

**THE PROBLEM OF
INTERNATIONAL INVESTMENT**

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THE PROBLEM OF INTERNATIONAL INVESTMENT

A Report by
a Study Group of Members of
the Royal Institute of
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FOREWORD

THE Council of the Royal Institute of International Affairs believe that this addition to the series of Study Group Reports will fill an important gap in the literature of international economics. It is an attempt, in the first place, to analyse objectively the conditions under which long-term capital may move between countries and to consider carefully the special factors in the world economy of to-day which tend to limit the extent to which such movements are possible or desirable. Secondly, the book contains a careful study of the post-war history of international investments which brings together facts and figures which are inaccessible to most students and business men.

The Council is indebted to the following group of members of the Institute for the preparation of the Report:

Mr. H. D. Henderson (*Chairman*).
Mr. C. I. C. Bosanquet.
Mr. A. T. K. Grant.
Mr. O. L. Lawrence.
Mr. C. G. Vickers, V.C.

In accordance with the usual practice in the preparation of Study Group publications, the Report was submitted, in draft form, to a number of authorities in Great Britain and other countries. These experts were invited to comment upon it and to criticize it from their various points of view, on the understanding that they would, by so doing, incur no responsibility for the final contents of the book, and the Study Group reserved to itself the right to accept or reject any proposed amendments. In this way, and by direct conversation, much valuable help and criticism was received from a number of authorities, including the following:

Professor J. W. Angell.	Mr. A. Loveday.
Dr. Herbert Feis.	Mr. F. H. Nixon, C.B.
Professor N. F. Hall.	Professor J. F. Parkinson.
Mr. H. V. Hodson.	M. Léonard Rist.
Mr. Carl Iversen.	Dr. Philippe Schwob.
Mr. J. M. Keynes, C.B.	Mr. D. A. Skelton.
Mr. Thomas W. Lamont.	Professor Eugene Staley.
Professor Henry Laufenburger.	

The Council wish to express their warm appreciation of the generosity of these authorities in thus placing their knowledge and experience at the disposal of the Group. They desire, further,

FOREWORD

especially to record their gratitude to Mr. R. K. C. Maguire, who has freely given his advice and assistance at every stage in the preparation of the book. Finally, both the Council and the members of the Group have to express their high appreciation of the services of Mr. A. W. Snelling and Mr. J. F. Cahan, who have acted as Group Secretaries, and who have drafted the greater part of the Report.

It should be understood by readers of this Report that the members who are responsible for its preparation, although they do not necessarily subscribe as individuals to every statement in the book, put it forward as an expression of their general views on the subject and as a useful contribution to the study of international affairs.

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1st March, 1937.

ASTOR,
Chairman of the Council.

BIBLIOGRAPHICAL NOTE

DURING the preparation of this Report, the drafters consulted over a hundred books and an equally large number of newspapers and periodicals. To give a complete list of these without some indication of their importance would, we feel, be useless, and to write a short note about each would occupy too much valuable space. We have therefore compromised. All statistical and factual sources and the most important works consulted in the writing of each section of the book have been cited in full in footnotes. The reader who wishes further information on a certain subject, therefore, has only to turn to the relevant section in the book and he will find there references to the books and papers which the drafters have found most helpful. References to books include the name of the publisher as well as the place and date of publication, so that they may be obtained with the least possible trouble.

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PART I

CHAPTER I

INTRODUCTION

IN the economic development of the Victorian Age international investment played what was widely recognized to be an essential part. International trade in general grew rapidly, and perhaps the most striking feature of this growth was the development of trade complementary and mutually advantageous in character between the old countries of Europe and what used to be known as the New World. On the European side Great Britain took the leading part in this process, and the phenomenal expansion of British economic life in the nineteenth century is to be attributed in no small degree to this fact. On the side of the New World, the United States was for a considerable time the principal participant, though trade with South America and the self-governing Dominions became increasingly important as the century drew to its close.

International investment was an essential condition of this increasing trade. The development of the new countries required large capital expenditure on the building of railways, the sinking of mines, the draining of marshes, the erection of towns; and the pace of the development would necessarily have been greatly retarded if these countries had had to depend upon their own resources for the savings and the capital equipment requisite for these purposes. International investment was, of course, not the only necessary condition. A large-scale migration of population was equally essential. In the nineteenth century, indeed, overseas investment, the migration of population, and the growth of international trade were linked together as different aspects of the process of the expansion of economic intercourse between the Old World and the New.

This intercourse was, as has already been suggested, highly beneficial to both parties to it. It made it possible for the peoples of the new countries to share to a degree which would otherwise have been impossible in the potential benefits of the series of mechanical inventions which were adding immensely to the productive powers of manufacturing industry. It enabled them, in other words, to share in the gains of the industrial revolution. It met a no less vital need of the peoples of Europe and particularly of Great Britain. It supplied them with the means of obtaining the abundant foodstuffs and raw materials which their rapidly growing industrial life imperatively required. It is impossible to study the history of the early part of the nineteenth century without being struck by the profound pessimism

of the social speculations of the time, contrasting sharply with the buoyant optimism of the latter half of the century. The law of population and the law of diminishing returns from land appeared in conjunction to present an almost insuperable obstacle to any real improvement of social conditions. As population grew, proportionately more food would be necessary if the standard of living were to be maintained. If, however, a country was dependent for its food supply on its domestic production, it could only obtain more food either by bringing uncultivated (and presumably poorer) lands into cultivation, or by working existing land more intensively. It was argued, not without some reason, that both of these methods entailed a diminishing yield of food for each additional unit of effort applied. Here was a difficulty of which the rapid technical advance in manufacturing industry appeared to offer no real solution.

In fact the escape from this dilemma was found, as soon as the development of ocean-going transport permitted, in the development of international trade of the type that has been indicated. The foodstuffs required by the growing populations of Great Britain and other European countries were supplied by bringing into cultivation the virgin lands of the New World. Markets were at the same time provided for the export of the manufactured goods which British factories were able to produce. It was thus through the development of international trade that the potentialities of the industrial revolution, which had hitherto seemed dangerously lopsided, were translated into a substantial and steady improvement in the standard of living.

In these circumstances, it is not surprising that international trade in general and international investment in general acquired a good name. Capital sunk in the development of new countries was not, it is true, the only type of international investment. Important sums of British capital were invested at different times in, for example, loans to foreign governments which used the proceeds largely for military purposes. But investments which were associated with the development of complementary international trade were so important as to be accepted by public opinion as the characteristic type of international investment. To encourage and facilitate international investment became accordingly a generally accepted maxim of policy in the latter part of the nineteenth century, both in borrowing and in lending countries.

The widespread adoption of the gold standard and the prestige which the gold standard system acquired were partly attributable to this cause. Assured exchange stability was an important, if not

an essential, condition of large-scale international investment, and hence it became the first *desideratum* of a monetary system that it should ensure exchange stability.

In the main, however, the development of international investment was not attributable to 'planning' or deliberate policy. It proceeded, as fitted the dominant philosophy of the age, on a *laissez-faire* basis; and the widespread advantages that followed supplied a favourite illustration of the congenial theme that a broad harmony prevailed under the free operation of natural economic forces between the interests of the individual and the general interest. It was not suggested that a man who subscribed to a loan for the construction of a railway overseas did so for public spirited reasons. It was admitted, indeed emphasized, that he invested abroad because he could get a higher return than he could obtain at home. The financial houses which issued the loans were equally moved by self-regarding considerations. But, though the individuals concerned were pursuing their own personal interests, the consequences were of great benefit to both the borrowing and the lending societies. Machinery or railway equipment was exported from Great Britain, where it could be most economically produced, to new countries where it could be put to the most advantageous use. The annual output of food-stuffs and raw materials in these countries was thereby largely increased, and these commodities were then exported to Great Britain, to the mutual advantage of both communities, partly by way of interest on the capital invested, and partly in exchange for the finished consumers' goods, cotton goods, hardware, &c., produced in British factories.

The process of international investment did not, of course, work with uninterrupted smoothness. It was punctuated by occasional financial crises (notably, for example, the Baring crisis in the 'nineties), by currency difficulties, and by periods of default on the part of some of the borrowing countries entailing losses for British and European investors. Such occurrences were followed by a sharp decline in the volume of fresh overseas investment, and by a serious depression for the exporting industries of Great Britain. Until the war, however, troubles of this sort amounted to no more than temporary interruptions of a powerful forward trend. Sooner or later the new countries would emerge from their difficulties, re-establish their position as credit-worthy borrowers, and proceed with their development on much the same lines as before. The setbacks that occurred were insufficient to shake the impression that the prevailing character of the process was highly beneficent.

Nor did the events of the war do anything to weaken this impression. By mobilizing and selling the more marketable of the overseas securities held by her nationals, Great Britain was able to obtain large sums of foreign exchange (particularly of dollars) for the purchase of food, munitions, and other war-time requirements, both for herself and for her allies. Indeed, in the period before the entry of the United States as a belligerent into the war, the exchange resources acquired in this way were indispensable to the allied war effort. Thus the overseas investments which had been gradually accumulated by the British public in the two or three preceding generations proved from 1914 to 1917 a war asset of the first importance. Moreover, the intimate economic and financial relations that existed between Great Britain and the agricultural communities overseas contributed powerfully in other ways to strengthen Great Britain for the purposes of war.

The war exerted an enduring influence on the economic prosperity of different countries, and on the balance of international indebtedness. The United States, hitherto a debtor country, emerged with a strong creditor position. Her nationals had acquired a large proportion of the American securities previously held by foreigners. Her government had large debts owing to her from the governments of the European allies, together with a claim to the American share of German reparation payments. This transformation of her position on capital account was accompanied, moreover, by a marked strengthening of her position in regard to the annual balance of international payments for current trading transactions. The decline of European agricultural productivity resulting from the war increased the world demand for American agricultural products, while American industry had acquired a firm grip on the world market for many industrial products, notably the newer commodities such as motor-cars, for which a steadily increasing demand could be assumed. To this picture the belligerent countries of the continent of Europe presented a sharp contrast. Germany emerged from the war stripped of her capital assets overseas and her mercantile marine; with both her industrial and her agricultural capacity seriously impaired, partly as the result of territorial losses; with the morale of her population enfeebled by famine and defeat, and perplexed by revolution; subject to vast liabilities in respect of reparations; and destined to pass through a prolonged and disastrous period of currency inflation. The greater part of central Europe was in an almost equally unenviable position. France, though victorious in the war, emerged in an economically weak condition. Traditionally she had been one of the great lending

countries, but her loans in the generation preceding the war had been directed in a preponderant degree to financing her ally Russia. With the advent of the Soviet Government to power these investments became worthless. A heavy capital expenditure was necessary for the reconstruction of the areas devastated by the war. Consoling herself with the hope that it would ultimately be defrayed from German reparations, France undertook this expenditure without attempting to provide for it from budget revenue, and she too was destined in consequence to undergo a serious currency inflation.

Between the continent of Europe and the United States, Great Britain occupied, as in so many other respects, an intermediate position. The sale of a large fraction of her international investments during the war left her with diminished but still substantial capital claims on the outside world. Her Government had contracted a heavy debt to the Government of the United States. As against this were claims, fully commensurate on paper though necessarily speculative in substance, on her European allies and on Germany. The productive power of her industry had not suffered any serious damage from the war; but during it many of her industries had been unable to supply more than a small fraction of the demands of their overseas customers, who had turned instead to rival producers; and when the war was over it proved impossible for some of these industries to recapture the ground in world markets that they had lost. Thus Great Britain emerged from the war not only with a weakened capital position but with a less favourable annual balance of payments, exporting less while continuing to import as much as before.

The economic statesmanship of the post-war decade was alive to the facts that have been summarized above, and fully recognized the importance of the problems resulting from them. Two broad morals were drawn which the experience of the nineteenth century made it entirely natural to draw. First, that for the reconstruction of the shattered system of Europe it was above all important to recreate a healthy and developing international economic life. Secondly, that in this recreative process large-scale international lending had an essential part to play. On the one side were the countries of central Europe with an urgent need for capital for reconstruction but with a greatly impaired capacity to save. On the other side were the people of the United States, growing rapidly in wealth and prosperity with a large and growing margin of savings. Surely this was precisely the type of situation for which international lending was the appropriate remedy. Surely, moreover, this was a situation in which international lending offered prospects of great mutual advantage, in

which the investors in the lending country might hope to get a materially higher return by lending abroad than by investing at home, while the borrowing countries would none the less obtain the capital they needed much more cheaply by borrowing from abroad than by relying on their own resources. It was recognized that it would not be an easy task to secure the international capital that was chiefly needed. This investment would have to flow along new channels. In particular the United States must assume the rôle of a major lending country, and it might prove difficult to induce American investors to enter this field. Many other impediments stood in the way which it would be necessary to overcome, and some of them were formidable. But as to the desirability of reviving large-scale international lending the economic statesmanship of the post-war decade entertained no doubts whatever, and in pursuit of this objective it set itself accordingly to the task of overcoming the obstacles that stood in the way.

These obstacles were many. The budgets of borrowing countries must be balanced; their currencies must be stabilized; or, if these things could not be done without a measure of financial assistance from abroad, effective arrangements must be made to ensure that they would be done as soon as the necessary measure of financial assistance was granted. To secure such arrangements necessarily entailed a departure from *laissez-faire*. Countries requiring assistance (Austria, Hungary, and several others) were obliged to submit themselves to external control in the interests of their creditors. In the case of Austria, it was further necessary for the governments of the creditor countries to guarantee the interest and the sinking fund of the loan which was raised. In most cases the arrangements were effected under the auspices of the League of Nations and the system of League Loans came into existence in this way. But other conditions were no less essential. International lending would be impossible except in an atmosphere of assured international peace. In the case of Germany, moreover, a settlement of the reparations problem which would safeguard against the possibility of a recurrence of episodes like the Ruhr occupation was imperative. This represented the most formidable of the obstacles in the path of post-war European financial reconstruction. For the problem of reparations involved the problem of war debts, and the solution of the two problems together involved the reconciling of irreconcilable national attitudes. No settlement of the reparations problem was accordingly reached which purported to be final or which informed financial opinion expected to endure for very long. But a tentative arrange-

ment, namely the Dawes Plan, was made in 1924 which it was hoped would prove a sufficient basis for the re-establishment of Germany as a credit-worthy borrower. An integral part of the Dawes Plan was the Dawes Loan ; and the successful issue of this loan as a result of the efforts of the financial authorities of the lending countries marked an important stage in the post-war financial policy. Within the next two years the general policy appeared to have achieved a remarkable measure of success. Currencies were stabilized throughout Europe, budgets were balanced, the economic life of Europe revived, and international trade expanded rapidly.

