the terms of trade in her favor which made possible a slight reduction in the large adverse merchandise trade balance in spite of reduced exports and well sustained imports,[20] but it also contributed to unemployment. A serious attempt to combat this by turning British productive powers to new types of export commodities could have been successful only at the cost of a reduction in real wages, as was pointed out by T. E. Gregory in his Addendum to the Macmillan Committee Report (p. 235):

"The gain through the alteration of the terms of trade in our favour involves a transfer of labour into alternative occupations, and, if it is to be absorbed in these occupations, labour may have to accept a lower marginal wage, because in those other occupations, there has *not* been a shift of the terms of trade in favour of the British seller."

[20] The merchandise import surplus for the first nine months of 1931 was at the annual rate of £376 million as compared with £387 million in 1930 and £381 million in 1931.

Such a shift, moreover, would have encountered the still substantial inertia which had constituted one of the major problems of British industry during the whole post-war period. Against this could be placed as offsets a substantial reduction in the cost to the nation of maintaining the unemployed and a slight direct contribution to reducing the net import surplus. These doubtful blessings are described, for the first quarter of 1931 in the body of the Macmillan Report (p. 114):

"During the first quarter of this year [1931] the quantity of our exports fell off by more than 30 per cent., whereas the reduction in the quantity of our imports was only 6 per cent. Nevertheless, as a result of the catastrophic fall of raw material prices, the visible balance of trade has been actually less adverse to us than in recent years, the net position in terms of money moving £5 millions in our favour, so that less of our surplus under other heads (i.e., from foreign interest, shipping, etc.), is being required to-day to finance our imports than in 1930 or in 1929. The same point can be strikingly illustrated by what has happened in the case of the single commodity wheat. At the price prevailing in December, 1930, the annual cost of our wheat imports would be about £30 millions less than it was in 1929, and £60 millions less than in 1925. It is obvious what a large contribution this single item represents to the national cost of supporting the present volume of unemployment. It is a great misfortune both for us and for the raw material countries that we should have a great volume of unemployment through their inability to purchase from us as a result of the fall in the price of their produce. But merely from the point of view of our balance of trade it is not to be overlooked that the latter fact not only balances the former but may even outweigh it."

When the changes in the terms of trade are considered in their relation, not narrowly to the merchandise balance, but to the whole balance of payments, a far different picture is presented. Indirectly the fall in prices was disastrous even from a balance of payments point of view for it undermined

the debt paying capacity of debtor countries and diminished the inward flow of British income from foreign investments, the decline in which was the main element in the adverse movement of current invisible income shown in Table 78. In 1929 this income was £504 million, in 1930 £431 million and, according to the approximations of the Midland Bank, it was running during the first nine months of 1931 at the rate of only £282 million per annum. Loss of income on capital invested abroad, the decline in income from shipping, together with the lack of any really substantial reduction in the net merchandise import surplus, produced a fundamental and increasing weakness of sterling during the depression. The terms of trade had, in fact, turned so greatly in favor of Great Britain that all the direct advantages were swallowed up in the loss of other income for which the change was responsible.

Under these circumstances Great Britain's effort to maintain her position as an international lender on long term had to be curtailed in the manner already described in our discussion of the deflationary effects of the ending of competitive international long term lending, and of the difficulties of Chile, Brazil, Argentina, Germany, Australia, and even India in breaking through the resistance of the London market to granting new long term accommodation. Even in the field of short term credit, the Macmillan Committee figures indicate that sterling bills accepted for foreign account steadily declined. This however was fully accounted for by the fall in the prices of many of the commodities financed. There can be no doubt that on the continent at least, and particularly in Germany, London pursued a bold policy in continuing to keep a large volume of sterling acceptance credit outstanding. The traditional sense of responsibility toward good customers in difficulties was strong, and the fatal consequences of wholesale withdrawals of accommodation were clearly recognized by the City. Reliance upon 'the feel' of the market rather than on a general economic analysis of

the position was not abandoned as a guide to action. It was not as clear then, as it has since become, that this was a source of danger under the peculiar circumstances of the time. In addition there was in the background as a driving force in the extension of short term credits the new competition within the London market and the inter-market competition between London and New York. At the cost of accentuating the already marked decline in the quality of bills held by the London market, the traditional responsibility of keeping open the short term credit resources of London in time of difficulty was not shirked.

The great gap left in British balance of payments figures by the absence of any direct estimate of the international movement of private securities and of many elements in the total short term capital movement prevents any really satisfactory analysis of the whole position. The balancing figure required in Table 78 to take account of these omissions and of the undoubtedly large margin of error in the other estimates, however, leaves no doubt of the continued vital importance throughout 1929–31 of the retention of foreign investments in sterling securities, of the employment of foreign short term funds in London, and the need of supplementing England's gold income from special sources.

The Role of Great Britain in World Gold Distribution

In our analysis of the changes in the London bullion market after the return to gold as compared to the pre-war period we stated that England's gold income no longer gave adequate assurance that her international credit operations could be carried on without apprehension concerning their effect upon the sterling exchange, and that the protection of the British gold standard was confided in large measure to the American capital market. In the international movement of gold from debtor to creditor countries that followed the decline of international long term lending the bulk of the gold shipments from South America and the Far East went, not to London,

the world's greatest financial center, but to New York,[21] to help meet obligations incurred there after the war. The vital significance of this was that when London shifted to New York part of her responsibility for distributing gold throughout the world, she shifted also part of her power to draw gold from the rest of the world in time of crisis through international credit operations. This fact, combined with the peculiar drawing powers of France over the world's gold, and the exceptional strength of several European 'neutral' exchanges for reasons already briefly stated in Chapter 26, together with the underlying weakness of sterling, accounts for the main features of the flow of gold through the London bullion market from October 1929 to June 1931.

At the conclusion of our discussion of Bank rate and the defense of sterling in Chapter 19 we stated that the raising of the Bank of England rate to 6½ per cent on September 26, 1929 stopped the drain of gold to the United States, but did not stop the French drain. France continued to draw gold from London as well as from New York from October 1929 to January 1930, and not until December 1929 did the unseasonable strength imparted to sterling by the return flow of funds from New York to Europe enable London to take gold from New York as an arbitrage transaction. London during these months continued to serve as a channel of remittance from New York to the continent, thus affording further illustrations of some of the technical points made in our abstract discussion in Chapter 17 of the effects of transferring international money market functions from London to New York. The December imports from America, however, were sufficient to offset the inconveniences of London's middleman position and to give England a net gold import for that month notwithstanding French demand. South African shipments were substantial, indicating a decline in Indian pur-

[21] E.g., South American gold shipments to New York in 1930 were about three times as great as to London.

chases in the bullion market.[22] Gold was coming in from South America, particularly from Argentina until December when the Caja de Conversion was closed. When the Argentine shipments ceased, an import movement from Australia began, owing to the acute financial difficulties described in Chapter 24.

The gold inflow continued without interruption until April 1930, but after January it was due to a somewhat different combination of circumstances. In February the bullion market was relieved by the practical suspension of French demand, a seasonal factor strong enough to impress its stamp upon the whole British gold movement from 1929 to 1931.[23] In the same month, however, a steady though moderate demand from Germany was suddenly swelled to large proportions partly as a result of the successful conclusion of the Hague negotiations.[24] At this moment, however, large shipments of gold were received in London from Spain. These were, providentially, perfectly timed to offset, together with the regular South African supplies, the German purchases and to prevent a net gold export. During March and April sterling was seasonally strong. The price of gold receded from the Bank of England selling price. The real tightness of the position is indicated, however, by the fact that only once, on March 25, was the Bank of England able to purchase gold at its statutory rate,[25] though for several weeks the market price hovered just above that rate (Chart 50). At this moment Belgium began to buy gold in London. The timing of these

[22] The force of Indian demand in the London bullion market is expressed in British gold export and import statistics largely through changes in the rate of inflow from South Africa on account of the direct physical shipment from Durban to India of South African gold bought in London.

[23] Cf. supra, The Treatment of Treasury and Bank of France Foreign Exchange Holdings.

[24] Cf. Ch. 25, The Gold and Foreign Exchange Reserves of the Reichsbank during the Negotiation and Adoption of the Young Plan.

[25] Samuel Montagu & Co., *Annual Bullion Letter, 1931*, p. 5.

purchases, was, in view of the announced policy of the National Bank of Belgium toward the gold exchange standard, evidence of inter-central bank cooperation between London and Brussels (cf. Ch. 26), for they were made when French demand had ceased, when German demand was once more moderate and when large shipments were coming in from Australia. Consequently, although in April exceptional Indian demands, due to very special circumstances (cf. Ch. 23), cut down the volume of available new gold from South Africa, British gold imports were substantial.