Above all, the policy unquestionably achieved the object of stimulating a large-scale flow of capital to the more impoverished parts of Europe. A very large proportion of this capital came from the United States, where a fashion set in for the purchase of foreign bonds which was stimulated by a host of agents, working on commission for the issuing houses, who canvassed potential buyers throughout the country. This large-scale international lending undoubtedly contributed, while it lasted, to facilitate European recovery. It served indeed for a time to put out of sight the fundamental difficulties of the position and to create a fairly widespread feeling that perhaps those difficulties were not really very formidable after all. The countries in which accumulated savings had been largely obliterated by the effects of currency inflation were able to borrow the sums necessary for the re-equipment of their national life, not indeed at low rates of interest (the high rates obtainable were the leading attraction of foreign bonds to the American public) but at rates which in an optimistic atmosphere of industrial recovery appeared tolerable. The fresh loans that were constantly being raised supplied the borrowing countries with the foreign exchange that was necessary for meeting the interest on the League Loans, the Dawes Loan, and other loans previously contracted. Indeed, they supplied Germany with sufficient foreign exchange to meet for some years her reparation obligations under the Dawes Plan. So long, then, as the American public continued to buy European bonds freely, the process of international economic reconstruction went as merrily as a marriage bell. Doubts were of course expressed in many quarters, alike in the United States, in Great Britain, and in Germany, as to whether the recuperative process could possibly continue on so precarious a foundation. In particular it was widely recognized that a new reparations settlement, involving a further scaling down of German obligations, was an inexorable necessity of the future. But there was a general disposition to hope for the best and to trust that the readjustments that

would be necessary would be effected, the more easily as the war receded, without any major disaster. Thus for a brief period it almost seemed as though the revival of international investment would play as noteworthy a part in rescuing the Old World from the devastations of the war in the twentieth century as it had played in the development of the New World in the nineteenth century.

The disillusionment came gradually, but in the end it was overwhelming and complete. From the latter part of 1927 the American investor lost his taste for foreign bonds, preferring the more exciting possibilities of a rising market in American equities. This impaired the exchange position of the borrowing countries, made them anxious accordingly to improve their trade balances, and gave rise to a tendency to discourage imports by raising tariffs. But at this stage the lending countries did not seriously distrust the position on the continent of Europe; it was generally expected in the United States that the time would soon come again when 'gentlemen would prefer bonds', and it was still possible for the banks of central Europe to obtain short-term credits from abroad on a considerable scale. Gradually the position became more difficult. The European countries began to lose gold to the United States; they found it necessary to raise their bank-rates and to restrict the volume of internal credit. Meanwhile other signs of an impending business reaction made their appearance. Evidence grew of an excessive accumulation of stocks in the case of many primary products. There followed in October 1929 the collapse of the Wall Street boom, and the gradual settling of severe depression on the economic life of every country. Faced with heavy losses and financial difficulties, Americans, private individuals and banks alike, attempted, as far as they could, to bring home the money which they had invested in Europe. This confronted the European countries with an impossible exchange position; requiring continuing credits from abroad to make ends meet on international account, they were quite unable to repay the sums that they had borrowed. Thus there ensued the international financial crisis of 1931, marked by the Standstill Agreements with Germany and the fall of sterling. This international financial crisis served in its turn greatly to aggravate the general economic depression. For a considerable period the governing pre-occupation in every country became an anxiety as to the stability of its exchange position. Dominated by this anxiety each country endeavoured to cut down its imports to a minimum, regardless of the reactions on the economic life of other countries. The prices of international commodities, of primary products in particular, sank to ruinous figures, and the combination of

exchange difficulties and internal insolvencies led to an ever-widening circle of defaults on international obligations. By 1933 the world had reached a position in which the volume of international trade had been reduced to about three-quarters of its 1929 level, and the system of international investment appeared to have completely broken down.

Nor is this all. In accounting for the exceptionally disastrous character of the depression, many observers lay the chief blame on the excessive and indiscriminating international lending of the later 'twenties. A central feature of the depression was the exchange difficulties with which many countries were confronted; and in these exchange difficulties the large sums required to meet the external debt service were a major factor. 'I venture to challenge', writes Sir Arthur Salter, 'a denial from any responsible person acquainted with the public borrowings of the years 1926-1928 of the assertion that, with the exception of loans recommended by the League of Nations and the central banks, the *bulk* of the foreign loans in these years to public authorities in debtor countries would better not have been made.'¹ No one, we think, has attempted to take up Sir Arthur Salter's challenge. It is now generally accepted that the international lending of the period in question only eased the difficulties of the moment at the expense of greatly aggravating them in subsequent years.

How did it come about that large-scale international lending, the revival of which represented one of the leading objectives of policy in the years immediately following the war, was productive of harm rather than good? For even a provisional answer to this question it is necessary to consider briefly various peculiar features of the international lending of the post-war period. First, as was inevitable for the reasons that have already been indicated, the rôle of the chief international lender passed during this period from Great Britain to the United States. The issuing of foreign loans is a highly skilled business for which the financial organization of the City of London is well adapted. The work of investigating any particular project is undertaken by issuing houses of great experience and high standing, which are accustomed to regard their own reputations as involved in the subsequent history of the loans which they sponsor. Behind these issuing houses is an investing public which had been accustomed for generations to regard overseas loans as one of the main channels for the investment of its savings, which did not need to be tempted either by high nominal rates of interest or high-speed methods of salesmanship to subscribe to issues which were vouched for by the

¹ *Recovery* (London, Bell, 1932), p. 106.

judgement of the issuing houses to which it was accustomed to look for leadership. But to the people of the United States foreign investment was an unfamiliar field. Their financial institutions necessarily lacked the experience which had been slowly accumulated by the British issuing houses. Moreover, they brought to bear on the problem different traditions. The spirit of enterprising salesmanship predominated over that of cautious responsibility.

A large share of the responsibility for the disasters that have overtaken the international loans of the post-war period is undoubtedly attributable to the recklessness and lack of discrimination with which many of these loans were made. It would be superficial, however, to assign the whole responsibility to such causes. Many of the loans which in the light of our after-knowledge seem imprudent to the point of recklessness did not seem so even to cautious observers in the atmosphere of the post-war decade. For a complete diagnosis of the trouble it is necessary to take into consideration factors of a more fundamental character.

This leads us to a second feature of post-war international lending. It is sometimes argued that the American post-war lending to Europe was fundamentally dissimilar from the typical international lending of the nineteenth century. This argument, it is worth noting, was advanced early in the period before the orgy of large-scale lending began.

'Mercantile nations', wrote Mr. J. M. Keynes in 1922, 'have always employed large funds in overseas trade. But the practice of foreign investment, as we know it now, is a very modern contrivance, a very unstable one, and only suited to peculiar circumstances. An old country can in this way develop a new one at a time when the latter could not possibly do so with its own resources alone; the arrangement may be mutually advantageous, and out of abundant profits the lender may hope to be repaid. But the position cannot be reversed. If European bonds are issued in America on the analogy of the American bonds issued in Europe during the nineteenth century, the analogy will be a false one; because, taken in the aggregate, there is no natural increase, no *real* sinking fund, out of which they can be repaid. The interest will be furnished out of new loans, so long as these are obtainable, and the financial structure will mount always higher, until it is not worth while to maintain any longer the illusion that it has foundations. The unwillingness of American investors to buy European bonds is based on common sense.'¹

This passage, however, perhaps hardly calls attention to the essential point. What is meant by the phrases 'no natural increase, no *real*

¹ *A Revision of the Treaty* (London, Macmillan, 1922).

sinking fund'? If it is a question of physical output, there can be little doubt that the productive power of German industry was materially increased as the result of the loans of the post-war period. Unfortunately the additional industrial productivity of Germany did comparatively little to enable her to meet the service of her external borrowings. The heart of the problem was the difficulty which Mr. Keynes elsewhere did so much to elucidate, the difficulty of transfer. To meet the service of her external borrowings it was not enough for Germany to produce additional goods to the required value. She must market those additional goods in world markets, thereby obtaining foreign exchange. Equally, for the United States to receive payment it was necessary that America should import additional goods from the outside world or else reduce her exports by a corresponding amount.

This is the essential respect in which the analogy between the international lending of the nineteenth century and that of the post-war decade breaks down. In the nineteenth century, as has been already pointed out, the chief lending country, namely Great Britain, herself constituted a market with unlimited possibilities of expansion for the produce of the countries to which she lent; and her lending served to increase the output of precisely the commodities which she was ready to consume. But when the United States lent money on a large scale to Germany in the later 'twenties there was only a somewhat weak presumption that Germany's capacity to sell goods in world markets would thereby be increased, and virtually no presumption at all that the United States herself would be willing to increase her imports in proportion to the growth of her interest claims.

There is, moreover, a third feature of the collapse of international lending which it is essential to appreciate. The purchases of foreign bonds by the American public between 1926 and 1928 were by no means confined to the bonds of European governments. Loans to Central and South American countries attracted an equal amount of attention and absorbed commensurate sums of money. These Central and South American communities are agricultural communities representing a field of investment analogous to those which were exploited with such success in the nineteenth century. Indeed, immediately after the passage quoted above, Mr. Keynes suggests that the United States might advantageously take 'the place hitherto held by England, France, and (on a small scale) Germany in providing capital for those new parts of the world less developed than herself, the British Dominions and South America'. In fact, however, investments in the post-war period in the Central and South American

countries have proved hardly less disappointing in their results than investments in Europe. Nor, as we have already suggested, can the failure of so many of these loans be wholly attributable to the recklessness and lack of discrimination with which they were made. A major contributory factor has been the economic difficulties which these countries have had to face, in common with other countries which specialize in the export of primary products to world markets.

If one of the outstanding features of the world depression of recent years was the development of an international monetary and financial crisis, another has been a world agricultural depression of unprecedented severity and duration. Agriculture throughout the world has exhibited the most extreme manifestations of the phenomena of overproduction and redundant capacity which were previously regarded as essentially industrial phenomena. The severity of the world agricultural depression is no doubt largely attributable to special circumstances which represent the aftermath of the war. But taken in conjunction with other factors, namely the decline in the rate of growth of population in the western world and the rapid growth of technical productivity in agriculture, it suggests that an important change is taking place in the fundamental conditions of the world's economy. The need which was so urgent in the nineteenth century for a constant and rapid extension of food-producing areas throughout the world is no longer so urgent as it was. International investment has been so largely associated in the past with the development of new food-producing areas that this change suggests that the scope for mutually advantageous international investment is likely in future to be much more restricted than it was in the nineteenth century.

But, however the break-down of the system of international investment in the last few years should be explained, this break-down constitutes a fact of the first importance. Large-scale international investment played, as has been indicated, a vital and constructive rôle in the economic life of the nineteenth century. Large-scale international lending was one of the main instruments by means of which the economic statesmanship of the post-war decade attempted to reconstruct the economic life of Europe. To-day the system of international investment lies shattered, and the idea of international lending is viewed with profound misgiving both in debtor and in creditor countries. Debtor peoples regard international loans as a barrier to their future prosperity; creditor countries as the grave of their accumulated savings. The discredit into which international

investment has fallen forms an important element in the prevailing trend towards economic nationalism.

Yet the fundamental fact which constitutes the ultimate justification for international investment still remains. Different countries are at different stages of economic development; some are more abundantly equipped with savings available for investment, others have larger and more urgent opportunities for the profitable investment of savings. If each country must rely on its own capital resources for its further development, the savings of the world will not be put to their most advantageous use. This consideration alone suggests that in the economic world of the future international investment, possibly along different lines and in different forms from those of the past, is or should be capable of playing an important part.

The primary object of this book is to consider the part which international investment might advantageously play in the world economy, and to examine the conditions which are necessary if it is to fulfil this part. These are not questions which in the present transitional condition of international affairs it is easy to answer decisively or confidently, and our aim is, therefore, rather to assemble the material which is necessary for the study of these questions and to call attention to the problems that arise than to formulate dogmatically conclusions of our own.

CHAPTER II

INTERNATIONAL INVESTMENT IN THE POST-WAR PERIOD

It is impossible to obtain perfectly reliable data as to the volume of investment undertaken by the nationals of any country within the geographical confines of another country. Even when statistics are available, it is often difficult to ascertain their precise meaning or to discover whether they are really comparable with statistics from other sources. The extent of long-term international investments, the purposes for which they were made and the ways in which they were used, must always, therefore, remain something of a mystery. The available estimates are considered in some detail in Part II of this book. From these data it is apparent that the principal creditor nations to-day are Great Britain, France, and the United States. The gross¹ external investments of the three principal lending countries in 1930, when post-war investments were at their peak, have been estimated at £3,726 millions, frs. 72,000 millions, and \$15,675 millions respectively. (These figures do not include either debts owed to the governments of these countries, or short-term debts of any kind.) When allowance is made for the investments of each of these creditor countries in the other two, it appears that rather more than £7,000 millions had been lent by these three countries to the rest of the world by 1930.² 'The rest of the world' includes quite literally every inhabited country on the globe, although some, of course, had borrowed on a much larger scale than others.

European borrowers had absorbed a large part of this capital. British investments in Europe amounted to only 8 per cent. of the total of British overseas investments, but this proportion was much higher in the case of the United States (about 30 per cent.), while an even larger,³ but indeterminate proportion of the foreign investments of France had been made in Europe. The largest single European debtor is Germany. At their peak in 1930, foreign long-term investments in that country are estimated to have amounted to Rm. 18 milliards (approximately £880 millions at the pre-1931 rate of exchange). Of this amount, more than 50 per cent. was owed to the United States, only 10 to 12 per cent. to Great Britain, and 5 per

¹ i.e. when no allowance is made for investments in them by nationals of other countries.

² Some estimates give a higher figure than this. See below, Chapter XIII, p. 221-2.

³ Estimated to be at least 60 per cent.

cent. to France. The remainder had been lent chiefly by Holland, Switzerland, and Sweden; but much of this capital must have been French or American in origin.