After seven months the gold inflow was ended in May 1930 by a sudden revival of French demand. This was partly due to the payment of the French share in the capital of the Bank for International Settlements [26] by the use of sterling balances, in itself evidence of the difference between London and Paris as international financial centers. Chiefly, however, it was due to the general factors set out in our discussion of the role of France in world gold distribution. For the next three months French demand dominated British gold movements and, in combination with reduced South African shipments and a falling off in receipts from Australia, caused substantial gold exports. It also led to a technical controversy that had the effect of raising the gold export point from London to Paris, and therefore allowed the London price of gold to fluctuate at over 84 s. 11½ d. per ounce for the rest of the year (Chart 50).

The cause of this unusual behavior of the London price of gold is described by Samuel Montagu and Company in their weekly bullion letter for June 11, 1930:

"An interesting position has arisen in the London gold market owing to the fact that the Bank of England is now giving out bars of standard fineness (about 9166/10000) instead of fine bars (ranging from 9950/10000 upwards) which buyers had been accustomed to receive from that institution. Under the Gold Standard Act of 1925 the Bank of England is entitled to sell bars of

[26] *Ibid., 1930.*

any fineness provided not lower than the standard of sovereigns (916⅔/1000). For many months past the Bank's stock of fine gold bars has been heavily depleted by withdrawals for the Continent, whilst the bulk of its receipts has been in the form of sovereigns, as will be seen by the following figures:

From June 1, 1929 to May 31, 1930

BAR GOLD		SOVEREIGNS	
Received	Withdrawn	Received from abroad	Withdrawn for export
£18,334,000	£63,615,000	£39,651,000	£452,000

It is therefore only natural that the Bank should decide to exercise its legal right of selling bar gold of standard fineness only. As the Bank of France does not accept bars of a lower fineness than 9950, a consequence of this change of practice is to lower the Gold Export point to France by the cost of refining the standard gold, and accordingly the rate fell rapidly yesterday from about 123.88 to 123.70 when the Bank's decision became known. It will be readily understood that there was unusually keen demand for the £476,000 of bar gold from South Africa in the open market to-day, as this was the only fine gold available for France. All but £30,000, which was required for India and the trade, was bought by France at the fixed price of 85 s. 0⅜ d. per fine ounce, a premium of ⅞ d. for delivery of fine gold being established over 84 s. 11½ d., which has been the maximum price for dealings in the open market since the restoration of the Gold Standard in 1925."

This situation was in popular discussion often attributed to a desire on the part of the Bank of England to shut off or reduce the gold movement to France and was considered by the orthodox as an impairment of the full beauties of the gold standard. There seems, however, to be no good reason for not accepting the above account of the matter at its face value. With the increased cost of gold when taken from the Bank of England French demand in London was for a while confined to fine gold from South Africa and French gold imports were diverted from London to New York, but in August

1930 standard gold was being taken at the Bank of England for shipment to France.[27]

Attention should be drawn to one additional aspect of this episode. Because gold sent to France from England had to be refined before it could be sold to the Bank of France, daily shipments were limited by the capacity of the refiners. Though the influence of this factor upon gold distribution through London in 1930 was probably slight it has a general interest for the study of the technical operation of the international gold standard. It was only one of several cases in gold standard history in which physical limitations in the handling of gold altered the suddenness and violence with which gold movements, if unfettered by any material restrictions, might take place, and which therefore have some bearing upon theoretical discussions of purely accounting devices for gold clearance. The existence of only one scale for the weighing of imported gold in New York is another example, as is the general limitation placed upon the amount of gold that can be insured on any one ship. The role of such physical limitations, though a minor one as a rule could, on occasion, become important, as it did in connection with the defense of the dollar against sudden French withdrawals in September and October 1931.[28] In the face of a steady and persistent demand such as that of France in London in 1930, it became only a technical detail. Nevertheless Samuel Montagu and Company in their *Annual Bullion Letter, 1931* attributed to it the long duration of French demand, and it is unquestionably true that the exceptionally large exports of January 1931 were partly owing to the fact that on January 16 the Bank of France signified its willingness to accept standard bars.

The price of gold remained above 84 s. 11½ d. in London until January 1931 (Chart 50), a proof of the dominance of

[27] *The Economist,* Jan. 3, 1931, p. 5.

[28] Cf. Ch. 32, Liquidation of French Dollar Balances and the Defense of the Dollar.

French demand. A premium on forward francs over spot francs even allowed gold to be bought forward for France before it reached London, and in August 1930 such purchases began.[29] Continental, especially Swiss and German demand, was also insistent from the late spring of 1930 to the end of the year. A special combination of circumstances during the late summer and early autumn interrupted the net outward flow, however. The changing situation in India was reflected in increasingly large and steady shipments from South Africa to London. Imports from South America, especially from Argentina and Brazil, were substantial, and Australia continued to ship large amounts. Finally in October further shipments began to come in from Spain. By the end of the year, however, these additions to England's gold income proved to be insufficient to offset continental demand, and over the year end England lost gold heavily. In November a special demand for gold by French banks anxious to assure their liquidity following the Oustric scandals arose,[30] and in December 1930 and January 1931 French demand carried all before it. Under these circumstances the autumn purchases of sterling bills by the Federal Reserve banks constituted inter-central bank cooperation of strategic importance. The New York exchange moved to a point within the range between market and Bank of England gold export points (Chart 50), but was not competitive at the Bank of England.

These year end shipments were the last net monthly gold exports before the spread of the confidence crisis to England in July 1931. The changes in the attitude of the East toward the precious metals were not only being expressed by continued large receipts from South Africa, but also by a growing stream of imports from the Malay States. The latter more than offset the moderate exports of gold from London to India that had continued until the middle of 1930. Of far more immediate importance was the reappearance of the

[29] Samuel Montagu & Co., *Annual Bullion Letter, 1930.*
[30] *Ibid., 1931.*

seasonal reduction in French demand. February 1931 was the first month since August 1930 when there were no French withdrawals of gold at the Bank of England,[31] and after March other exports to the continent also temporarily ceased. Under the accumulating difficulties of her internal position and under pressure of the secondary withdrawal of funds from abroad following the crisis of September 1930, Germany's demand for gold in London fell off at the beginning of 1931, and disappeared entirely in March. In February and March Belgian demand had temporarily reappeared, once more being timed to coincide with seasonal strength in sterling. Hence it did not prevent the London price of gold from again receding from the Bank of England selling price (Chart 50). On March 16 the Bank of England was able to buy gold in the market for the first time since March 25, 1930, paying the fixed price of 84 s. 10¼ d., and on March 31 the London price of gold reached 84 s. 9¾ d., the lowest in five years.[32] Under these relatively favorable circumstances the British government took a step which was variously interpreted, but in general was considered to reflect apprehension concerning the position of sterling. Since the early days of the war the Treasury had prevented its operations in the sterling-dollar exchange from influencing the market unduly by operating a trading account known as the Dollar Exchange Account. Since the funding of the American war debt one of the principal uses of this account had been to handle the actual accumulation of dollars needed for the payments under the agreement.[33] Announcement was made on May 2 that a £20 million balance in this Account would be taken into the 1931–32 budget as non-tax revenue. Because this balance was held partly in dollars and partly in sterling this did not necessarily mean that the Treasury was strengthening itself

[31] *Ibid.* [32] *Ibid.*

[33] The Dollar Exchange Account was the predecessor and first model of the Exchange Equalization Account established in 1932; cf. Ch. 31, The Establishment of the Exchange Equalization Account.

by a fund of $100 million for the further defense of the pound,[84] though some proportion of the total was undoubtedly made available in dollars. The action finds a place in the story of British gold movements chiefly because it was part of the psychological background of later events.

The whole situation was changed with the outbreak of the confidence crisis in June 1931.[85] The bullion market became very active. In June regular South African shipments were being supplemented by imports from the Straits Settlements and India, and in addition £9 million in gold was received from Germany. At the same time individual Germans were buying gold in the market. These hoarding purchases were small in individual amount, but large in the aggregate. The movement of frightened capital from Germany brought Switzerland into the market. Competition was keen and on June 16 the price went to 85 s. 10¼ d. In July England was subjected to an international run described by Samuel Montagu and Company in their *Annual Bullion Letter, 1931:*

"All the exchanges became adverse. Available supplies of South African gold and other gold were readily absorbed, the former being sold while on the high seas. The demands upon the Bank of England were unprecedented, and during the period 16th to 29th July, withdrawals of gold from the Bank, principally for France, but also for Holland, Belgium and Switzerland, resulted in a net efflux of no less than £32,061,408."