A second large group of debtor countries is the British Dominions and colonies. British investments in Empire countries amounted to not less than £2,187 millions in 1930, or nearly 60 per cent. of the total of British overseas investments. American long-term investments in the British Empire (excluding the United Kingdom) amounted to nearly \$4,600 millions, or about 30 per cent. of the total. It is not possible to estimate the extent of French investments in this area, but they must have been relatively small. The largest Empire debtor is Canada, in which British and foreign investments to a total of \$6,478 millions were outstanding on the 1st January 1931. Of this amount, \$2,205 millions represented British investments and \$4,108 millions American investments. In Australia and New Zealand, British investments in 1930 were estimated at about £665 millions and American investments at \$419 millions, making a total of roughly £750 millions. In India, British investments were valued at about £480 millions and American at \$39 millions and the total of British and foreign investments was about £500 millions.

The third important group of debtor states is the republics of Latin America. British investments in Latin America were valued at £830 millions in 1930, and those of the United States at about \$5,150 millions. There are also some French investments, but adequate statistics are not available and these are, in any case, small in comparison with those of the other two creditor countries. This area has also been a field for investment on a smaller scale by other countries such as, for example, Canada. It is, perhaps, permissible to guess that the total long-term investments of North American and European countries in Latin America in 1930 amounted to not less than £2,000 millions. The largest single Latin American debtor is Argentina. In 1930 British investments in that country amounted to £450 millions, and American investments to \$808 millions, and there were also indeterminate amounts invested by other countries. In Brazil, British investments amounted to £190 millions and there were also American investments of \$550 millions and investments by other countries valued at not more than £250 millions. In Cuba, American investments were very large—about \$1,067 millions in 1930—and there were also British investments valued at £37 millions.

Broadly speaking, the British Dominions and colonies (with the exception of Canada) and the Latin American countries do not produce relatively large quantities of manufactured goods. They all

rely upon exports of primary products—foodstuffs and raw materials—with which to purchase the products of the industrialized countries. When they borrow abroad, they usually do so in order to purchase capital goods for the purpose of developing their transport and communications systems and public utilities in general, for, with the exception of mining, industries which produce foodstuffs or raw materials usually require relatively small amounts of capital. Even mechanized cereal production uses a very small proportion of capital per unit of output, and many other primary producing industries require even less, especially in countries in which labour is cheap. But such countries do require roads, railways, bridges, electric power plants and transmission systems, harbours and canals, and other forms of capital equipment which, while not a direct part of the primary producing industries, are nevertheless very important adjuncts to them. It was, therefore, to provide these things that much of the external borrowing of such countries was required. Some of it was obtained by government and municipal borrowing and some by private borrowing. The building of a railway can, for example, be undertaken as a general rule either by a government or by a private company with more or less equal success. Government bonds, therefore, may in fact be equivalent to the loan capital of a private company in many cases, and it is certain that much of the borrowing of the public authorities of the British Dominions and colonies and the Latin American republics was undertaken for purposes of this kind.

Great Britain's investments in her overseas Empire amounted to more than £2,000 millions in 1930. At least £1,500 millions of this was represented by government and municipal bonds and the securities of private railway and public utility companies. A further £100 millions was invested in private mining enterprises. This left only £400 to £500 millions, or less than 25 per cent. of the total, for all other private industries. This distribution is not very different from that of 1914, although the tendency for Dominion governments to take over private railway enterprises has altered slightly the relative sizes of British holdings of government bonds and railway securities without changing the proportion which the two together bear to the total of investment within the Empire.¹ In South America, British holdings of government and municipal bonds and railway and public utility securities amounted to nearly £550 millions, or over 65 per cent. of the total British investment in that area in 1930.

The investments of the United States are distributed in a very similar way, though there is some tendency to prefer the newer types

¹ See below, Chapter XIII, pp. 227-31.

of public utilities—telegraph and telephone companies, for example—to railways. In Canada, where alternative opportunities were most readily available, United States investors had placed \$825 millions in government and municipal securities, \$806 millions in railways, and \$557 millions in other public utilities, making a total for these three categories of \$2,188 millions, or 54 per cent. of their total investments in that country.¹ American investments in other parts of the British Empire are not large. In Australia and New Zealand, total United States investments were \$419 millions in 1930, of which \$262 millions were represented by the bonds of public authorities in those countries. In Latin America² investments in government and government-guaranteed securities amounted to \$1,575 millions out of a total of \$5,244 millions. The value of American investments in railways and public utilities in these countries is unfortunately not available. It has, however, been estimated that out of a total of \$15,675 millions of United States capital invested abroad, 18 per cent. was borrowed by such concerns, and there cannot be the slightest doubt that the corresponding proportion for investments in Latin America alone would be much higher. If it were taken as, say, 25 per cent., the value of United States investments in government, municipal, railway, and other public utility securities in Latin America was between \$2,850 and \$2,900 millions in 1930, or roughly 55 per cent. of total American investments in that area.

British investments, then, in the principal primary producing countries of the world are overwhelmingly the result of the borrowings of public authorities and public utility undertakings, since about 70 per cent. of the British long-term capital employed in such countries is represented by the securities of these bodies. In the case of United States investments, the proportion is somewhat smaller—50 to 60 per cent. Borrowers of this type are welcomed by those who invest abroad. They can borrow most easily by the public issue of securities, since investors appreciate the necessity of investments in public works and similar undertakings. Moreover, such borrowers often purchase capital goods in the lending country, and, finally, consumers in the lending country may expect to benefit in the long run, since such investments tend to lower the cost of the foodstuffs and raw materials exported by the borrowing country.

In a somewhat different class are the investments of Britain, France, and the United States in continental Europe. The larger

¹ These figures refer to 1 Jan. 1931.

² Including the British West Indies and other British possessions in the Caribbean area.

borrowing countries of Europe are not essentially producers of raw materials for export; still less are they exporters of large quantities of foodstuffs. Investments in them would not therefore be likely in any case to prove of much benefit to the consuming public in the lending countries. In fact, much of the post-war borrowing of European countries did not even give an immediate stimulus to the exports of the lending countries, since the proceeds of the loans were often used to pay the interest due on past debts and, in some cases, to meet reparation payments, or to buy gold and foreign exchange, not for use, but to act as reserve funds for central banks. The benefits which arose from this type of lending were not of the same kind as those described above. Governments borrowed for reconstruction purposes or in order to balance budget deficits which could not be eliminated by taxation because of the widespread industrial depression. Later, when these needs became less urgent, in many European countries and particularly in Germany, they borrowed to construct swimming baths, public libraries, and theatres which, although they raised the standard of life of the community, did not help very directly to increase the efficiency of the borrowing countries' export industries. Finally, they borrowed in order to rearm.

British long-term investments in Europe amounted to only about £300 millions in 1930. United States investments were much larger, and, excluding the British Isles, amounted to \$4,282 millions in 1930.¹ Of this, \$2,420 millions were in government securities and \$968 millions represented the 'direct' investments of American firms in subsidiary or associated companies or in their own branch establishments. The value of French investments in Europe is unknown, but it could hardly have been less than frs. 40 milliards in 1930. In addition, considerable sums had been lent to France, Germany, and other European borrowers by Switzerland, Holland, and the Scandinavian countries which had, in turn, borrowed from Great Britain and the United States. The difficulty of estimating the volume of capital invested in Europe is further complicated by the fact that much of it had been borrowed nominally on short-term. A large part of these short-term funds were, however, used for purposes normally associated with long-term loans and, since they were continually renewed, gradually assumed that character, at least in the minds of the borrowers.

The post-war borrowing of most European countries can be roughly divided into three categories, viz. stabilization and relief loans, post-stabilization borrowing, both public and private, and re-

¹ \$472 millions in France are included in this figure.

armament loans, though it is often difficult to draw sharp distinctions, especially between the last two classes. Stabilization and relief loans are typified by the Dawes and Young Loans to Germany and by the League Loans to Austria, Hungary, Greece, Bulgaria, Estonia, and Danzig. These loans were subscribed principally by Great Britain and the United States, but also to a lesser extent by a number of the more fortunate European countries. The Dawes and Young Loans amounted to Rm. 2.4 milliards (£117 millions) and the League Loans to £81 millions. In addition, countries such as Poland, Roumania, and Czechoslovakia received stabilization and relief loans principally from the United States and France. As had been the case before the war, French loans to European countries were very largely conditioned by political considerations. The borrowing of actual or potential political allies was encouraged just as that of Russia had been a decade earlier, and, although the first loans to members of the Little Entente were used for stabilization and relief purposes, the later ones were used, as in pre-war Russia, to develop the military strength of the borrowers. In Italy, too, foreign loans, especially to Albania, were encouraged for similar reasons, and in both countries loans to ex-enemies or potential enemies were usually discouraged. British and American lending was, on the other hand, free from such political motives. After the first stabilization or relief loan to any country had achieved its purpose, British and American capital was usually attracted to the borrower who could offer the highest return, and loans were consequently made to most European countries irrespective of their political affiliations. Germany, the largest of these borrowing countries, was able to absorb the greatest amounts of foreign capital, and by 1930 had borrowed Rm. 18 milliards on long- and Rm. 15 to 16 milliards on short-term, a total of about Rm. 33½ milliards (£1,640 millions), of which about half had come from the United States. Rm. 6 to 7 milliards of the long-term borrowing represented the purchases of German securities, mortgages, &c., by foreigners. Of the remainder, about one-quarter consisted of the Dawes and Young Loans, and one-fifth of the borrowings of States and municipalities; about 15 per cent. had been borrowed by public utility undertakings, leaving 40 per cent., about Rm. 4 milliards, as the borrowing of private enterprise. An examination of the uses to which these loans were put would be useful but is, unfortunately, impossible, since the alleged purpose of new issues or the name of the borrower is seldom an accurate guide to the actual use to which the loan was put. It is, however, clear that although this borrowing enabled Germany to buy a large volume of imports, it did very little

to increase the relative efficiency of her export industries and thereby to provide a means of meeting service payments when they became due. Moreover, although a large part of these imports came from the principal lending countries, an even larger part, consisting mainly of raw materials, did not. Similarly, German exports, 70 to 80 per cent. of which consisted of manufactured goods, were sent only to a small extent to her principal creditor, the United States, because that country was quite able to produce such goods for herself, and therefore prevented imports of foreign goods by means of her tariff.

In short, the economic conditions under which foreign investment in Germany took place were radically different from those surrounding British and American investment in the British Empire and in Latin America. This analysis, which has been chiefly concerned with German borrowing, applies with minor modifications to the post-war borrowing of most other European countries. These transactions were very different in kind, not only from contemporary transactions between the creditor countries and most other debtors, but also from pre-war international investments which consisted almost entirely of capital exports to primary producing countries.

After 1930 the volume of new overseas lending declined sharply, and practically ceased in 1932, since which date there has been a slight tendency for it to recover again. Many public and private borrowers have been unable to fulfil the terms of their loan contracts, and there are many equity holdings which yield only a negligible return to their foreign owners. Excluding Russian and Mexican securities, it is estimated that of approximately £332 millions of British capital invested in the securities of foreign governments and municipalities, about 35 per cent. was not receiving its full contractual service payments at the beginning of 1935. During the three years 1931-3, £20 millions of interest and £14 millions of capital repayments due to British holders of these classes of securities were unpaid. Further, the average yield on £700 millions of British-owned loan capital in companies operating overseas declined from 4·8 per cent. in 1929 to 3·7 per cent. in 1933. American investors suffered in a similar way. Of \$7,500 millions of foreign dollar bonds outstanding on the 31st December 1935, only slightly more than 60 per cent. were receiving full service payments. The total interest and dividend payments made by foreigners to American investors had fallen from \$979 millions in 1929 to \$426 millions in 1935.¹

This decline in the yield of overseas investments was not confined

¹ Excluding inter-governmental debt. For further details of the history of British and American investments in recent years see below, Chapter XIV.

to those in any one country or group of countries; but extended to investments all over the world. It was, however, most marked in the case of those in European and Latin American countries, and it is in these areas that defaults on loan contracts have been heaviest.

Of a total of £1,206 millions of sterling securities issued by South American borrowers and outstanding at the end of 1934, £708 millions, or nearly 60 per cent., were receiving no interest whatever at that date, and the average rate of interest on the whole body of investment was only 1.6 per cent. per annum. These figures may be compared with those for 1929, when the amount of outstanding securities was about the same, £1,214 millions, but only £289 millions were in complete default on interest payments and the average rate of interest was 4½ per cent.¹ A similar story may be told of American investments in this area. Of a total of \$1,866 millions of dollar bonds issued on behalf of Latin American borrowers and outstanding on the 31st December 1935, \$1,501 millions were in complete or partial default on interest payments.

In Europe, a similar situation prevails. British holders of Dawes and Young Loans, and the holders of bonds of the Potash Syndicate are the only investors who receive full service payments from their German debtors. Of the League Loans, only those to Danzig, Estonia, and Austria are not in default,² although in some cases, the Hungarian Loan for example, payment is made in full in local currency, only a part of which can be converted into the currency of the lender. In all, probably about one-half of the £120 millions of British holdings of the bonds of European governments and municipalities are in some stage of default. The position of American investments in Europe is equally unfortunate. Of the \$2,376 millions of the dollar bonds of European borrowers which were outstanding at the end of 1935, \$1,223 millions were in complete or partial default on interest payments. The restricted incidence of these defaults is, however, reassuring. Defaulted German bonds accounted for \$884 millions or 72 per cent. of the total in default, and Russian bonds for \$75 millions or 6 per cent. of the total. The remainder, \$264 millions, consisted principally of the bonds of only six defaulting countries: Bulgaria, Greece, Hungary, Roumania, Yugoslavia, and Sweden.³ In other words, the defaulted bonds of Russia, Germany, the

¹ It should be noted that the whole of these sterling securities were not owned by British investors.

² Technically, the Austrian Loan, which was in any case guaranteed by the governments of the lending countries, no longer exists, since it was replaced by a new loan in 1933.

³ For further details see below, Chapter XIV, pp. 306-7. No government or municipal bonds are in default in the case of Sweden.

Succession States, Greece, and Roumania formed 93 per cent. of the total in default, and no default had occurred on \$1,154 millions or 49 per cent. of the total outstanding. The bonds of over a dozen European borrowing countries were completely untouched by default.

Perhaps, however, the great efforts which many borrowers have made to avoid default have been no less remarkable than the defaults, heavy though they were, of those who found themselves unable to avoid them. Austria has suffered severely from the depression, yet the service on her League Loan was always paid in full. This is also true of the loans to Estonia and Danzig, and these are countries in which there have been serious political as well as economic difficulties. In the countries of the British Empire, default has occurred on only a few municipal and private obligations; in no case has a national government defaulted. This clean record has been preserved, in the case of Australia, only by compulsory conversion of the internal debt and large-scale, voluntary conversion of the external debt, and, in the case of Newfoundland, only by the direct intervention of the United Kingdom Government. Similarly, the Argentine Government, by drastic exchange restrictions, conversions, and repayments, has avoided default on its external obligations, although faced with a serious decline in the value of its exports, and many smaller borrowers have—sometimes with great difficulty—continued to meet their obligations in full. Many defaults have occurred; but these have been confined to the bonds of relatively few borrowers and there have been no cases of absolute repudiation of debtors' obligations to foreign bond-holders.¹

¹ Between Jan. 1930 and March 1934 the following foreign governments had defaulted at some time or other on their sterling loans:

Brazil (Federal and States)	Ecuador	Peru
Bulgaria	Germany (States only)	Roumania
Chile	Greece	Russia
China	Hungary	Salvador
Colombia	Mexico	Turkey
Costa Rica	Paraguay	Uruguay
		Yugoslavia

During the same period, no default occurred on the sterling securities of the central governments of:

Argentina	Finland	Persia
Austria	France	Poland
Belgium	Holland	Portugal
Cuba	Honduras	Siam
Czechoslovakia	Iceland	Spain
Denmark	Italy	Sweden
Egypt	Japan	Switzerland
Estonia	Norway	Venesuela

Guatemala and Nicaragua had maintained interest payments in full, but had

Before the war by far the largest part of the overseas investments of the principal lending countries were in the semi-developed countries of the world, whose chief products were raw materials and food-stuffs which were exported to the industrial countries. Most of these investments were made, not in the primary producing industries themselves, but in the bonds of governments, and the securities of railways and other public utility enterprises. After the war this sort of investment was continued, but there was also an increased volume of investment in other countries and for rather different purposes. Regardless of their purpose, many post-war investments have—for the moment—proved to be failures. Creditors and debtors alike are suffering from the present stagnation of international commercial and financial intercourse. It is the purpose of the next two chapters to consider in the light of recent developments what may be expected to be the future of international investment. The future of lending of the old type is discussed in Chapter III, and various new types are discussed in Chapter IV.

defaulted on sinking fund payments. (Cf. *House of Commons Debates*, 5 Mar. 1934, p. 1627, and 6 Mar. 1934, p. 1661.)

CHAPTER III

THE FUTURE OF INTERNATIONAL INVESTMENT

THE decline in the value of international trade has been one of the most striking phenomena of the last seven years. The quantum of world trade stands at about three-quarters of its 1929 level; the index of the gold prices of goods entering into international trade is not more than half its pre-depression figure; and the gold value of world trade is about one-third of its former level. The most severe decline has been in the value of the export trade of agricultural countries. Up to a point, indeed, this is a normal feature of depressions, since the prices of primary products usually fall more severely than those of manufactured goods. But on this occasion the fall in agricultural prices has been both more severe and of longer duration than in previous depressions, despite the widespread attempts which have been made to raise prices by restriction and other schemes. Moreover, even though the last three years have witnessed a substantial measure of recovery, it is only in the last twelve months that prices of primary products have begun to rise.

It is, as has been suggested, exceedingly difficult to explain this continued depression of agriculture solely as a cyclical variation. Nor will any explanation which stresses such transient factors as the aftermath of war or monetary, financial, and political causes wholly account for such an unprecedented and persistent depression. Although all these factors have contributed to the collapse, it appears that there have been more fundamental tendencies at work which have accentuated the fall in agricultural prices and which are likely to remain of the utmost importance. Since such a large part of the international investment undertaken by all the important creditor countries has resulted in the expansion of the indebtedness of agricultural countries, it is clear that any circumstances which vitally affect agricultural prices will alter both the ability of those debtors to maintain service payments on the debts which they have already contracted, and also the magnitude of the debt burdens which they will be able to bear in the future.

There are three fundamental tendencies which appear to be injuriously affecting agriculture at the present time and which are likely to increase rather than diminish in intensity. Briefly they are as follows: (1) the revolutionary change in population trends throughout the 'western world', (2) the rapid progress in agricultural tech-

nique, and (3) increased economic nationalism. The influence of each of these will be separately considered.

There have recently been a number of investigations into the probable magnitude and age-composition of the population of Great Britain and other countries during the next few decades.¹ The results have shown that, on the basis of any realistic assumptions regarding the trend of fertility and mortality rates, a decline in population is to be expected in the not far distant future in most western European countries.

The maximum population in Great Britain will probably be reached before 1941. After that date a decline is sooner or later to be expected.² It is important to realize on what assumptions this forecast is made. It is *not* dependent upon any assumption that the average size of the family will decrease still further. Neither is it the result of any comparatively recent change in the rate of reproduction. The absolute number of births began to decline one generation ago, the birth-rate about two generations ago, and the net reproduction rate some three generations ago. Even assuming no further decline in the average size of the family, the number of potential mothers of child-bearing age in one generation's time will be only about two-thirds the number living now. What indeed is likely to be the future trend of fertility and mortality rates it is difficult to guess, but no conceivable fall in mortality rates can suffice to offset the tendency for the population to decline. Dr. Enid Charles has given three estimates of the future trend of population based on three different sets of assumptions. Even on the most 'optimistic' of these, viz. that the decline in mortality rates is accompanied by an increase in fertility rates to the 1931 level, a decline in population is to be expected after about 1965. If it is assumed that there is no change in the size of the average family or the expectancy of life, the decline would begin in some ten years time; finally, the most conservative of the three estimates, which is based on the assumption that fertility and mortality rates both continue to decline at their present rates, indicates a decline in population from now onwards at an increasing rate such that seven-eighths of the population would disappear in a century.

¹ See articles by Dr. Grace C. Leybourne in the *Sociological Review*, April 1934; by Dr. E. C. Snow in the *Journal of the Royal Statistical Society*, part II, 1935; by Dr. Enid Charles in the London and Cambridge Economic Service, Special Memorandum No. 40, and *The Economist*, 15 Feb. 1936, p. 347.

² See *The Agricultural Dilemma*, by Lord Astor and others (London, P. S. King, 1935), pp. 1-16.

A very similar prospect confronts the whole of northern and western Europe.¹ Professor Ferenczi sets out the position as follows:

'While around 1880 the tradition of large families still ruled in Europe (30-40 births per thousand), the birth-rate now ranges somewhere between 15 and 25 per thousand. France, which from the beginning of the nineteenth century was experiencing an increasing fall in the birth-rate, now finds herself heading a large number of states similarly placed, the latest recruit being Germany, where up to the war the number of births was very high. Even in Italy, in spite of energetic measures taken by the Government, the birth-rate tends to fall. The old level is only maintained in the Near and Far East. But even in Poland, the U.S.S.R. and Japan it would seem as if the crisis has led to increased birth-control among certain classes. The fall in the death-rate also has followed parallel paths in almost every country—at present it ranges between 11 and 24 per thousand—but not sufficiently to counterbalance the movement of the birth-rate.

'To grasp the full significance of these facts, one must examine the official and other estimates of future population that have been published. The German Statistical Office anticipates that the population of eastern central and northern Europe will become stationary in the second half of the century; that France will reach her maximum (some 40,000,000) during the present decade. . . . For the United States the Presidential Committee on Social Trends prophesies that the maximum will be reached in 1980 with 150,000,000.

'According to the German Statistical Office, the population of Germany, estimated at 46.9 millions at the end of the century, will fall until it becomes equal to that of Poland. The importance of a development such as this for the economic relationships between the powers and the economic needs of the nations should not be under-estimated, nor the significance of the anticipated fall in France around 1960 and the simultaneous increase in Italy (37.7 millions and 50.3 millions respectively).'²

Moreover, the position in the British Dominions (apart from the French-speaking section of Canada) is not materially different. Broadly speaking, in place of the rapidly increasing populations of the nineteenth century, slowly increasing populations have been substituted in the whole of what we call the western world. In many countries it is almost certain that maxima will soon be reached and that population will then become stationary. In general, there is a strong presumption that the population of the western world as a whole will have begun to decline within the next generation.

This profound secular change must necessarily affect the position

¹ Cf. Prof. A. M. Carr-Saunders, *World Population* (Oxford, 1936), and D. V. Glass, *The Struggle for Population* (Oxford, 1936).

² *Revue Economique Internationale*, May 1934, p. 366.

of all exporting countries, and particularly those which supply agricultural products. The tacit assumption on which the new countries have based their development hitherto has been that Great Britain and other European countries would provide indefinitely expanding markets for primary products. But this assumption can no longer be relied upon. It is true that the consumption per head of the British people may be expected to increase with further technological progress and improvements in the standard of living, but as human beings become better off, they usually spend a relatively smaller part of their incomes upon articles of food, and the increase in their consumption of commodities of all kinds is usually proportionately less than the increase in their demand for services. It is unlikely, therefore, that the aggregate demand of Great Britain for certain staple foodstuffs, such as wheat, will increase very substantially in future; indeed, if the British population begins to decline rapidly, the demand for such commodities must be expected rather to decrease. Moreover, the British demand for primary products as a whole, including raw materials, is unlikely in these circumstances to increase nearly so rapidly as it did in the nineteenth century. The same propositions hold true, broadly, of other western countries.

The fluctuations in general trade activity exert, of course, an important influence on the demand for raw materials and a lesser influence on the demand for foodstuffs. The abnormally severe depression of the early 'thirties may thus have led to an unduly pessimistic impression of the possibilities of the world market for primary products. It is equally possible, on the other hand, that the general trade recovery which is now in progress may give rise to a disposition to minimize unduly the influence that the change in population trends is destined to exert. It is also true that the consumption of foodstuffs in Great Britain and other European countries is much less than is desirable on nutritional grounds and that there is thus, in a sense, large scope for possible expansion of demand. The co-existence of widespread under-nourishment with agricultural over-production has given rise in recent years to an agitation in favour of measures to stimulate the consumption of food, and certain steps, such as the cheap milk scheme in British elementary schools, have been taken with this end in view. Over a long period, it is possible that 'nutritional policies' will be considerably extended, though in the years that lie immediately ahead they are likely to be limited by the budgetary difficulties with which the leading European governments will be faced as the result of rearmament expenditure. But, on the most favourable view, it seems improbable that better nutrition can

supply more than a partial offset, so far as the aggregate consumption of foodstuffs is concerned, to the effects of the change in the trend of populations.

The rapid progress now being made in agricultural technique is greatly increasing the technical efficiency of the factors employed in primary production, and has in fact been so remarkable as to prompt the suggestion that we are now in an age of 'agricultural revolution' analogous to the 'industrial revolution' of the last two centuries. It has been pointed out that 'the number of workers required to produce a given quantity of goods is being reduced about as rapidly in agriculture as it is in industry'.¹ In the six years 1925-31 it has been estimated that the milk yield per cow rose in England and Wales by about 12 per cent., while there has been a parallel reduction in the amount of labour required per cow. This is typical of many branches of agriculture and of countries overseas as well as of the United Kingdom. All over the world, the scientific breeding of animals, the increasing use of mechanical appliances, the development of new methods of farming, artificial fertilizers, improved transport, and biological discoveries have helped to increase the output of agricultural products per unit of labour and land employed.

These developments tend to reinforce the results which are likely to follow from population changes. Countries which specialize in the export of agricultural produce are improving their methods so rapidly that they are capable of exporting steadily increasing quantities of produce from their existing areas of production, and at the same time it appears that the demand for these goods is likely to expand at a slower rate than formerly, or even to decline. Faced with this situation, agricultural countries have encouraged the establishment of domestic industries, usually behind tariff walls. It is hoped that these industries will give employment to resources which it is no longer economically possible to use in agriculture and that they will help to diversify the agricultural countries' exports and to make them less dependent upon imports from abroad. Countries which were importers of foodstuffs, on the other hand, have attempted to protect their domestic agriculture from the full force of the decline in prices and have thereby aggravated the situation in agricultural countries. The changes in the population outlook, the improvement in agricultural technique, and the growth of high agrarian protectionism have been most disadvantageous to agricultural countries, while their answer has been to impose restrictions

¹ *The Agricultural Dilemma*, p. 10.

on the import of manufactured articles and to pursue the ideal of industrial autarchy.

The movement towards economic nationalism has been one of the outstanding developments of the past six years. It has gathered impetus from various forces. The chief desires are that a country should be independent of foreign sources of supply, often for military as well as economic reasons, and that it should be independent of foreign sources of demand, usually for economic reasons. But many other factors, some more and some less clearly defined, enter in as well.

Systematic attempts to render a country independent of foreign sources of supply which might be cut off by an enemy are essentially post-war phenomena. The widespread attempt to produce oil, e.g. out of coal, by countries lacking in domestic oil supplies, the specially favoured treatment accorded to certain chemical industries, e.g. by the Dyestuffs Act in Great Britain, and spectacular endeavours such as Mussolini's 'battle of the grain', illustrate the importance attached to this need. The war showed very clearly the possibilities of blockade in warfare and the dependence of modern industrialized countries on overseas sources of food supply. Further, the principle of economic sanctions rests on the possibility of conducting effective economic blockades and boycotts. As a result, the military arguments for economic nationalism not only embrace technical processes, or the necessary raw materials for munitions purposes, but also the nation's food supply as a whole. Germany and Italy have both adopted policies designed to make them self-supporting as far as foodstuffs are concerned, and there can be little doubt that the comparative ineffectiveness of the League sanctions against Italy was partly due to the successful pursuit of this objective. Elsewhere, the assistance of domestic agricultural producers is an admitted aim, even though it is generally agreed that the world is suffering from a superabundance of primary foodstuffs.