At the height of this crisis, in the week of July 15, the sterling-dollar rate reached 4.83 15/16, yet gold did not move to New York. This notable fact was the result of informal resistance by the London money market to the outward movement of gold. Financial institutions in London dependent on the Bank of England for the standing of their paper in the market are sensitive not only to the state of the exchanges, but to Bank of England atmosphere as well. When this atmosphere is clearly adverse to gold exports three gradations

[84] *The Economist,* May 2, 1931, p. 936.

[85] Cf. Ch. 28, The Austro-German Crisis and The Breakup of the Nucleus.

of such resistance are possible. During the war the bullion brokers themselves refused on patriotic grounds to execute orders.[86] This method was not resorted to between 1925 and September 1931, but less conspicuous obstacles were on occasion placed in the path of gold arbitrage movements. In November 1928 English houses that usually did gold arbitrage business were inclined to hold back and let someone else, either another house or a foreign branch bank, take the initiative. From April to July 1931 English houses would neither take the initiative, though the rate went *below* gold export point, nor execute orders for others. This was a far stronger and more general method of resistance to gold exports than the one used in 1928. The restraint exercised at this time was sufficient to ensure that during that critical period England's gold problem was not complicated by exports to America. After July 1931, when the exchange rate was kept *at* the gold export point by the use of foreign credits, orders were freely executed.[87]

On July 23 Bank rate was raised from 2½ to 3½ per cent, followed by the announcement that credits amounting to £50 million had been granted the Bank of England by the Federal Reserve Bank of New York and the Bank of France. Bank rate was again raised, to 4½ per cent, on July 30, and the exchanges moved in favor of England. On August 5, however, they suddenly reacted, and a revival of continental demand resulted in a loss of gold of £2,500,000 by the Bank of England to France and the Netherlands. On August 28 the Treasury announced credits of $200 million and 5 milliard francs from American and French financial groups. With this help the exchanges were supported. "Until the middle of September the Bank of England secured gold from

[86] Cf. Ch. 2, The Minimum Change in Legal Form Consistent with the Necessary Changes in Practice.

[87] It was stated to the writer on good London authority that these foreign credits were not intended to prevent gold from leaving England, but to keep the foreign exchange rates at the gold points, and that this was necessary because of lack of transport.

the open market, but only by paying over the statutory buying price. An 'undisclosed buyer' was also in the market, but, as had happened on previous occasions, the purchases were followed by announcements by the Bank of either purchase of bar gold or the 'release' of sovereigns 'set aside,' from which it would seem that the gold secured by the 'undisclosed buyer' had indirectly found its way into the Bank of England's holding." [38]

On September 15 buyers for the Netherlands appeared in the market, and gold began to be withdrawn from the Bank. Demand became intense and was the immediate precursor of the suspension of the gold standard.

Prolongation of Established Credit Control Techniques until June 1931

The international flow of gold described above was faithfully reflected in the statements of the Bank of England. Until June 1931 changes in the Bank's gold holdings together with the strong seasonal fluctuations in the amount of notes in circulation caused a series of sharp fluctuations in the reserve of the Banking Department (Chart 40). The manner in which they combined to produce this result is shown in Chart 39, which also indicates that during 1930 the Bank's reserve was still being built up by a continued decline in notes in circulation.[39]

Until the end of 1930 the established techniques of credit control, which had from 1925 to 1929 prevented changes in the factors playing upon the Bank of England's own reserve or changes in the amount of government deposits from influencing 'bankers balances at the Bank of England,' were, with very slight modifications, still in full force and effect (cf. Ch. 19). The main open market operations of the Bank were directed toward offsetting the fluctuations in its own

[38] Samuel Montagu & Co., *Annual Bullion Letter, 1931*, p. 7.

[39] This appears graphically in Chart 39 in the rising of the Reserve line above the gold line.

reserve. In spite of budget difficulties, which were accumulating during the period, and refunding operations involving over £100 million in government securities, public deposits were kept within the now familiar range of £10 to £20 million. The fluctuations within that range were greater than in previous years, and were not as closely offset by the combined movement of reserves and securities though close inspection of the top line of Chart 40 A and the 'public deposits' line in Chart 40 B reveals that they were taken account of in open market operations. In April they were more than fully offset, but in September they were less than fully offset, so that 'bankers balances' were subject to some variation from this cause. This was a minor matter. No trend appeared in the movement of 'bankers balances' and the seasonal fluctuations, which were of the traditional pattern, called by Mr. Smit in describing the pre-war figures the 'W' pattern, had to be taken care of as before by accommodation secured by the banks through discounts and advances. During 1930, in fact, the general movement of the two items was unusually alike (Chart 42).

Upon this stable credit base, supplemented by a slight increase in their cash holdings, the London clearing banks built up during 1930 a credit superstructure which carried their deposits to the highest point yet reached. On December 3, 1930 they averaged £1,838 million as compared to the December 1928 peak of £1,815 million. As stated at the end of our discussion of the credit superstructure before the depression, this was due entirely to a large increase in their 'bills discounted,' of which the major element was an increase in treasury bills discounted. In the first quarter of 1930 the government made a vigorous effort to reduce the floating debt by the retirement of a more than seasonally large amount of treasury bills, a step prepared for in 1928 when a substantial portion of the floating debt was transferred from the form of 'advances from government departments' to the form of treasury bills (Charts 6 and 7). Nevertheless, the seasonal reduc-

tion in 'treasury bills discounted' and the corresponding reduction in 'total deposits' of the London clearing banks was not unusually large (Chart 45 A), an indication that the proportion of total treasury bills outstanding held by the banks was increasing. After April 1930, when the process was seasonally reversed, the government increased its treasury bills outstanding more than in any other recent year except 1928 when the form of the floating debt was changed. At the same time the London clearing banks increased their discounts of treasury bills by more than the amount that had been customary during the preceding seven or eight years.[40] This indicates that during this period also the clearing banks were increasing their relative importance as holders of treasury bills, and 'total deposits' were greatly increased.

In this respect, and in others the behavior of the credit superstructure in 1930 was very much like its behavior during the last preceding great cyclical recession, 1921–22. Almost the same words used in our discussion of the English credit superstructure during deflation in Chapter 10 can be applied to the position in 1930. The banks were clearly giving unusual assistance to the government in facing the fiscal problems of a deflationary period through their support of the treasury bill market, while at the same time, in their search for employment of their funds, they were increasing their investments as their advances fell off. Chart 76 B discloses the similarities in the ratio system of the joint stock banks in 1921–22 and 1930. They are characteristic features of a period of abundant credit and easy money.

With the release of pressure on the exchanges following the ending of the New York Stock Exchange boom such a period had begun in England. Bank rate was reduced by

[40] The increases in the two items from May to December 1925–30 were (millions of pounds):

	1925	*1926*	*1927*	*1928*	*1929*	*1930*
Treasury bills outstanding	75	97	89	231	96	124
Treasury bills discounted by the London clearing banks	11	42	30	42	12	84

successive stages of ½ per cent from 6½ on October 31, 1929 to 3 per cent on May 1, 1930, following at varying intervals reductions in the New York rate. The open market rate for three month bills fell even faster so that during the spring of 1930 a differential in interest rates in favor of New York was definitely established (Chart 49). A wide spread, amounting at times to nearly 1 per cent, also appeared between the market rate and Bank rate (Chart 48), rendering Bank rate ineffective and creating difficulties for the discount houses. Since the discount houses obtained most of their funds for carrying treasury bills at 1 per cent below Bank rate there was little profit in keeping a large portfolio, a circumstance that may have had something to do with the increased holdings of treasury bills by the banks. The domestic situation seemed to call for a further reduction in Bank rate, but the international position forbade it. With the end of the revival of foreign lending in New York the need for a higher interest rate in London than in New York became extremely important to strengthen sterling. In the autumn of 1930, a time when seasonal weakness in sterling could still be expected, the New York bid for gold, though not competitive with the strong continental demand in the London bullion market, was only just under the 'market gold export point' (Charts 50 and 51). Consequently Bank rate was held at 3 per cent. The downward course of open market rates was checked, and with subsequent reductions in New York rates, the London open market rate for three month bills soon moved once more to a position between the New York acceptance and the New York call money rate (Chart 49). The gap between the London market rate and Bank rate still persisted, however, until the Bank took steps, by its open market policy, to draw the two rates closer together. Toward the end of the year this became increasingly desirable from a foreign exchange point of view. Gold was moving heavily to the continent, as described above. The dollar, in spite of active

support given sterling by the Federal Reserve Bank of New York, once more moved above bullion market gold export point, though it was not strong enough to draw gold from the Bank of England (Chart 50).

It is not, therefore, surprising that during the first months of 1931 an increase in Bank of England reserves due to a seasonal return of notes from circulation was more than fully offset by open market sales of government securities. Though 'discounts and advances' were not substantially reduced, 'bankers balances' declined (Charts 40 and 42). The market was tightened, and by April the gap between Bank rate and market rate was brought once more to normal proportions. Meanwhile the gold flow had again changed. Gold began to flow in steadily, and on May 14 the Bank of England reduced its rate to 2½ per cent.