But it would be a grave mistake to assign the movement in favour of agricultural protection on the part of industrialized countries mainly or even largely to reasons of national defence. Were there profitable alternative opportunities of employment, the movement would never have proceeded as far as it has. Large-scale unemployment, however, has induced governments to look to agriculture as a palliative, even though it is an expensive one. Thus the movement has been intensified rather than originated by circumstances attendant on the depression. Exchange weakness has also been a factor

necessitating agricultural protection; indeed, in some countries, it has been the predominant factor.

Considerations such as these are supplemented and reinforced by arguments of every description—rational and non-rational—couched in highly rhetorical terms.

‘For social, historical and psychological reasons, the preservation of agriculture appears to the majority of countries as an absolutely vital question, and one which cannot be considered as a purely economic problem. The peasant class, which is an element of order and stability and an admirable reserve of energy, forms, at any rate in the countries of the Old World, the basis of the social edifice, and plays an essential part in reconstituting and rejuvenating the physical strength of generations worn out by life in industrial and large urban centres.

‘All countries indeed, even the most strongly industrialised, consider it necessary to support their agriculture, which, moreover, in every case occupies a great part of the population. Even when, as in England, it represents a small minority, it nevertheless constitutes one of the chief categories of producers, and that is why, provided that no excesses are indulged in, which would defeat their own ends, a Government can hardly be criticised for endeavouring to maintain the rural classes at a reasonable level of prosperity in order that they may continue to exercise the important part which they play in the national life.

‘Even the agricultural exporting countries cannot but regard such an aim with sympathy.

‘Furthermore, it would be impossible in practice to neglect the special interests of agriculture out of regard for principles of pure economics, in view of the enormous political force which it represents in every country, irrespective of climate, development or system of government.’¹

These arguments are paralleled by those of a distinguished British economist:

‘We destroy the beauty of the countryside because the unappropriated splendours of nature have no economic value. We are capable of shutting off the sun and the stars because they do not pay a dividend. . . . We have until recently conceived it a moral duty to ruin the tillers of the soil and destroy the age-long human traditions attendant on husbandry if we could get a loaf of bread thereby a tenth of a penny cheaper. There was nothing which it was not our duty to sacrifice to the Moloch and Mammon in one; for we faithfully believed that the worship of these monsters would overcome the evil of poverty and lead the next generation safely and comfortably, on the back of compound interest, into economic peace.’²

¹ Economic Committee of the League of Nations: *Consideration on the Present Evolution of Agricultural Protectionism*, (Geneva 1935), p. 8.

² J. M. Keynes in *The New Statesman and Nation*, 15 July 1933.

Thus several forces are working in the same direction. First, there is the desire for a safe food supply in time of war; second, there is the attempt to find a speedy solution of pressing unemployment problems; and finally, there is the emotional revolt typified in the last quotation.

At its worst the movement towards economic self-sufficiency is nothing more than a rather desperate attempt to transfer unemployment abroad during a period of acute crisis, and this aspect has been uppermost during the recent period of economic distress. But it would be a mistake to look at these cruder aspects and to condemn the movement towards self-sufficiency as a temporary aberration which will disappear as more favourable conditions return. Such a superficial view misses the difficulties which are always threatening countries which lack a diversified economic structure.

The benefits of international specialization are often very unequally distributed between countries in a period of rapid change. A country cannot commit itself without misgiving to one or two lines of production on which it is almost entirely dependent for its ability to purchase from abroad its necessities and everyday luxuries. An individual who finds that his occupation has become profitless can in many countries fall back on resources from the public authorities or elsewhere to tide him over until he can find a new occupation. There is no unemployment relief or system of economic insurance for states.¹ The desire for a diversified economic structure is part of the attempt to spread risks. A country dependent on one or two commodities may consider it worth while to pay a high price for economic security, and to develop alternative lines of production as an insurance against the uncertainties of economic change. The justifiable criticism that economic nationalism is wasteful and only makes things worse must be tempered by a realization of the not unreasonable desire of certain countries to achieve greater economic security through a diversified economic structure.

These are the forces which seem at the present time to be working against international specialization of the pre-war type. Such considerations must always have been present, but now they seem to be possessed of unusual force. Is the reason for this that the war has brought out only too clearly the uncertainties of economic life? Or are there more fundamental reasons for the change?

¹ The principle, accepted by certain states members of the League of Nations, that when applying sanctions some compensation should be made to those countries who suffer most in the cause of collective security, may perhaps be regarded as representing the germ of such an idea, but the possibility of its development at the present time appears remote.

It would be a mistake to assume that the success of economic nationalism is due to enhanced fear alone, for technical changes have also been of great importance:

'Pre-war production was based upon steam-power, and the use of steam gave the coal-bearing regions of the world so great an advantage that the benefits of geographic concentration were obvious and of extreme importance. Post-war production has been based largely, and to a rapidly increasing extent, upon oil and electricity, which favour a wider distribution of industry not only within a country but also between different countries. Natural advantages tend to diminish in respect of a large group of industries; differences in real costs tend to be reduced. For this reason the penalty suffered from the pursuit of a policy of economic nationalism is not so severe as of old, although it would still be regarded as severe in a world of peace in which the inhabitants felt free to pursue that policy which would maintain the highest standard of living permitted by the known resources of nature and man.'¹

In short, the price of economic nationalism has fallen, and many more countries can afford to pay it, without an impossible diminution of the standard of living.

This process is not, of course, due to the lessened importance of coal alone. The mere spread of technical methods was bound in course of time to enlarge the area in which manufacturing could be carried on at a profit. Britain was the leader of the industrial revolution, but her position in the post-war years has been, not unjustly, likened to that of 'a patentee whose patent is running out'. Coal is no longer the only source of power; and proximity to labour, to raw materials, or to the ultimate consuming market has now become more important than easy access to coal-mines. Power for industrial purposes can not only be transported more readily, but can be used efficiently in small amounts.

It seems likely, therefore, that even if no conscious efforts had been made to divert activity artificially by means of tariffs and similar measures, there would still have been economic forces tending to prevent the more extreme forms of specialization, and to encourage more diversified economic structures. In fact it is this tendency which has made economic nationalism a practicable proposition. At the very best, even if the tariffs and restrictions of the last few years are substantially reduced, international trade, it appears, will still tend to become less important relatively to domestic trade.

Thus there are three major forces which tend to-day to alter very materially the outlook for agricultural producers all over the world,

¹ Professor J. H. Jones in *Lloyds Bank Review*, Feb. 1934, p. 49.

and particularly for those who are dependent upon an export market. The populations of the industrial countries—the principal importers of foodstuffs—have almost ceased to expand and will soon decline; the cost of production of agricultural produce has been lowered and competition consequently intensified by revolutionary changes in agricultural technique; finally, the desire of so many countries to be economically self-sufficient has resulted in an increase in the protection and assistance given to their own food producers by tariffs and subsidies. Agricultural producers in Latin America and elsewhere must find, therefore, that the world demand for their products is no longer increasing at its pre-war (or even pre-depression) rate.

If the exporters in many countries, and particularly the exporters of foodstuffs, find that the demand of the industrialized countries for their products no longer continues to expand as it did in the past, what will happen to the trend of international investment? The lending countries will find that the inducements which most borrowers can offer to investors are less desirable than those offered in the past and they will therefore be less willing to lend abroad than they were before the depression. For an entrepreneur who is faced with a falling demand for his product can, in the absence of extremely labour-saving inventions, employ more capital per unit of output only if the price which he has to pay for it is also falling. Further, borrowing countries will be less willing to import manufactured goods from the lending countries if the latter are unwilling to buy primary products; for, if the borrowing countries' exports diminish without a corresponding decline in their imports, they will find it increasingly difficult to meet the service payments on their debts, because their export surplus will have decreased. This difficulty can, of course, be overcome if the lending countries are willing to continue to lend, but this is precisely the solution—which is really no solution—that was adopted with such disastrous results in the post-war decade. Given the assumption that the profitability of most of the industries which produce primary products—especially agriculture—will be permanently less than before 1930, the lending countries, and Great Britain in particular, can only continue to lend if there arise industries which can profitably employ foreign capital in the face of the declining profitability of agriculture.

This requirement is met to some extent in the case of industries developed to produce manufactured articles for domestic consumption in agricultural countries. A list of some of the industries of this type which are being developed in South America is given below.¹

¹ See p. 268.

Such industries must import such things as heavy machinery and structural steel, and these might be provided by borrowing from the country which produces them. The exports of goods and the exports of capital from lending countries would expand, and conditions would, at first sight, appear to be the same as in the past. There are, however, two fundamental points of difference. In the first place, the demand of these industries for new foreign capital will probably be both temporary and limited: they cannot expect to find a continually expanding export market in the face of present tariff tendencies, or a continually increasing population or rising standard of living within their own countries. Secondly, if these industries do not produce for export, the service payments on their borrowings must be paid by means of exports of primary products; but, if, as has been assumed, the demand for these is no longer increasing, it may be extremely difficult for service payments to be met when these industries cease to borrow. Lending, then, for the development of industries for the production of goods for home consumption can be continued only for a short period.

In no direction is there evidence that Great Britain will ever again be able profitably to invest abroad on the same scale as in the past. The opportunities for the profitable utilization of capital do not exist. Lending to overseas borrowers may be expected to continue, but it will most probably be both smaller in volume and different in kind. This is, perhaps, a gloomy picture. But no country can continue indefinitely to lend increasing amounts abroad. One day, new lending would cease, and exports would diminish relatively to imports so that the interest payments due on past loans could be paid. If lending were continued on the pre-war scale, this would inevitably happen. At some time or other, Britain would become almost completely dependent for her imports on the interest paid by her overseas creditors; and her exports would be few and would consist mainly of manufactured goods requiring a high degree of technical development for their production. Such an outlook is, perhaps, even worse than the one which confronts the British public to-day.¹

¹ The picture of a country which had become dependent to a great degree upon the income from its overseas investments has been painted by Mr. Bernard Shaw, *The Apple Cart*, Act 1:

Proteus [emphatically] And we have abolished poverty and hardship. . . .

Magnus. . . . Our big business men have abolished them. But how? By sending our capital abroad to places where poverty and hardship still exist: in other words, where labor is cheap. We live in comfort on the imported profits of that capital. . . . You think this prosperity is safe?

Balbus. Safe! Look at my constituency: Northeast-by-north Birmingham,

The consequences which are likely to follow from large-scale capital exports in the future are, then, less promising than they have been in the past. If overseas investments are to be permitted to expand, it is essential that steps should be taken to ensure that debtors are permitted to pay the service on their loans, and barriers must not be erected which make it more difficult for them to export to creditor countries. The demand of western Europe for primary products is unlikely to expand at its old rate. Receipt of the income from an increasing body of overseas investment can therefore only take place if lenders are prepared to become *rentier* nations to an ever greater extent, or if they are prepared to specialize in the manufacture of high-grade and luxury products. In neither case does the prospect appear to be very promising, and it may be argued with some force that in these circumstances it would be unwise to give an indiscriminating stimulus to international lending in the future on the general ground that international lending has been beneficial in the past.

Briefly, this argument leads to the conclusion that large-scale, long-term international investment is likely to give rise to more serious exchange and transfer difficulties in the future than it has done in the past. For the reasons suggested it appears that borrowers will experience increased difficulties in paying the service on their loans. International trade is likely to remain for a considerable time at a lower level than that of 1929; it is almost certain to remain subject in a large number of markets to a greater measure of restriction and regulation as well as to greater political uncertainties than were formerly common. The rate at which the export of primary products from agricultural to industrial countries may be expected to grow is not likely, in the face of western population trends and the rapid progress in agricultural technique, to give the same profitable scope for investing capital in the development of new areas for primary production as it has done hitherto. Thus in these circumstances, the

with its four square miles of confectionery works! Do you know that in the Christmas cracker trade Birmingham is the workshop of the world?

Cressus. Take Gateshead and Middlesbrough alone! Do you know that there has not been a day's unemployment there for five years past, and that their daily output of chocolate creams totals up to twenty thousand tons?

Magnus. It is certainly a consoling thought that if we were peacefully blockaded by the League of Nations we could live for at least three weeks on our chocolate creams . . . I dread revolution. . . . I was thinking of the countries on whose tribute we are living. Suppose it occurs to them to stop paying it! That has happened before.

Pliny. Oh no, sir: no, no, no. What would become of their foreign trade with us?

Magnus. At a pinch, I think they could do without the Christmas crackers.

opportunities for sound international investment are likely to be materially less than they were before the war. In particular, loans for purposes of opening up new territories by building railways will seldom be possible, and it was just this type of transaction which was most suitably handled by pre-war investment technique.

These conclusions, which involve debtors' difficulties, may be paralleled from the lenders' side of the transaction. Large-scale lending is likely not only to involve debtors in exchange and transfer difficulties when interest payments fall due, but also to disturb the balances of payments of the lenders when exports of capital take place. The idea that 'capital movements create their own balances', which has for long provided the standard refutation to the arguments of those who were impressed by the bogey of overlending, has lost much of its reality in a world where long-term capital issues no longer constitute the whole or even the majority of long-term capital exports. There used to be a presumption that when a foreign issue was floated a part and often a large part of the proceeds would be used for buying goods and services in the lending country, thus increasing that country's exports. But when capital is exported to purchase securities already issued on foreign stock exchanges the assumption cannot be made that exports will then be increased automatically. It can be argued that large-scale capital movements of this nature will inevitably lead to a rise in the rate of interest in the lending country and that exports will be cheapened relatively to imports. Such would probably be the result in the long run. But how fundamental are the necessary readjustments; how far-reaching the social consequences if viewed in terms of the unemployment created; how much removed is such a process from that which was consequent upon making a long-term loan in the old days. Political upheavals in Europe and other parts of the world have shown that readjustments which were once regarded as automatic may be fraught with such disastrous consequences for certain sections of the community that, instead of being simple and unavoidable, they may endanger the whole fabric of the state.

Thus, from the standpoint of the lending country, international investment is likely on the one hand to prove less valuable socially and less safe for the individual investor, and on the other, if undertaken on an extensive scale, to entail greater dangers of exchange troubles than formerly. Nevertheless, the fact remains that different countries are very unequally endowed with capital, and annual savings per head vary enormously from place to place. There is no reason to expect that disparities in interest rates between different countries

will diminish, and any decline in the volume of international capital movements will tend to increase them. Accordingly it is to be expected that, in so far as these differences of interest rates are not offset by differences in risk, an incentive will remain for investors in regions where capital is relatively plentiful to seek to increase their earnings by exporting capital to places where it is relatively scarce. It would be foolish, therefore, to envisage a cessation of all long-term capital movements.

Thus it is important to inquire through which channels investment can most beneficially be conducted; how far through new issues, how far through the expansion of direct investments by large industrial and commercial undertakings, and how far by other means such as the purchase of securities or the guaranteeing of export credits. The object of the preceding pages has been to show that, *prima facie*, the case for international investment rests on more slender grounds than formerly. But there is still scope for lending overseas if forms can be found for it appropriate to the changed circumstances of the present time—if the methods employed, the channels utilized, and the control exerted are such as to involve the minimum of dislocation.

CHAPTER IV

TYPES OF INTERNATIONAL INVESTMENTS

FROM the point of view of the average British or American investor, foreign investment has usually meant the purchase of securities which were publicly issued in London or New York on behalf of a foreign or colonial government, municipality, or private enterprise. To a much smaller extent, it has meant the purchase of securities issued on a foreign capital market or of physical capital goods or land in the debtor country. It is important to note, however, that new issues can only be used in certain fairly well-defined circumstances and for particular types of investments.

Lending to other countries through the new issue market is a particularly suitable method if the issue is large and the borrower is a government or public authority or a large and fairly well-known private firm. If the issue is small and the borrower unknown, the method is not nearly so suitable. The cost of making a public issue does not vary directly with the amount of the issue, but bears most heavily upon small borrowers. Both professional investors and the general public find it easier to obtain information about the position of large companies, and they are therefore inclined to assess the probable risks at a higher rate in the case of small firms. Again, even if the firm is large and well known, the investor must be assured that the purposes for which new capital are to be used are likely to be profitable, and experience has shown him that the development of new primary producing areas by means of railways and other public utility enterprises are often worth while, so he may be less willing to put his money into a kind of undertaking which has not previously been tried.¹ Finally, new issues are only practicable if there is reasonable hope of exchange stability during the currency of the loan, as otherwise the borrower is faced with the possibility of having to meet far heavier charges in terms of his own currency than those he originally contemplated.

In Chapter II it was shown that a very large part of the international investment of the past has been the result of the borrowings of public authorities and public utility enterprises, and that much of the money so raised was used to purchase capital equipment for the development of new countries whose principal products were food-stuffs and raw materials. The new issue market, it is clear, is the most suitable channel for such investment. Individual issues tend

¹ That this is not always true is shown in Appendix III, below.

to be sufficiently large for costs of issue to be small per unit of capital raised, and borrowers are usually either public authorities or large and well-known firms. Finally, in the nineteenth century at least, the risk of exchange fluctuations was so small that it could be neglected.

There are still, in many countries, opportunities for new investments in railways, roads, electric power developments, and public buildings, but the scope for such investments is much more limited than it was before the war or even in later years. Most credit-worthy borrowing countries are reasonably well supplied with capital equipment of this sort—Canada, for example, is probably over-developed in the matter of railways. Moreover, as has been shown in the last chapter, food-producing countries are not in a position to embark upon large-scale capital expenditure, since the demand for their products is no longer expanding as it has done in the past. Finally, the world of to-day does not possess an international monetary standard, and the risks of lending to countries with paper currencies and fluctuating exchanges are enormously greater than under gold standard conditions. Despite all sorts of safeguarding clauses, the investor must now be much less sure that he will receive his interest payments in full. In these circumstances, it would not be unwarrantable to suggest that the importance of the new issue market as a channel of international investment may decline relatively to that of other channels which are more suited to types of investment which may be expected to be used to an increasing extent under present conditions.

The acceptance of this conclusion does not, however, imply that new issues will cease to be an important form of investment in future. In some countries extensive capital equipment is necessary if economic progress is to continue at all. In the first place, although the demand for foodstuffs is not expected to continue to expand at its old rate, there is no reason to believe that the demand for essential raw materials will cease to increase. Moreover, the relative importance of different raw materials may change. This generation has seen the rise of oil and hydro-electric power, which have taken the place of coal in many uses, and of wood pulp which is supplanting cotton, silk, and wool in varying degrees. Aluminium and other light metals are tending to be used instead of steel, and there is no limit to the extent to which such developments may take place. An agricultural country such as Canada may find, for example, partly as the result of developments such as this, and partly because of the declining profitability of its food-producing industries, that it is now

profitable to exploit hitherto undeveloped resources in the north, and for this new roads and railways would be as necessary as mining equipment. Such changes may occur in many of the semi-developed countries of the world, and for them all new capital will be required. Generally, it will be cheaper to raise this capital in London or New York, where there are highly organized capital markets, than to attempt to procure it locally; generally also it will be possible to raise it by means of new issues. This, then, is one important use of new capital which can be expected to be furnished in much the same way as in the past.

New capital issues will also be required for other purposes. The aftermath of war and the aftermath of severe depression are essentially similar. In both cases confidence must be restored and the stability of currencies assured, and this may be done by means of international loans which can also be used to replace capital equipment which, in the one case, was destroyed by war, and in the other by enforced neglect. Thus it is very possible that the next few years may witness a repetition on a smaller scale of the series of stabilization and relief loans which were made to many European countries between 1924 and 1928. This is another field in which new issues may be expected to be important; but issues for this purpose are, as has been shown in Chapter II, very different from issues which are intended to finance, for example, railway construction. They are not primarily intended to be used for the purchase of real capital assets, and they seldom serve directly to increase the demand of the borrowing country for the exports of the particular country which supplied the loan, or to increase the efficiency of production in the borrowing country. Their function is, rather, to restore confidence in the borrower, and to secure stability in the exchanges so that the risks borne by lenders may be diminished and that international trade and international lending may begin again. The fact that such loans are so indirectly beneficial, especially to the lender, raises special problems which will be discussed in another chapter where questions of official policy towards international lending are considered.

There are, then, two purposes for which international investment through new issues may be expected in future on a substantial scale: for the development of areas to produce raw materials, and for stabilization and relief purposes. But new issues are not the only channel through which international lending may take place. Three other types of investment, the relative importance of which may be expected to increase, must be considered, viz. those which are described in the United States as 'direct investments', institutional

investments, and medium-term credits. These are all types of international investment which are especially suited to modern conditions, which require not only that more care should be taken in the selection of investments, but that risks should be more widely spread and that individual borrowings should be of relatively small amount.

'Direct' investments are, roughly, those made not by individuals but by firms which wish to expand their overseas business and which therefore make investments in other countries.¹ Large international concerns produce and sell goods or maintain services in a number of countries. They have access to at least one capital market, and possibly to several. Their reserves are large and are constantly being augmented, and these funds must be invested. They also possess specialized knowledge both of the operations which they undertake and the markets in which they borrow. As a result, the overhead costs involved in any new operations are likely to be smaller than they would be for an entirely new and independent company, and the big concern can usually raise money more cheaply through its banking connexions and has less difficulty in convincing credit institutions and capital markets of the advantages of the new developments in question.

American direct investments abroad, which consist of the security holdings of American industrial and commercial concerns, were about equal in volume before the depression to private holdings of foreign securities. From 1925 to 1930 the direct investments of American companies were increasing at the rate of between \$200 millions and \$400 millions a year. Even during 1932 and 1933 industrial undertakings both in Great Britain and the United States continued to increase their external investments. This was the case because, in the first place, changes in demand have sometimes necessitated the provision of new factories, &c., in overseas countries. A conspicuous example is international aviation. International air transport companies have continued to expand and in the process there has been an increase in the demand, not only for aeroplanes, hotels, and aerodromes, but also, for example, for facilities for the supply of oil and petrol. Secondly, there has been a certain amount of what might be described as 'involuntary investment' by international companies during the depression. International concerns with blocked balances have frequently found themselves in a position in which they could only bring their money out at a great discount or leave it in the country and run the risk of deprecia-

¹ A discussion of the definition of the term, and the extent of American 'direct' investments will be found in Chapter XI, pp. 185-94.

tion, and they have therefore preferred to invest in the country imposing the exchange restrictions. On occasion, blocked balances, in Germany for example, have been liquidated by purchases of all kinds of goods—ranging from ships to harmonicas—but this has been possible only after a bargain has been made with the central authority. Such bargains often contain the condition that the owner of the blocked balance shall add to it a certain sum in free foreign exchange before he can use it to buy goods for export. Thirdly, the growth of economic and political nationalism in recent years has occasionally been responsible for the growth of direct investments; thus, for instance, oil companies have found themselves obliged to erect local refineries in France because legislation compelled them to do so.

Even small concerns have found it profitable to establish branches in foreign countries in which competing domestic industries are protected by high tariffs. In some cases, the establishment of a better sales and distributing organization and a satisfactory maintenance service has been sufficient to increase exports despite tariff barriers. In others, it has been necessary to establish assembling works, in which parts that have been manufactured abroad are assembled into the completed article. In some others, the differences between the import duties on the parts and those levied on the completed article are not large, and branch factories have been established which carry out the whole process of manufacture with domestic labour and raw materials and foreign capital. Regional tariff agreements such as those existing between the British Dominions and the United Kingdom offer a considerable incentive to this type of development, as is illustrated by the increasing number of United States firms which have established factories in Canada for the manufacture of products which are admitted into Empire countries under the British preferential tariff.

International business organizations have several methods which they may use in order to procure capital for these purposes. They may float new issues in the normal manner and obtain money from the general public and from financial and savings institutions; their shares or debentures may be sold to financial houses for resale to the public; or funds previously accumulated by the company may be reinvested in the business. The amounts put to reserve by public companies have always tended to be large, but the proportion of profits which were 'ploughed back' in this way a few years ago was certainly larger than before the war. In any of these cases, an export of capital may result as, for instance, if a controlling interest is

purchased in an enterprise abroad which will work in conjunction with the main company; or if land, plant, or factories overseas are bought outright; or if new subsidiary companies registered overseas are established by the parent company; or machinery and equipment are purchased in one country, exported, and erected in another. These methods were all in use before 1930 and accounted for a very considerable volume of international investment, although it is not possible to ascertain with much accuracy the sums involved.

Direct investments in overseas countries by firms which wish to develop their export market have been increasingly important in recent years and may be expected to become even more so. It has already been shown that the opportunities for investments which can most easily be financed by new issues are becoming severely limited. New overseas investments by individual firms are, however, especially suitable in present circumstances. They are undertaken only by those who have a specialized knowledge of the branch of industry concerned and, often, by firms which have interests in many countries and are thereby able to spread their risks. Such investment, too, is often correlated with exports of capital goods from the lending country so that the exchange difficulties in making the loan are diminished. At the same time, the exchange difficulties involved in making service payments are also lessened, for this kind of investment is usually an equity investment, whereas new issues for overseas borrowers are very often fixed-interest-bearing. There is, therefore, some tendency for the yield to vary with the general prosperity of trade, so that in periods of depression the burden of interest charges may be reduced.

Another type of international investment, that which takes place through the intermediary of investment institutions, is also becoming increasingly important. These institutions include investment trusts, insurance companies, banks, and mortgage and loan companies. British banks seldom invest a large part of their assets in long-term securities, except government securities, and it is not, therefore, to be expected that even those banks which have overseas interests will ever be large lenders on long-term, although they may be extremely important as international short-term credit institutions. No statistics are available of the size of British banks' overseas assets. United States banks have, in the past, tended to hold a larger proportion of long-term assets than British banks, and they have also lent large sums abroad, particularly to Germany. After their recent experiences, however, it is unlikely that they will care to undertake this business on a large scale for some time to come. The organization of French

banques d'affaires and of German *Kreditbanken* would permit them to carry on international long-term investment on a large scale; but it appears that, in recent years, they have been almost exclusively concerned with domestic investment, although some French banks have interests in the colonies and, possibly, in some European countries. Even the international banks, such as the British banks operating in South America, are not responsible for a large amount of long-term investment, and banks as a whole must usually be regarded as intermediaries for short-term lending.

Finance and land companies have been important investment intermediaries in the past, though the extent of their overseas holdings is unknown. Since, however, the days of large-scale land settlement are over, such institutions cannot be expected to expand very considerably, although they may well make investments in urban properties in other countries.

Quantitatively much more important than these are investment trusts and insurance companies. *The Economist*¹ gave the total number of investment trusts in Great Britain at the end of 1933 as 197, with a paid up capital of £295,582,000. About one-half of the holdings of the trusts consisted of foreign and colonial securities, but a comprehensive analysis is impossible since many of the trusts do not show details in their published statements. Moreover, holdings are sometimes shown at 'market' values and sometimes at 'book' values.

The following figures² show the geographical distribution of the investments in 1933 for those which do publish details.

*Geographical Distribution of British Investment Trusts' Holdings,
1933*

	<i>41 companies, with holdings of £63,404,000 at 'market' values</i>	<i>56 companies, with holdings of £96,153,000 at 'book' values</i>
	%	%
United Kingdom	48.0	40.4
British Overseas Empire	11.3	13.2
United States	11.8	10.2
Latin America	11.7	15.2
Europe	11.6	13.1
Elsewhere.	5.6	7.9
	100.0	100.0

¹ Investment Trust Supplement, 1 Dec. 1934.

² Based on statistics in *The Economist*, loc. cit.

It is interesting to note that the geographical distribution of these holdings differs substantially from that of British overseas investments as a whole.

Geographical Distribution of British Investment Trusts' Overseas Holdings compared with that of all British Overseas Investments

	41 'Market Value' Trusts, 1933	56 'Book Value' Trusts, 1933	Total British over- seas investment ¹
	%	%	%
British Empire .	21.7	22.1	59
United States .	22.7	17.1	5
Latin America .	22.5	25.5	21
Europe .	22.3	22.0	8
Elsewhere .	10.8	13.3	7
	100.0	100.0	100

From this it appears that investment trusts have purchased American and European securities rather more, and Dominion and colonial securities rather less, than British investors as a whole.² This is probably to be explained by the relatively low yields obtainable on Dominion and colonial securities, many of which are trustee securities in Great Britain.

Such comparative figures as are available for 1929 do not suggest that there were any noteworthy changes in the geographical distribution of investment trusts' holdings between that date and 1933.