The English Credit Base and Credit Superstructure under Emergency Measures

After the total deposits of the London clearing banks reached their peak in December 1930 a declining trend set in which lasted beyond the time when England abandoned the gold standard. This reflected a steady fall in 'advances' while 'investments' remained stationary and 'bills discounted' resumed their customary seasonal fluctuations without special features. The moderate decline in 'bankers balances at the Bank of England,' in progress since the spring, was accentuated after the half-yearly seasonal in June, but further deflationary pressure was avoided after the end of July. This was, however, accomplished only by resort to exceptional measures. The effects of the international run on Germany immediately preceding and following the proposal of the Hoover moratorium are clearly reflected in the growth of the Bank's gold holdings which, subject to slight modifications by changes in the note circulation, built up the reserve (Chart 59). The effects of the general crisis following the

closing of the Darmstädter Bank and the freezing of foreign short term assets in Germany[41] appear in the great gold losses of the weeks of July 15 and 24. It was at this time that the Macmillan Report was published so that extraordinary weight was attached to its findings concerning the short term

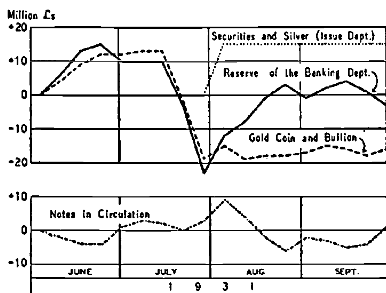


CHART 59

Bank of England, Factors affecting the Reserve of the Banking Department, June–September 1931, changes cumulated weekly

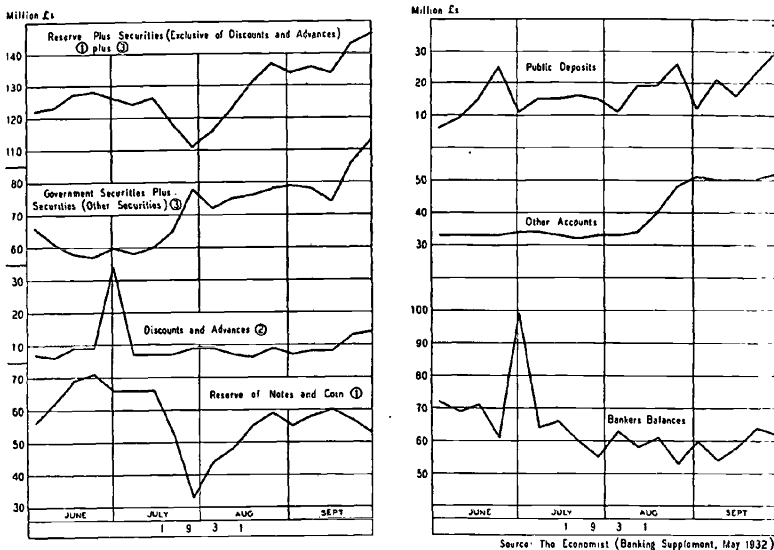
international indebtedness of the London market. During this crisis also, as already indicated, the New York exchange dropped far under gold point without loss of gold to the Bank of England, and credits of £25 million each were obtained by the Bank of England from the Bank of France and from the Federal Reserve banks. Bank rate was raised from 2½ to 3½ per cent on July 23 and to 4½ per cent on July 31, and the proceeds of the new credits were used to support sterling. This may be seen statistically in the exceptionally large increase in foreign bills purchased by the Federal Reserve banks in August (cf. p. 985). Together with the reestablishment of a substantial interest rate differential in favor of London as compared to New York (Chart 49), this stopped the drain of gold, but not before the Bank of England reserve had fallen £17 million below the so-called 'Cunliffe Limit,' and its proportion had fallen from 57 to 32 per cent. To offset the deflationary results of these gold losses large open market operations were undertaken. In this instance the contraction in 'bankers balances' due to the gold exports

[41] Cf. Ch. 28, The Austro-German Crisis.

was not fully made good, and they fell £11 million below the level prevailing after the conclusion of the half yearly settlements. When added to the contraction of the early months of the year this represented a substantial reduction in the credit base. During the remaining seven weeks of Great

CHART 60

Bank of England, Assets and Liabilities
June–September 1931, weekly



Britain's adherence to the gold standard there was no further contraction, but also no increase. When early in August advantage was taken for the first time of the provisions of the Currency and Bank Notes Act of 1928, to increase the fiduciary issue and strengthen the Bank of England's reserve, this was done without affecting 'bankers balances.'

The Bank's statement of August 5 showed an increase in the fiduciary issue of £15 million, but because of seasonal movements in the note circulation, the full effect of this increase was not reflected at once in the reserve. On August 26, how-

ever, the reserve was slightly higher than it had been on June 3. The policy of insulating the British domestic credit system from the full consequences of international gold movements was, in this instance, applied to the reserves of the Bank of England itself. The transfer from the Banking Department to the Issue Department of £15 million in securities to provide for the increase in the fiduciary issue was not accompanied by a corresponding decline in securities in the Banking Department or increase in 'public deposits.' The presumption is that securities were purchased in the open market to provide a substantial part of this requirement. After August 5 total securities in the Banking Department actually increased. These operations, together with a return flow of currency, would have increased 'bankers balances' after August 5 had it not been for simultaneous increases in 'public deposits' followed by increases in 'other deposits.' The increases in 'public deposits' were, in view of their behavior in previous years, probably seasonal, though the fluctuations were substantial and were now reflected in 'bankers balances.' The increase in 'other deposits' was the first major change in this account since early in 1920. Since it coincided with the use of the international credits secured by the Bank in defense of the exchange, it may be inferred that it represented a part of this indebtedness. The net result of these operations was that about two-thirds of the contraction of the cash basis of credit that would otherwise have accompanied the loss of gold in July was replaced by Bank of England credit.

The Suspension of the Gold Standard with Bank Rate at 4½ per cent

The increase in Bank rate to 4½ per cent on July 31 was the last increase before Great Britain abandoned the gold standard on September 21, 1931. In the first week of August the Committee on National Expenditure (the May Committee) made its report (Cmd. 3920) on the British budget. Applying the strictest canons of fiscal probity to their problem, the

majority of the Committee envisaged an approaching budget deficit of £120 million, after meeting sinking fund requirements, and recommended cuts in expenditure of £100 million. This report was followed on August 23 by the resignation of the Cabinet and the formation of a National Government. Confidence in the British position was however badly shaken by the succession of events and was not revived by the announcement of the two groups of foreign credits obtained from France and the United States.[42] Withdrawals of foreign funds continued and the proceeds of these credits were rapidly used up. On September 15 the Admiralty announced 'unrest' in the Navy as a result of pay cuts and on September 16 dispersed the Atlantic fleet to its home ports. This was followed by general declines in foreign stock exchanges, by a liquidation of British government securities, and an intensified withdrawal of British capital. On September 18 the Treasury requested further credits in New York and Paris and was refused.[43] Still Bank rate remained at 4½ per cent, and when the decision was taken to abandon the gold standard, this rate still prevailed. On September 21 the suspension of the gold standard was announced and an explanatory statement was issued by the government in which it was disclosed that from July to September foreign withdrawals from Great Britain had amounted to £200 million. On the same day Parliament passed a short act known as the Gold Standard (Amendment) Act. This Act provided that Section 2 of the Gold Standard Act of 1925, which placed the Bank of England under obligation to sell gold in bars of approximately 400 fine ounces at the fixed price of 77 s. 10½ d. per standard ounce, should cease to have effect and that Section 1 of the Gold Standard Act of 1925, which relieved the Bank of England from the duty of redeeming its notes in gold and suspended the free coinage of gold in England, should continue

[42] Cf. supra, p. 1014. For the details of these arrangements cf. *The Economist*, Sept. 5, 1931, p. 421.
[43] 'A Diary of the Crisis,' *ibid.*, Sept. 26, 1931, p. 555.

in force. It also empowered the Treasury to take such measures "in relation to the exchanges or otherwise as they may consider expedient for meeting the difficulties arising in connection with the suspension of the gold standard."