'As regards policy in the matter of "switching" from one group to another during depression, the "book value" figures are most informative. They suggest a degree of rigidity in geographical distribution which may come as a surprise to investors who may have attached importance to the ability of the companies to trim their sails to the prevailing wind. The figures suggest a certain desire to "fly" from devastated areas, like South America and Europe, for more profitable territories like Great Britain and the Empire; but the effect on the general distribution of assets has been relatively small.

'If the desire to "switch" geographically be inferred from the "book value" figures, the "market value" percentages may be regarded as a reflection of its concrete effects in the conditions of the last four years. The post-war trust sample appears to include companies whose investments are less in the United Kingdom and more in Europe than the average. Subject to this qualification, it would appear that a larger proportion

¹ 1930.

² There has been no change in the geographical distribution of British overseas investments as a whole since 1930 on a sufficient scale to invalidate this conclusion.

of investment trust holdings, at market values, was in Great Britain and the Empire in 1933 than in 1929, and that this was less a result of deliberate policy than of the fact that the "foreign" securities had depreciated more rapidly than the "home" and "Empire" trust securities.¹

Though it would appear that investment trusts did not do much towards 'switching' their holdings in the face of depression, it does not follow that they are unable to extend their operations in new directions during periods of relative prosperity. Between 1923 and 1929 available figures show a strong movement into European securities which coincided with the establishment of several new trusts. Too much attention should not, however, be given to changes in investment trusts' portfolios, since the directors may sometimes be more concerned with the immediate *market* prospects for the securities which they hold than with long-run considerations of the probable future yield.

In the same category as investment trusts may be placed insurance companies, which are also important international investment intermediaries. The diversity of the investments of British insurance companies may be illustrated by the following statistics which show the distribution of the assets of four companies, the Prudential, the Pearl, the Alliance, and the Sun Life.²

Investments of Four Insurance Companies, December, 1933

	£	%
<i>Mortgages:</i>		
In United Kingdom and Irish Free State	19,530,800	4.69
Foreign	6,292,300	1.51
Loans on rates, policies, &c.	43,769,100	10.52
<i>Investments:</i>		
British Government and Municipal	145,877,800	35.05
Indian and Colonial Government and Municipal	34,420,500	8.27
Foreign Government and Municipal	22,255,700	5.35
Debentures, railways, industrials, &c.	62,488,300	15.01
Preference shares and stocks	27,093,000	6.51
Ordinary stocks and shares	32,177,800	7.73
Property, ground rents, &c.	19,615,700	4.71
Investments in subsidiary companies, reversions, &c.	2,707,400	0.65
	416,228,400	100.00

Unfortunately, debentures and shares are not classified according to the country in which the issuer carries on his business, but it can be

¹ *Economist*, loc. cit.

² From Francis Williams, 'Insurance Companies and Investment Trusts' in *Studies in Capital and Investment* (London, Gollancz, 1935), p. 149.

seen from the above table that 13·62 per cent. of the assets of these four companies were invested in foreign and colonial government and municipal bonds. This proportion is very similar to that given for all British insurance companies at the end of 1934, when it was estimated that out of total assets of £1,465 millions, £193,650,000 or about 13·2 per cent. were invested in this class of securities.¹ The importance of insurance companies as overseas investment intermediaries is shown by the fact that they hold about one-eighth of all the securities of overseas public bodies which are owned in Great Britain. If their interests in private enterprise abroad are included, it is permissible to estimate that the overseas assets of British insurance companies amount to between £250 and £300 millions, but their *net* investments are smaller, since they have also considerable external liabilities. Insurance companies have been important international investment intermediaries throughout the post-war years. Their total assets doubled between 1918 and 1930, and over the same period their holdings of the securities of public authorities overseas also nearly doubled. Since 1930, however, their new funds have been employed principally within Great Britain itself.

There is no reason to expect that the funds which insurance companies will have to invest will be smaller or, indeed, that they will cease to expand, in future years. It does not, of course, follow from this that they will choose to distribute their assets as between home and foreign and colonial securities in the same way as they have done in the past, though there is one part of their foreign investments which appears to be increasing rapidly at the present time: their purchases of American securities which have been issued, not in London, but in New York.

It may be estimated that British investment trusts, insurance companies, overseas banks, and miscellaneous financial institutions possess long-term overseas assets at the present time to the value of not less than £500 millions. A large part of this capital, possibly as much as two-thirds, has been exported since the war. The premiums paid on insurance policies and the subscriptions made to other sorts of financial issues have been the means of a very large amount of international investment; but the geographical destination of this capital was obscured by the intermediary through which it passed, and was probably unknown to many of the individuals whose savings it actually represented.

¹ Cf. *The Statist*, 6 July 1935. It must be remembered that the investments of insurance companies are partly conditioned by legal restrictions imposed on them in the countries in which they operate.

It is to be expected that these intermediaries will continue to form an important channel for international investment, and one feature of their activities must be clearly noted. The type of investment in which they take part to the greatest extent—the purchase of securities already issued on foreign stock exchanges—is very different from that which characterized most of the pre-war and much of the post-war international investment of Great Britain. It represents the purchase of existing securities rather than the provision of capital for new investment. The securities purchased are as likely to be those of creditor countries, e.g. the United States, as of countries which require to borrow from abroad. Investment of this type is therefore more likely to add to the difficulties of maintaining exchange stability than to contribute to their solution and, unlike the more 'primitive' types of international investment, there is no presumption that it will serve to promote a more economical utilization of the world's capital resources.

Finally, there is a third kind of investment which is tending to take the place of publicly issued securities to a certain degree, viz. medium-term credits. The trade of any country is almost entirely financed by credit. This may take many forms, but the most important is the bill of exchange. This is, however, a short-term credit (usually less than twelve months), and it is unsuitable for financing trade in capital goods for which medium-term credit (one to five years) is required. This point was stressed by the Macmillan Committee:

'With the immense growth in the mechanisation of industry throughout the world, the demand for longer credits for financing the production and sale of machinery of all kinds appears to be growing. The purchaser abroad requires very often two or three years before he can complete his payments, and therefore contracts are likely to go to those sellers who can provide sufficiently long credit. Since we must look in the future particularly to exports in which skill and experience largely enter, we believe that the facilities for financing exports of machinery of all kinds are of particular importance. At present, however, we do not believe that the facilities available here in the case of foreign trade are so complete as those provided in some other countries, and we think that it would in fact often be necessary for British traders to obtain either directly or indirectly such facilities from foreign institutions. This is a situation which should be remedied, and British institutions, similar to those which cover the ground satisfactorily at home, should be developed for the purpose of assisting British industry and trade abroad. We see no reason why sufficiently strong institutions should not create a market for their own short-term securities by means of which any sound business negotiated may be financed.'¹

in ¹ *Report of the Committee on Finance and Industry*, Cmd. 3897 of 1931, para. 395.

Under present-day conditions it is more than ever desirable that exchange stability should be maintained. Medium-term export credits help to do this by correlating exports of capital with exports of goods. In brief, they enable worthy borrowers to obtain credit, but prevent this lending from causing the exchanges of the creditor country to become adverse, by ensuring that the demand for the currency of that country will also be increased by exports of goods. They are, moreover, beneficial to the industries of the lending country and help to maintain a high level of employment. These are results which need not necessarily follow from long-term lending through the new issue market, and they constitute the chief advantages which medium-term export credits have to offer. But there are others as well. The risks attached to medium-term lending are relatively smaller, in the first place, simply because the period of the credit is shorter and, secondly, as a result of the technical conditions under which such credits are granted. They are used primarily to finance exports of capital goods, usually in connexion with a contract for the building of a bridge or a road or some other piece of capital equipment. The exports of goods are, therefore, spread over a considerable part of the period of the credit, and the lender may expect to begin to receive service payments before all the exports of goods have taken place. If these payments are not promptly forthcoming, pressure may then be placed on the borrower by withholding shipments of goods and thus forcing him to incur the risk that he may be left with a half-finished structure. Finally, since the exporter normally exercises considerable control on the spot, he can be well informed of the financial position of the borrower, and further credits may be refused if adverse developments are to be expected.

The British financial market possesses no institutions which specialize in the provision of such facilities as this. It can handle bills of exchange or long-term loans with the greatest efficiency, but is not able so easily to deal with credits of an intermediate length. In recent years, however, this deficiency has been partly removed by an extension of the work of the Export Credits Guarantee Department of the Board of Trade. A description of the work of this Department, and a discussion of its merits, will be given in a later chapter.

There are, then, various types of international investments which may be expected to increase in importance relatively to new issues. These are 'direct' investments, purchases of securities on foreign stock exchanges, and medium-term credits. They will tend to be preferred because the conditions under which long-term capital may move from one country to another have changed, and, when new

capital is required by a borrowing country, it will often be found that the new issue market is not the most suitable channel through which to obtain it.

When the problem of international investment is considered from the point of view of the creditor countries, it will be seen that conditions in these countries tend also to limit the volume of new investment and to govern the channels through which it may take place. In the next chapters the problems of the balances of payments of creditors, of exchange stability, and of the rôle of the state in international investment are discussed. The conclusions that we have reached in this and the previous chapter will be found to be reinforced by those to which this discussion will lead. It is necessary first to examine the question of the balances of payments, because it has often been the balance of payments position which has disturbed exchange stability and has caused governments to intervene in the sphere of international investment.

CHAPTER V

THE BALANCE OF INTERNATIONAL PAYMENTS

'The Mercantilists were not impelled by the circumstances of their time to pay as much attention to the two groups of invisible imports and exports—those due to international credit and absenteeism—as they did to the services of commerce and shipping. But the financial and commercial troubles of the great French war made English statesmen and economists examine the balance of trade with a care and thoroughness never before attempted; and they found that some important matters had been overlooked.'¹

'In years past we have gone to great trouble and expense in recording and regulating the flow of emigration and immigration. The time has arrived when, as a nation, we must pay close attention to the migration of capital and its relation to our foreign trade in order to avoid such movements as occurred during the 1923-1933 period.'²

THE object of this chapter is to consider the way in which the problem of international investment is affected by what is called the balance of international payments.

The balance of payments of a country may be conveniently divided into two parts: the balance on income account and the balance on capital account. The former covers all transactions which entail the purchase from or sale to another country of merchandise and services, and includes also receipts or payments in respect of dividends or interest on investments, loans, and debts. Every country must pay for its imports somehow. It may pay for them, as in large part at least every country does, by exporting commodities. If the value of its recorded imports exceeds (or falls short of) the value of its recorded exports, the country has what is sometimes called an adverse (or favourable) 'visible' balance of trade. This, however, is only part of the balance of payments on current account. A country may be entitled to payments from abroad on account of the sale by its nationals of various services, such as shipping and banking services, or the provision of services to foreign tourists which are not recorded in the returns of foreign trade. Conversely, it may be liable to make payments abroad in respect of the purchase of similar services. Again, it may be entitled to receive or liable to make payments in respect of interest on loans or dividends on investments. All such items enter into the balance of payments on current account.

But a country may also be entitled to receive payments from

¹ Alfred Marshall, *Money, Credit, and Commerce* (London, Macmillan, 1923), p. 135.

² George N. Peek, Special Adviser to the President on Foreign Trade, in a letter to President Roosevelt, 30 Aug. 1934 (Washington, Government Printing Office, 1934).

abroad or be obliged to make payments abroad in respect of capital transactions. Its nationals may subscribe to a loan that is issued by the government of another country, or they may purchase stock exchange securities from the citizens of another country, or they may invest money abroad in many other forms. Conversely, they may borrow from abroad in a variety of ways.

Capital assets bought by the citizens of one country from the citizens of another must be paid for just as much as commodities that are imported in the ordinary course of trade.

If we include among these capital assets the gold which central banks or governments sell for export or acquire from abroad, the aggregate payments which a country makes abroad must exactly balance the payments which it receives from abroad. There may be a substantial balance in the one direction or the other on current account, but this must be exactly offset by a corresponding balance in the opposite direction upon capital account. This must hold good not only from year to year but from week to week, and even from day to day.

Certain elements in the capital account, however, have a special claim to be regarded as the balancing items through which this equality is maintained. The chief of these is gold. Under the traditional gold standard system, any marked tendency for a country's payments abroad to exceed or fall short of its receipts led directly to an outflow or inflow of gold, and this remains essentially true in many countries which have departed from the gold standard, though the gold may now be drawn from or added to the reserves of exchange equalization funds rather than those of central banks. But gold is not the only asset which is used in the day-to-day adjustments of the balance of payments. Holdings of foreign currencies or of bank deposits or bills in a foreign financial centre may fulfil the same function. The essential point is that in every country some authority, whether it be the government, the central bank, or a group of banks which are largely concerned with foreign remittances, maintains a substantial reserve of liquid assets readily convertible into foreign currencies in order to facilitate external payments, and it is upon this reserve that the first impact falls of any excess or deficiency in the balance of payments. It will often be convenient in this chapter to refer to this reserve shortly as the 'gold reserve'.¹

In most countries, however, this reserve would not be large enough

¹ This should not be confused with the gold supply in a gold-producing country. In the case of such countries, gold exports are not in any way different from exports of merchandise.

to sustain a large adverse balance of payments which persisted over a long period. Indeed, in no country would it be possible to meet an adverse balance of payments indefinitely by drawing on its reserve. Conversely, there are limits, though less definite and insistent limits, to the extent to which the financial authorities of a country are normally willing to accumulate assets of gold or foreign currencies. It is thus fundamentally necessary that a reasonable equilibrium should be maintained over a long period in a country's balance of payments on current and capital accounts, when we exclude from the latter the elements which are used to adjust differences from day to day.

It is this necessity that gives rise to the problem of the relation between a country's balance of payments on current account and its capacity to lend abroad. If a country has a favourable balance of payments on current account its nationals can lend abroad to the extent of this favourable balance without causing thereby any drain upon its gold reserve. If, however, it has no favourable balance on current account, or if its nationals in fact lend abroad to an extent larger than its favourable balance, its gold reserve will be depleted. Within reasonable limits and for a reasonable time there may be no objection to this. It may indeed happen that a country possessing an exceptionally heavy gold reserve may be positively anxious to see it reduced to smaller dimensions. In such circumstances, it will welcome a tendency for its nationals to lend abroad to an extent greater than its favourable balance on current account. But a persistent outflow of gold would be unwelcome to a country whose gold reserve is already no larger than it desires normally to retain. To avoid such a persistent outflow it is essential that its net foreign lending should be kept within the limits of its favourable balance of payments on current account. This is what is meant by the common dictum that a country's capacity to lend abroad is limited by its 'export surplus'. The phrase 'export surplus' is a convenient one to use as a synonym for the longer phrase 'a favourable balance of payments on current account', but it must not be forgotten that a large variety of transactions other than the import and export of commodities enter into its computation.