For six years England had defended sterling with the aid of a relatively high Bank rate. The resulting pressure upon the British economy had been resisted by the banks and resented by industry and labor. It had not forced the fundamental changes in British industry required by England's new position in world commerce. In the absence of a true laissez-faire economy and in a social system that forbade any encroachments upon the minimum standard of living of the working classes, Bank rate had lost its effectiveness as an engine of economic reconstruction within the country. It was well recognized within the Bank of England that a high Bank rate in the summer of 1931 would not have contributed to the solution of England's fundamental problems. It was possible, even probable, that a high rate imposed in the midst of the crisis would have been interpreted as a sign of weakness and have added to the outward flow of funds rather than the reverse. The time was past when the British, justified by the knowledge of their great commercial strength, could boast that a 10 per cent Bank rate could pull gold out of the earth. Properly interpreted, the fact that England left the gold standard with Bank rate at 4½ per cent is the key to the understanding of the defense of sterling during the whole Experimentation period.

CHAPTER 28

The Defense of the International Gold Standard as a Whole, 1929–1931

The imposing edifice of the international gold standard as a world institution was not allowed to crumble away without a struggle. The weakness of its foundations, the ways in which that weakness was made manifest, and the efforts put forth to combat it in various countries have been analyzed in Chapters 21–27. Only the task of presenting certain aspects of the defense of the system as a whole remains before our account of the great post-war Experiment of returning to gold is complete. This task has four parts: first, to emphasize in a few summary statements the nature of the uncoordinated natural response of the world credit system, under the private profit motive, to the forces of the depression in the international field; second, to describe the effort to complete the post-war movement toward currency stabilization; third, to indicate the new techniques of financial cooperation developed during the crisis; fourth, to show the role of politico-economic conflict in weakening the cooperative effort to preserve the gold standard system.

The Attempt to Finance the Depression by Short Term International Lending

Under the impact of world-wide deflationary forces the decentralized post-war world credit structure as a whole attempted to follow, in the international sphere, the pre-war British precedent of financing a period of cyclical depression by providing adequate short term credits until a new basis for long term lending could be reestablished. The means to do so were abundant, and the motives leading to their employment

were strong. One of the most striking features of the first years of the depression was the failure of bank deposits in the creditor countries to contract on a scale at all proportionate to its severity. The banking systems of the creditors were under pressure to find employment for their funds, as is indicated by the spread between long and short term interest rates. They were offered remunerative employment by the debtors, for another striking feature of the depression was the intricate process by which the flow of funds from debtor to creditor countries contributed to wide differences in their respective interest rates. These were accentuated by the policy of central banks in creditor countries, especially in the United States, of promoting extremely easy money conditions in their own markets. The powerful motive of self-interest was thus enlisted in the task of bridging the gap in credit extension created by the falling off of long term international lending. The short term foreign lending of credit institutions of all kinds in response to this motive completed the series of steps, inherent in the very organization of the world credit system, by which private banking adapted itself to meet the needs of the downward swing of the cycle in the international field.

This natural response of the world credit system to the calls made upon it was modified by the decentralization of financial power. In Great Britain the whole weight of long banking tradition was behind it, but the foundations that made it safe to follow that tradition were undermined. In the United States the whole process of shifting from the long to the short term shoulder in international lending was largely robbed of its effectiveness because the United States, though a creditor country, still continued to attract much foreign capital. In France the assumption of an active role in international short term finance was contrary to established tradition and to the banking organization and habits of the country, and the French effort to remove from the New York and London markets the responsibility for the employment of French short term funds in debtor countries did not progress

far beyond the stage of good intentions. Finally the rise of international deposit banking and the substitution, in the centers of international finance, of deposit-attracting policies for deposit-compelling powers introduced a new major element of risk not present before the war. Nevertheless the response of the center countries as a group to the demands of the debtor countries for short term accommodation was impressive. In every debtor country whose position has been reviewed the receipt of short term credits from abroad at strategic points in its efforts to protect its exchanges or solve domestic problems has had an important place.

Had the lack of balance in the world economic system been of the kind that led even to the great world cyclical depressions of the past this short term lending might have been adequate to perform its financing function. But the lack of economic balance was at this time of a different type. A price had to be paid for the economic disorders of the preceding fifteen years. Twice postponed by the misuse on a grand scale of the traditional means of adjustment of the international gold standard, a genuine restriction of consumption to capacity to pay and of productive capacity to available markets had to be worked out. The illusions surrounding the payment of international political debts without transfer of goods had to be abandoned. Under these circumstances short term international lending was not fundamentally bridging a gap in world credit extension until a healing financial liquidation and readjustment in trade and production had run its normal course. It was part of a severe and long continued struggle for the final allocation of many of the real costs of war and reconstruction and for the discovery of a new basis for the world's exchange of goods.

The Attempt to complete the Gold Standard System after Disintegration at the Periphery had already begun

One aspect of this struggle was the shifting of economic burdens by periphery countries whose exchanges had depreciated

in London and New York early in the depression. Another was the simultaneous effort to complete the unfinished business of returning to gold. The conversion of the de facto stabilization of Roumania into de jure stabilization with French assistance was described in Chapter 24. In June 1931, upon the advice of a League of Nations commission and after two years of de facto stabilization, the Portuguese escudo was stabilized at 108 escudos to the pound sterling. This involved not only the abandonment of the old parity of 4½ escudos to the pound, long an historical relic, but also the 'official' exchange rate of 99 escudos to the pound left over from preceding attempts at practical exchange control.[1] Of far greater importance in influencing the international movement of gold and testing the efficiency of new instruments of international cooperation were the currency experiments of Japan and Spain.

Japan

At the end of 1928 the foreign exchange holdings of the Japanese government and the Bank of Japan were only 114 million yen, as compared to 1,343 million yen at the end of 1919. The yen, weakened by the crisis of 1927, gradually declined until the summer of 1929, but the underlying position was improving. The large adverse merchandise trade balances of previous years were not repeated owing in part to exceptionally good rice harvests, and in 1929, for the first time in a decade, a balance was approximately struck in the merchandise items in the balance of payments. On November 21, 1929 it was officially announced that the embargo on the export of gold, in force since 1917, would be removed on January 11, 1930. In preparation for this step the Japanese government and the Bank of Japan had begun to strengthen their badly depleted holdings of foreign exchange. At the time of the announcement these holdings were already 240 million yen, which was to be increased to 300 million before the end of the year. In

[1] *The Economist*, June 6, 1931, p. 1214.

addition, the government arranged for two foreign credits, one for £5 million in London and one for $25 million in New York.[2] Armed with these special resources Japan returned to the gold standard in January 1930.

The appreciation of the yen from a monthly average rate of 43.88 cents in June 1929 to 49.13 in February 1930 had a depressing effect on Japanese export trade which was already in difficulties owing to a reduction in American demand for raw silk and Asiatic demand for cotton piece goods, and the fall in price of these staples. Exports were consequently heavily reduced in value, raw silk, for example, falling 18 per cent in quantity, but 43 per cent in value. On the other hand, Japanese imports, consisting chiefly of food and raw materials, fell greatly in price, and the approximate balance in merchandise trade of 1929 was repeated in 1930 without great curtailment in the quantity of imports.[3] The position of Japan therefore differed from that of other countries dependent upon the production of staple raw materials falling rapidly in price, because the terms of trade did not move heavily against her. Her international debtor position, moreover, was, relative to her resources, not so burdensome as that of many such countries. Notwithstanding these advantages, the foreign assets provided to support the yen proved inadequate and gold exports began on a large scale almost immediately after the return to gold. The maturing of American loans and credits drew a steady stream of Japanese gold to the United States, though this was partly offset by imports from China and Siberia. In 1930 the gold holdings of the Bank of Japan and the government were reduced, according to figures published in the *Federal Reserve Bulletin,* $131 million, while Japanese gold shipments to the United States were $156 million. In 1931 the general situation developed along the same lines until the outbreak of the confidence crisis in Europe. The re-

[2] *Ibid.,* Nov. 23, 1929, p. 963; Jan. 4, 1930, p. 24.

[3] League of Nations, Memorandum on Trade and Balances of Payments, 1930: Vol. I, *Review of World Trade, 1930* (Geneva, 1931), p. 40.

percussions of this crisis in Japan are described in the Annual Report of the Bank of Japan for 1931 (*Federal Reserve Bulletin,* May 1932, p. 309):

"The financial difficulties which began in Austria and Germany, and led eventually to the suspension of the gold standard by Great Britain, made their influence felt in Japan, where the situation was further aggravated by the outbreak of the Manchurian disturbance about the same time. Prices of staple commodities and securities underwent so sharp a decline that stock exchange transactions were temporarily suspended. Owing partly to anxiety regarding the gold standard in Japan, the foreign exchange market had to meet a strong demand for dollars, which caused an outflow of gold in considerable amount and a decline in the volume of funds available to the market. Toward the end of the year money became tighter and dearer. With the change of Government on December 13, gold exports and the conversion of bank notes into gold coin were prohibited except under license, and thereafter the yen exchange declined steadily, while commodity prices advanced."

In the preparations for and in the history of the short lived return to gold by Japan the dominant role of the New York exchange is in sharp contrast to the pre-war management of the yen through the use of sterling balances. The outflow of gold from Japan was one of the most important elements in the general movement of gold from debtor to creditor countries (Table 67). The fact that, because of the previous diversion of Japanese borrowing from London to New York, its destination was America rather than England is one of the most striking illustrations of the general change that had taken place in the position of London in world gold distribution.

Spain

In contrast to the decided and direct course pursued by Japan in formulating a program for returning to gold and the liberal gold exports permitted after the removal of the export em-

bargo, the attempts to stabilize the Spanish peseta were marked by vacillation and indecision, by a traditional reluctance to use existing gold reserves, and finally by a rejection of orthodox methods of stabilization altogether. Though London was the center through which the major flow of Spanish external payments passed and though the gold exports occasionally permitted to support the Spanish exchange were shipments to London, the direct participation of Great Britain in the stabilization efforts of Spain was gradually diminished as the depression progressed. Indirectly her interest in these efforts probably remained substantial and her advice was at all times sought.

For various reasons Spain had remained up to the eve of the world depression outside the main current of the worldwide post-war stabilization movement. In 1920 the war-time premium of the peseta over the dollar disappeared and during the next five years Spanish resources were drained and her political institutions disturbed by the Riff wars. The peseta fluctuated violently, though in general it followed the lead of sterling (Charts 22 and 24). At the time of England's return to the gold standard in April 1925 the rate on London was 33½ pesetas to the pound, about three-quarters of prewar parity. This parity, however, had been for years before the war merely theoretical and does not accurately represent the pre-war position of the peseta in the world system of exchange rates. Its existence, however, was of practical importance, for the Spanish government, even during the first stages of the world depression, never clearly renounced the ultimate aim of returning to it. In 1926 the successful conclusion of the Riff wars and the firm establishment of the dictatorship seemed to promise a more stable future, but the gradual concentration of European exchange speculation upon the peseta as one after another of the European currencies achieved de facto or de jure stabilization was a constant threat hanging over the market. In January 1927 a speculative movement, based upon the impression that the peseta would

soon be officially forced upward toward its old par of 25.22 pesetas to the pound carried the rate to just under 28. Favorable export trade helped to maintain this rate but it clearly overvalued the peseta, which soon began to decline. The government, however, intervened, giving the exchange official support, and in June 1928, with the rate just under 30 to the pound, formal measures of exchange pegging were introduced. A Foreign Exchange Committee was established to buy and sell foreign currencies and to supervise the exchange operations of private banks. This Committee was provided with foreign resources through a £5 million credit arranged in London and a $25 million credit arranged in New York. Armed with these credits and with the aid of a £2 million gold shipment to London in November, the Committee was able for the next six months to keep the peseta relatively stable in spite of speculative activity which had now turned to the other side of the market.[4]

In December 1928 a commission was appointed by the government to study the possibility of returning to the gold standard, but almost immediately afterward the revival of political disturbances invited the reappearance of bear raids by speculators. In January and February 1929 the peseta fell to about 34 to the pound, a rate at which, according to purchasing power parity calculations, it was definitely undervalued. In June the government commission made its report which was not published. It appears to have advised against any attempt to return to the nominal parity and in favor of stabilizing the peseta at a point corresponding as nearly as possible to its external value. At the same time it held out hopes that world prices might rise more nearly to Spanish prices and therefore suggested a postponement of the whole problem. This faint reflection of similar British hopes, de-

[4] The facts in this summary are taken from the excellent short account of 'The Troubles of the Peseta' in *The Economist,* Dec. 28, 1929, pp. 1239–40, and the article on Spanish Monetary Developments in the *Midland Bank Review* for Oct.–Nov. 1929.

scribed in Chapter 10, was thoroughly unrealistic at a moment when a declining price trend was already in motion on a world scale (cf. Ch. 21). No definite course was charted. The government declared formally in July in favor of stabilization and revised the budget with that end in view, but even then did not accept the devaluation of the peseta as part of its program. It renewed its £5 million London credit and $20 million of its New York credit which expired in July, and continued to support the exchange at the cost of gradually exhausting its foreign resources. Until September the peseta was held at under 33 to the pound but in October 1929 official support was abandoned. As shown in Chart 55, this inaugurated a period of steady decline which lasted a full year. In December the government attempted to raise funds with which to repay the foreign credits and provide itself with further foreign balances for the defense of the peseta by offering a Pta. 350 million 'gold loan.' By this loan it hoped to attract a large amount of foreign exchange from Spanish citizens abroad and other Spanish speaking peoples. Though successful in Spain, the loan did not prove to be a constructive factor in supporting the peseta.

After this series of failures the Bank of Spain and the government enlisted the help of the newly organized Bank for International Settlements, which from July 1930 to the spring of 1931 was much concerned with the problem of Spanish stabilization.[5] Its Managing Director, M. Quesnay, twice visited Spain, the Governor of the Bank of Spain, Señor Bas, met the governors of other central banks at Basle, and the President of the B.I.S. and M. Quesnay on one occasion accompanied Señor Bas to London and Paris. In November 1930 M. Quesnay presented a report to the Bank of Spain in which he concluded that Spain was in a position to embark upon the first step of a stabilization program, that of confining day to day fluctuations in the peseta within defined limits. In December the B.I.S. granted the Bank of Spain a stabilization

[5] E. L. Dulles, *The Bank for International Settlements at Work*, p. 117.

credit of £3 million against deposit of gold. This gold was physically sent to London where it was held under earmark for the B.I.S. by the Bank of England. Essentially a device for overcoming the psychological gold export embargo existing in Spain, this arrangement was subjected to criticism particularly in London on the ground that the Bank of Spain, with gold reserves of 2,500 million pesetas and a note circulation of 4,500 million, was amply able to part with sufficient gold to provide the foreign exchange needed for the stabilization operation without calling for assistance of this type, but the credit was granted when the B.I.S. became convinced that such sales of gold were politically impossible. At the same time negotiations were begun for private banking credits, but were interrupted by threats of revolution in Spain in December.[6] In January 1931 Señor Bas resigned as Governor of the Bank of Spain but the negotiations were renewed by his successor, and in March a $50 million Spanish loan was arranged with J. P. Morgan and Company of New York and a further credit, the equivalent of $10 million, was arranged in Paris with a syndicate headed by the Banque de Paris et des Pays Bas. Hardly had these loans been arranged when revolution broke out, culminating in the abdication of King Alfonso on April 14. The Republican parties had opposed the credits, which were canceled by the Republican government without having been drawn upon. The new government undertook to support the peseta by using existing foreign balances and taking measures to prevent the flight of capital. The peseta, which had recovered in March to the level prevailing at the time of M. Quesnay's report, again began to fall (Chart 55). This decline was not checked by the publication on May 29 of an elaborate decree restricting private exchange dealings and the export of capital [7] which made Spain the first important European country to pass under the regime of formal exchange control during the world depression. The great task

[6] *Ibid.*, pp. 225, 235.
[7] B.I.S., *Foreign Exchange Regulations, 1st Issue.*

of completing the international gold standard facade was left unfinished even in Europe, and the first major attempt of the B.I.S. to perform the functions of the money doctor ended in failure.

The Attempt to develop New Techniques of International Financial Cooperation through the B.I.S.

Between the New York Stock Exchange crisis and England's abandonment of the gold standard every one of the agencies for international financial cooperation developed during Restoration (cf. Ch. 11) was used with energy, and in many cases, with effect. In addition, new techniques of central bank cooperation through the B.I.S., directed toward overcoming some of the difficulties of operating the international gold standard in a decentralized world credit system, were developed and the new bank was used as a channel for cooperative lending to meet emergency situations. Both aspects of the work of the B.I.S. were illustrated by the assistance it offered Spain. The broad and many sided activity of which this was a part cannot, of course, be comprehensively treated here. Using Miss Dulles' work as a guide, however, we may summarize its main outlines. The program of technical cooperation through the B.I.S. was designed to promote the following objectives:

1) It was the object of the B.I.S. to increase the strength and liquidity of central banks. As was natural from its form of organization and ownership the Bank was animated by a general desire to strengthen the control of each central bank in its own market. At its first Board meeting in May 1930 it was agreed that all transactions should be carried out through central banks but not necessarily with central banks. Both the Bank of England and the Bank of France requested that all transactions be made with them, thus asserting fully their own veto power over B.I.S. transactions in their own markets. In harmony with this principle the policy of the B.I.S. during the first year of its life was to refuse the deposits of private

banks and most other forms of contact with them except as depositaries of B.I.S. funds. Even this contact was progressively reduced and B.I.S. funds were more and more concentrated in the hands of central banks. In order to promote the liquidity of central banks the B.I.S. discouraged the growth of its own time deposits by paying only a small differential interest rate on them.

2) It was the aim of the B.I.S. to provide a clearing mechanism for inter-central bank and inter-governmental payments. One of its original and primary purposes was to clear the payments made on reparation and war debts account, a circumstance that compelled it to keep a large part of its deposits in New York where most of its commitments were. The duties of the Bank in facilitating this large one-way movement of funds in pursuance of its primary purposes were in fundamental contradiction to its secondary aims of promoting the smooth and effective functioning of the international gold standard. In addition, the Bank made available a more general clearing service to central banks through the development of its so-called Deposits D. The privilege was offered to central banks making deposits of this type to withdraw them in any one of ten currencies at an exchange rate to be fixed by the Bank within the gold points. This arrangement was made possible by the discount facilities of the Bank in the ten markets and it was hoped thereby to effect more clearing cancellations by taking transactions out of the open market, and to avoid sudden pressure on the exchanges. These hopes were not realized in practice and the facility was little used.

3) The B.I.S. hoped to deal with the problem of unfaithful money by encouraging the development of the 'money employed' account by central banks. Under this form of deposit central banks, which usually did not pay interest on deposits, accepted the deposits of other central banks and paid to the depositing bank a return based upon the use made of the money less a commission for guaranteeing the investment.

The Bank hoped to become the intermediary between central banks in the placing of such deposits, and thus to concentrate gold exchange balances of central banks.

4) The B.I.S. hoped to soften the competitive features of the gold exchange standard by concentrating gold exchange reserves in some degree in its own hands in order to decrease somewhat the dangers of sudden withdrawals of these balances.

5) The B.I.S. hoped to overcome the psychological barriers to the international movement of gold existing in many countries. It was ready to lend against gold and to buy and sell gold for central banks and hold it in custody. In addition to economy and convenience, secrecy was an important advantage in these transactions, for gold bought through the B.I.S. by a central bank could be sold again without public criticism. Greece, Australia, Poland, Spain, Estonia, Lithuania, and other countries utilized this facility before the end of 1930.[8]

The development of techniques of this sort in a tentative and preliminary way was constructive but not in sum very important under the exceptional circumstances of the time. Had the decentralized world credit structure been the result of slow evolution and had it operated in a basically balanced world economic system, these techniques would have had greater significance as refinements of an already effective financial machinery. In 1930 they were in the nature of a very mild poultice on a very inflamed surface, more indicative of the presence of the sore than effective to heal it.

More important was the use of the B.I.S. as an agency for cooperative lending. This also may be formulated in a brief classification:

1) The B.I.S. acted as Trustee for the Dawes and Young Loans and for the Austrian Loan of July 1, 1930. The com-

[8] The passages in Dulles, *op. cit.*, in which these five objectives are described are found on pp. 204, 103, 186, 92–3; 352; 170–2; 158; 79–80.

plexity of the problems involved in handling this duty is indicated by Miss Dulles (*op. cit.*, p. 360) in describing the marketing of the Young Loan:

"It is probable that the loan issued by the B.I.S. in June, 1930, was the most complicated piece of international finance which had ever been arranged. The issue was made on nine markets and in as many currencies. The proceeds were distributed among seven countries, not all included in the other nine. Moreover, the loan was served out of two separate sources, and in all of the currencies of the original issue. There were financial agreements with the seven different governments who were to share in the proceeds, as well as with banks, lawyers, and commission houses in the nine countries who were taking portions of the loan."

The existence of an agency that could administer these details and perform the international clearing functions involved in them was undoubtedly a great technical advance in the efficiency with which international cooperative lending, once decided upon, could be handled, and was to that extent an encouragement to such lending.

2) The B.I.S. lent its influence to forwarding the movement for mobilizing middle term and long term credits. In October 1930 it set up a committee on middle term credits and encouraged the initiative of private international bankers in substituting long for short term credit by subscribing "by way of example" to the capital stock of the International Mortgage Bank of Basle and the Compagnie Centrale des Prêts Fonciers of Amsterdam.[9] This, however, amounted to little more than giving its blessing to a movement that was still-born.

3) The B.I.S. directed the investment of its own funds in such a way as to meet the most urgent needs of international financial cooperation. Most of its long term investments were in Germany. These investments were relatively small, being limited both by the size of the Bank and by the nature of its

[9] *Ibid.*, p. 202, and 2d Annual Report of the Bank (*Federal Reserve Bulletin*, June 1932, p. 366).

own liabilities. The Bank could not meet the demand of debtor countries for long term accommodation, and there was no demand for the short term accommodation in stable currencies which it could provide.

4) The B.I.S. was receptive to calls made upon it for emergency short term international credits by central banks and governments, and active in the negotiation of such credits supplied by others.

It was by the exercise of the fourth of these functions, and by providing a natural and regular channel of communication between central banks, and fulfilling the special obligations laid upon it by the Young Plan that the Bank played an important role in the series of events immediately preceding the break-up of the nucleus of the gold standard system.

The Attempt to combine Technical Cooperation with Politico-Economic Conflict

The increase in political tension in Europe from the Nazi electoral victories in Germany in September 1930 to the announcement of the proposal for the Austro-German Customs Union and its effect upon the defense of the gold standard in Central and Eastern Europe was emphasized at the end of Chapter 24. The effectiveness of all international financial cooperation, including the work of the B.I.S., was seriously diminished by this tension. Not only that, but the whole effort to bridge the gap in international lending by short term credit, whether by the uncoordinated action of the credit system or by the deliberate effort of central banks and international agencies, was threatened by it. As in 1914, the money markets had become adjusted to the existing volume of short term international debt, and any sudden change in its amount and distribution constituted a serious danger to the whole international financial mechanism.[10] During the summer and autumn of 1931 these dangers became actual in a series of events in which many of the elements isolated in

[10] Cf. Ch. 1, and *World Economic Survey, 1931/2*, p. 179.

our analysis were acting and reacting upon one another in a most intricate way. These events have been so often and so ably treated that they have become a more than twice told tale. They may therefore be summed up here in the briefest form, in the hope that the background of analysis presented in these studies will place them in their true perspective in the history of the international gold standard.

The Austro-German Crisis

The difficulties of the Credit Anstalt were announced on May 11, 1931. Three days before, the French Chamber of Deputies had concluded a debate on French policy toward the Anschluss question during which the whole Briand policy of reconciliation was under attack. Two days later, May 13, M. Briand was defeated in the French presidential elections. The political atmosphere could not have been worse for securing united international action to help Austria. Such help was almost immediately requested, however. The first run on the Credit Anstalt was met by heavy discounts at the National Bank resulting in an increase in its bill portfolio and a loss in foreign exchange reserves as early as May 15. On May 16 proposals were laid before the International Committee on Austrian Loan Control for a new loan of 100 million schillings to cover advances by the government to help the Credit Anstalt. On the same day the B.I.S. sent representatives to Vienna to offer assistance and on the following day the application for the new loan was approved in Geneva. Negotiations for this loan were at once opened by the Austrian government with a banking group headed by Rothschild's and Lazard Frères. The loan was to take the form of an issue of Austrian treasury bills. On May 18 the B.I.S. informed the Austrian government that it had authorized a credit of 100 million schillings ($14 million) in cooperation with various central banks under which it would discount Austrian commercial bills and paper guaranteed by the National Bank of Austria. In taking this action the B.I.S. disassociated itself

from the government loan negotiations for help to the Credit Anstalt, for it had become clear that the granting of this loan had become subject to the condition that the Austrian government should give up the Anschluss Agreement. Meanwhile, the whole question of the Anschluss had been raised before the League of Nations, and on British initiative the legal aspects of the case were referred on May 23 to the Hague Court for an Advisory Opinion. The flight of capital and losses of foreign exchange reserves by the National Bank, however, continued to increase and on May 28 an agreement was reached with foreign creditors of the Credit Anstalt for a two year moratorium under a government guarantee of its foreign liabilities. On June 9 the 100 million schilling loan was granted by the B.I.S., but negotiations for the loan from private bankers had reached a deadlock. Rather than accept the political conditions attached the Austrian government resigned on June 18. The next day the entire amount of 150 million schillings (£5 million) was advanced by the Bank of England. This action had very constructive effects in Austria, but met with a very unfavorable reception in France and rendered later Anglo-French cooperation more difficult.

On June 5 and 6 Dr. Bruening and Herr Curtius went to England, a visit which had been postponed because of the urgent questions, including a critical phase of the disarmament negotiations, that came before the May meeting of the League Council. The German statesmen were able to impress the City with the gravity of the German position, but the Treasury and the Bank of England were not yet convinced, and were not prepared to admit the necessity of a drastic revision of the Young Plan or large scale assistance to Germany. At the same time, a further drastic step was taken in the development of the German government's economic policy by the publication of a new set of emergency decrees. The main features of these were further salary cuts for government officials, reductions in war pensions, reduction in departmental estimates, more indirect taxation, and a 'crisis

tax' on wages and incomes. Further, state and communal budgets were also reduced, principally by salary cuts, and reforms in the unemployment insurance system designed to reduce its cost were undertaken. These drastic deflationary measures provoked a political crisis in Germany during which great pressure was brought to bear on Dr. Bruening to convene the Reichstag or at least the Budget Committee. A fresh outflow of foreign funds began and by the second week in June the situation became alarming. On June 13 the Reichsbank raised its rate from 5 to 7 per cent without checking the withdrawals. On Friday, June 19, there was a panic in Berlin, and the Reichsbank prepared to put into effect drastic credit restriction, in order to prevent its foreign exchange and gold from being further drained by discount operations. Further French withdrawals at this time practically completed the repatriation of French funds from Germany. The severity of the crisis may be judged from the fact that there were times during June when absolutely no market for reichsmarks existed in Switzerland. In the United States the German difficulties were watched with greater appreciation of their gravity than was shown in Great Britain. On June 14 President Hoover summoned his financial advisers and on June 20 he announced his proposal for a one year moratorium on all inter-governmental war debts and reparation payments. The panic in Berlin was stopped and the credit restriction measures were made mild instead of drastic. It soon became clear, however, that acceptance of the moratorium by France, next to the United States the largest loser, was not to be won easily. Two weeks passed in negotiation before agreement on the plan was announced, and during these two weeks the flight of capital and withdrawal of foreign funds from Germany became even more violent. To help meet the half yearly settlements in Germany, which were extremely difficult under the circumstances, the B.I.S. offered the Reichsbank a $100 million loan for two weeks on June 25. On July 4 agreement on the Hoover Moratorium

was announced but by this time confidence in Germany was profoundly shaken and the outward movement of capital continued. On July 7, however, more help was secured in the form of a $50 million credit granted to the Gold Discount Bank by an American syndicate. These short credits were merely stop-gap measures and on July 9 Dr. Luther, President of the Reichsbank, started on a four day journey to Paris, London, and Basle in search of foreign loans. It was too late. The political price demanded by France was one Germany would not pay, and the difficulties of her banking system and of her economy as a whole had made Germany a bad credit risk. The failure of the 'Nordwolle,'[11] the biggest German textile concern, whose far flung investments had largely been acquired by the use of short term money, caused a run upon the Darmstädter Bank which was closely associated with it. In the absence of adequate support from the other banks the Darmstädter Bank was forced to close on July 13, the day on which Dr. Luther returned, empty handed, from abroad. On the same day the government guaranteed the deposits of the Darmstädter Bank and issued an emergency decree ordering all banks to suspend cash payments and interbank clearance on July 14 and 15. "The government utilized this short respite to issue various emergency decrees to protect the banking system from domestic and foreign runs and to prevent the flight of foreign capital. A decree issued on July 15 concentrated all foreign exchange transactions and payments abroad in the hands of the Reichsbank or institutions designated by it as agents." On the same day the Reichsbank, whose losses of reserves (Chart 56) had brought them below the legal limit, raised its rate of discount from 7 to 10 per cent.

[11] One of the causes of the collapse of the Nordwolle was its failure to follow, in its wool buying policy, the trend of the market in Manchester. It tried to make itself independent in wool which it shipped directly to Bremen from Argentina. Nevertheless the Nordwolle was bankrupted by the fall in the price of wool and its failure was in a sense a demonstration of the great psychological importance the world over of the lead taken by Great Britain in the commodity markets. Cf. Ch. 21.

"On July 16 the banks were permitted to open for limited payments, and on August 1 restrictions on domestic withdrawals were completely abolished."[12] The Reichsbank rate, however, was simultaneously raised from 10 to 15 per cent and was kept at this level until the signing of the Hoover debt plan on August 11, when it was reduced to 10 per cent.

At the height of the crisis on July 15, the $100 million two week B.I.S. credit to the Reichsbank fell due, but was prolonged until August 4 with Federal Reserve bank participation. On the same day the British government invited representatives of all the Powers to a conference in London on July 20. Active consultations were undertaken in preparation for this conference. The French made proposals for aid to Germany in the form of a loan subject to very severe political conditions including the abandonment of the Zollverein, resumption of Young Plan payments after the Hoover year, and cessation of agitation for treaty revision for ten years.[13] This proposal was at once rejected by Dr. Bruening on July 16, and on the next day it was officially announced in Washington that the United States would not become involved in any political situation connected with economic help for Germany and that the Federal Reserve Board would give no credit to Germany except in conjunction with all central banks, including the Bank of France.[14]

From July 20 to 23 the Seven Power Conference met in London and recommended that the $100 million Reichsbank credit be renewed on due date for another three months, that concerted measures be taken to maintain the then existing volume of foreign credits in Germany and that the B.I.S. be invited to convene a committee to study the possibility of converting a portion of the short term credits into long term credits. This committee became known as the Wiggin Committee and its report as the Layton Report. Before this was

[12] Madden and Nadler, *op. cit.*, p. 402.

[13] Cf. Wheeler-Bennett, *op. cit.*, pp. 74-7.

[14] *The Economist*, 'A Diary of the Crisis,' July 18, 1931, p. 104.

drawn up, a temporary agreement was reached in Berlin on July 29 to prevent further withdrawals of short term British and American banking funds.

With this agreement the most acute phase of the crisis in Germany ended after Germany had in seven months, according to the Layton Report, repaid to her foreign creditors 3½ milliard marks. There was, however, no return to 'normal' conditions. Exchange control was further developed, an abnormally high bank rate was maintained, and Germany entered upon a thoroughgoing banking reorganization which, contrary to the expectations of the government of the day, culminated in the complete subordination of the banking system to the state and the complete reversal of the post-war stabilization principle of the independent central bank. This reorganization began with the guarantee of the deposits of the Darmstädter Bank by the government and a substantial government participation in the capital of the Dresdner Bank.[15] A new clearing association (Ueberweisungs-Verband) was created and a new institution, the Acceptance and Guarantee Bank of Berlin, was organized to accept bills not in themselves eligible for discount at the Reichsbank and to pave the way for the resumption of business in the private discount market. The government, directly and indirectly, provided more than half the capital of this institution. On September 19, 1931 government supervision of the banks was introduced and the office of Reichs-Commissioner for Banking was created.[16]

While this reorganization was in progress withdrawal of foreign funds continued, and the Reichsbank suffered further losses in reserves (Chart 56). The freezing of foreign short term funds in Germany was confined to banking funds, and other short term funds were freely withdrawn. On September

[15] The provision of government capital to the banks was intended to be temporary and the Bruening government looked forward to a future program of decentralization in banking.

[16] Madden and Nadler, *op. cit.*, pp. 402–3.

1 negotiations were completed for a formal Stillstand agreement with banking creditors, which immobilized $1,250 million of foreign funds, and on September 2 the Reichsbank rate was reduced to 8 per cent. In this Stillstand agreement, in which the utmost limits of German law were explored in the search for liens upon the German debtors, the note of political conflict was still struck. For the agreement was to endure for six months from September 1, 1931, or until the adoption of a plan suggested by a financial committee appointed on recommendation of the London Conference, or for the period of central bank advances through the B.I.S., *whichever was shortest.* The periodical renewal of these very short term central banking credits therefore gave occasion for the exertion of periodic political pressure upon Germany upon pain of a breakdown of the Stillstand agreements.

The Breakup of the Nucleus

The closing of the German banks on July 15 and the freezing of about £70 million [17] of British short term assets in Germany was the signal for heavy withdrawals of foreign funds from Great Britain. At this time French withdrawals of gold from London were suddenly resumed on a large scale, and the political atmosphere was not improved by charges that these withdrawals were partly motivated by resentment over the Bank of England loan to the National Bank of Austria on June 19. Meanwhile the mobilization of foreign central banking funds in the United States had been begun and the steady flow of gold from both New York and London to the Neth-

[17] In a statement issued by the London Clearing House in December 1931, based on returns from banks and acceptance houses in London doing business with Germany, the amount of credit facilities held at the disposal of Germany by London banks and acceptance houses under the first German Stillstand agreement was on July 31, 1931 "less than £64,000,000" (Samuel Montagu & Co., *Weekly Review of the Foreign Exchanges,* Dec. 31, 1931, p. 733). In introducing the Gold Standard (Amendment) Act, 1931, into the House of Commons on Sept. 21, 1931, Mr. Snowden said (*The Times,* Sept. 23, 1931, p. 7): "Apart from the Agreement as a result of the London Conference we have locked up £70,000,000 of our assets in Germany."