At this stage of the argument a further complicating factor needs to be considered. Capital transactions between countries may take, as has already been indicated, a great variety of forms; but they fall under two broad heads which it is important to distinguish, namely, long-term lending and short-term lending. An important part of the short-term lending takes the form of the movement of funds from one centre to another in response to the attractions exerted by

the relative interest rates obtainable in different centres for short-term money. A country which is losing gold on a greater scale than it desires may seek to protect its reserve by raising its short-term interest rates. This indeed was the normal practice under the traditional gold standard régime; and it is still likely to be followed in some degree, though much less as a matter of course, under a system of managed currencies. The following sequence of cause and effect may thus occur; a country may lose gold because it has an adverse balance of payments on current account, or because its net lending abroad exceeds its favourable balance. Its financial authority raises the level of short-term interest rates. Short-term money is thereby attracted from abroad and the drain of gold is checked, for the time being at least. It may often be convenient that temporary fluctuations in the current balance should be met in this way, rather than by a movement of gold. But there are limits to the extent to which this is appropriate or sound. From the standpoint of the balance of payments, the attraction of short-term funds is equivalent to a reduction in the net volume of foreign lending, and the country in question may be said accordingly to have ceased to lend abroad in excess of its export surplus. But it may none the less be drifting into a fundamentally unsound position. It may, to use another common phrase, be 'lending long and borrowing short', and if such a tendency were to persist for a prolonged period, a highly dangerous situation would result. The short-term money that was attracted into the country by relatively high short-term interest rates might be withdrawn suddenly at an inconvenient time, possibly for political rather than economic reasons. A large withdrawal of short-term funds is equivalent from the standpoint of the balance of payments to a sudden large-scale (though unintended) increase of foreign lending, and must be expected to lead to a heavy drain on the country's gold reserve. Withdrawals of short-term money were indeed the chief feature of the widespread international financial crisis of 1931 which led among other consequences to the enforced departure of Great Britain from the gold standard.

Thus, on the one hand, short-term capital movements between countries have the significance that they may interpose something in the nature of a buffer, which may sometimes be useful, between the balance of payments in respect of other items and the reserve of gold or foreign exchange maintained by the financial authority. It is not necessary that a country which is 'lending long' to an extent greater than its export surplus should lose gold. In such circumstances the long-term lending may be offset for a considerable period,

and in some degree perhaps it is likely to be offset, by short-term borrowing. On the other hand, since funds borrowed on short-term may be withdrawn at short notice, they can only serve appropriately as a corrective for a temporary and not for a persistent divergence. Over a long period it is essential that a reasonable equilibrium should be maintained between the net volume of a country's *long-term* lending or borrowing and its balance of payments on current account.

We turn to the practical corollaries that follow from these general considerations. We shall consider first the problem of lending countries, and later the problem of borrowing countries. A lending country cannot lend abroad on a scale which is substantially or persistently in excess of its 'export surplus' as defined above. But here it is necessary to remember that an increase of foreign lending may serve to stimulate exports and thus to increase the export surplus of the country making the loan. How far it will have this effect will depend largely on the type of the lending transactions. As has been already shown, there are many types of international investment in which the movement of money is directly and naturally associated with the supply of capital goods. This is most markedly true in the case of credits which are granted for the purpose of financing exports. It also holds true in a high degree of the type of international investment in which a large industrial concern in one country establishes a branch works in another country; for in such cases the greater part of the capital equipment will usually be obtained from the country of the parent concern. The condition of the balance of payments imposes no limit to the dimensions which international investment can assume whenever the lending of money is directly associated with the export of goods of a commensurate value.

When, however, the international investment takes the form of, say, a loan issued by a government or municipality or public utility company in the capital market of another country, it is uncertain how far the exports of the lending country will be increased as a consequence. If the loan is raised for the purpose of financing some capital development requiring the import of equipment from abroad, there is doubtless a presumption that some part at least of this equipment will be purchased from the lending country. But this presumption is far weaker than it was in the days when Great Britain was both the chief producer of capital goods and the leading country in international finance. A considerable part of the equipment required may be produced within the borrowing country, and the remainder may be imported from industrial countries other than the lender. It is unsafe, therefore, under modern conditions to assume

that any large part of a loan raised for development purposes will be used to purchase the products of the lending country, unless conditions to that effect are expressly attached to the issue of the loan. Moreover, the loan may not be raised for purposes of capital development, but for internal financial or monetary purposes which will not, directly at least, increase the imports of the borrowing country. Similarly, imports and exports are not directly affected by that rapidly expanding form of international investment, the purchase of stock exchange securities from the nationals of one country by the nationals of another.

It is sometimes argued that an increase of foreign lending must lead somehow to a commensurate increase of exports, though it may be hard to trace the exact channels through which this will come about. The borrowing country acquires as the result of the loan so much purchasing power in terms of the currency of the lending country. If the actual borrowers do not wish to use this purchasing power to buy goods from the lending country, they will none the less wish to make use of it somehow; they will sell it in the foreign exchange market, and those who buy it from them there, who may be other persons in the borrowing country or perhaps persons in another country, will presumably buy it in order to finance purchases from the lending country. Thus directly or indirectly, it is argued, perhaps through a complex process of 'triangular trade' the loan is likely to stimulate exports from the country which provides the money.

This argument, however, ignores the possibility that the gold reserve of a country may be depleted. It is possible, that is to say, that the exports which are eventually stimulated from the lending country as the result of a loan may be exports of the gold or foreign exchange held as a reserve by its central bank, rather than exports of ordinary merchandise. This indeed is likely to be the consequence if the loan is not of the type which promotes exports directly, and if the country is already tending to lend abroad in excess of its export surplus. It is true, of course, that there are limits to the extent to which gold movements are possible; but a country that is losing gold heavily will be obliged to take steps such as raising bank-rate and curtailing credit, or imposing restrictions on imports to improve its balance of payments on current account or to diminish its foreign lending. In other words, if a country is lending abroad in excess of its export surplus, the necessary equilibrium may eventually be re-established, not by an increase in its exports of goods, but by a reduction of its imports or by a curtailment of foreign lending, and an extremely disagreeable process entailing deflation and widespread

unemployment may be necessary to achieve this end. The contention that foreign lending of any type must necessarily entail a commensurate expansion of exports from the lending country cannot be sustained.

We return, therefore, to the broad proposition that a country cannot lend substantially or persistently in excess of its export surplus. The qualifying words 'substantially or persistently' should be noted. It is a mistake to suppose that the magnitude of the export surplus in any particular year imposes a precise and rigid limit on the extent of the long-term lending that is practicable or prudent in that particular year. It is also important to remember that a loan or investment normally yields a return in the form of interest or dividends, so that, apart from any effect which it may have immediately in stimulating exports, it is likely to improve the balance of payments of the lending country on current account in subsequent years. But when due allowance has been made for such considerations, it remains true that the condition of the balance of payments sets limits to the extent to which a country can prudently lend abroad. If these limits are exceeded, exchange difficulties are likely to ensue, leading ultimately either to the unpleasant corrective medicine of a deflationary process or to a fall in the exchange value of the country's currency. Thus the proposition which we have enunciated has in a large degree the force of a practical precept. It is unwise for a country to attempt to lend abroad largely or persistently in excess of its export surplus. But what of the converse proposition? Can it be asserted with equal truth that it is undesirable that a country should fail to lend abroad on a scale commensurate with its favourable balance of payments on current account?

Up to a point similar considerations apply. If a country's foreign lending falls short of its export surplus, its central bank will accumulate gold. If this accumulation becomes large it will be difficult for the country to avoid either an inflationary development or an appreciation in the exchange value of its currency. Either of these results may entail serious disadvantages. In the long run, it is as fundamentally necessary that a country's foreign lending should not fall short of its export surplus as that it should not exceed it. But it is necessary to be cautious before proceeding to draw the moral.

If for any reason the only foreign investments that it was practicable to make were unsound investments unlikely to yield a return, it would be absurd for a country to make such investments merely because it had a favourable balance of payments on current account. In such a case it would clearly be better for it to restore the necessary

equilibrium in other ways, e.g. by modifying its tariff policy so as to permit a larger volume of imports, or by permitting an appreciation of its currency which would discourage its exports. In short, when a country is tending to lend abroad persistently less than its favourable balance of payments on current account, it *may* be desirable that it should lend abroad more largely, or it *may* be desirable that it should import more freely and export less, i.e. that its favourable margin on the balance of payments should disappear. Which of these courses will be preferable will depend largely on the opportunities for sound investment offered by the borrowing countries, but sooner or later one of these courses will be inevitable. It is impossible for a country to maintain persistently a large export surplus while refraining from lending abroad. The attempt to do so is likely to cause difficulties both to itself and to the outside world.

With these considerations in mind, it will be useful to review in some detail the balance of payments positions of the principal lending countries, Great Britain and the United States. In the years before the war Great Britain had an export surplus on current account which was almost continually increasing and which approached the sum of £200 millions in 1913. Imports of goods always exceeded exports (although by a much smaller amount than after the war), but the invisible items were all 'favourable' and it was, therefore, the income from her past investments, her shipping, and the services of her commercial and financial institutions which Great Britain used to lend to overseas borrowers. After the war, the export surplus on current account was much smaller—it averaged about £87 millions during the eight years 1922 to 1929. This decline was the result of a great decrease in exports relatively to imports so that the mean 'unfavourable' balance of merchandise trade was about £337 millions between 1922 and 1929, compared with £132 millions in 1913. According to the estimates of the Midland Bank, Great Britain did not, in these circumstances, reduce the volume of her long-term overseas lending to as great an extent as the decline in the export surplus on current account would have warranted. The average annual amount of new issues for overseas borrowers between 1922 and 1929 was about £123 millions, or approximately £36 millions more than the estimated average annual export surplus on current account. This 'over-lending' was only possible because Britain was importing short-term capital (especially after 1925), and it was one of the principal causes of the difficulties of 1931.¹

At the present time Great Britain's export surplus on current

¹ See also pp. 138-42.

account is very much smaller than it was a few years ago. From 1931 to 1934 there was, indeed, an *import* surplus; i.e. Great Britain had actually an unfavourable balance of payments on income account when all invisible items, including services and interest and dividend receipts, had been included. This was largely attributable to abnormal slump conditions. In the past two years there has been an improvement, and in 1935 there was an estimated 'export surplus' of £37 millions. In the light of recent developments, however, it seems doubtful whether this improvement will continue or will even be sustained. For against the further recovery that may doubtless be expected under certain headings as world conditions improve, we have to reckon for some years to come with a new influence, namely, intensive rearmament, which must tend both to increase imports and to reduce exports, and thus to impair Britain's visible balance of trade.

In comparing the present position of Great Britain with her past position in respect of the balance of payments, there are indeed three main factors to be considered:

- (1) the decline in Britain's receipts from her foreign debtors, as the result partly of default, partly of the lower earnings of overseas industries, and partly of the general fall in long-term rates of interest;
- (2) the continuing loss of export trade, especially in cotton goods; and
- (3) the rearmament programme.

The first of these factors is discussed at length elsewhere;¹ the second factor is so important that we think it well to give some relevant details.

That Great Britain has lost—probably for ever—a very large part of her former huge trade in cotton goods cannot be more clearly demonstrated than by the following statistics:

Exports of Cotton Piece Goods
(Indices, 1927=100)

From	Great Britain	Japan	Great Britain and Japan
1927 . . .	100	100	100
1928 . . .	94	104	97
1929 . . .	89	131	100
1930 . . .	58	115	73
1931 . . .	43	104	57
1932 . . .	53	149	77
1933 . . .	49	153	75
1934 . . .	48	189	83
1935 . . .	47	200	85

¹ See below, Chapter XIV.

Exports of Cotton Piece Goods from Japan, expressed as a Percentage of Corresponding Exports from Great Britain

	<i>Per cent.</i>
1927	33
1928	37
1929	49
1930	65
1931	82
1932	92
1933	103
1934	129
1935	140

Exports of Cotton Piece Goods from Great Britain

	<i>Value</i>	<i>Proportion of total British exports</i>
	<i>(£ millions)</i>	<i>per cent.</i>
1913	97.8	18.6
1927	110.0	15.5
1928	107.3	14.9
1929	99.3	13.6
1930	61.3	10.7
1931	37.3	9.6
1932	43.6	12.0
1933	40.2	10.9
1934	39.8	10.1
1935	39.5	9.3

Imports of Cotton Piece Goods into British India

Years ending 31 March	<i>Total imports</i>		<i>From the United Kingdom</i>	
	<i>Value</i>	<i>Quantity</i>	<i>Quantity</i>	<i>Per cent. of total</i>
	<i>(£'000)</i>	<i>(Mill. yds.)</i>	<i>(Mill. yds.)</i>	
1927-8	40,642	1,937	1,530	79
1928-9	39,656	1,900	1,443	76
1929-30	37,011	1,883	1,235	66
1930-1	14,919	882	521	59
1931-2	10,727	752	377	50
1932-3	15,555	1,194	586	49
1933-4	9,783	761	415	54
1934-5	12,697	944	552	59
1935-6	11,835	947	440	47

The first two of the above tables¹ show the rise of Japan as a cotton-exporting country during the last decade; the third shows the extent of Britain's loss measured in money, and the importance of it from

¹ The indices are based on the quantity, not the value, of exports.

the point of view of her exports as a whole; and the fourth illustrates the effects of the Indian tariff and Japanese competition on Britain's market in India. Between 1927 and 1933 British exports of cotton piece goods diminished in volume by slightly more than 50 per cent.; in the same period, Japanese exports increased by 100 per cent. In every year during this period, Japanese exports increased relatively to British exports. In 1927 the quantity of cotton piece goods exported by Japan was only one-third of that exported by Great Britain; two years later, this proportion had risen to one half; in the next year, it was two-thirds; in 1933, Japanese exports were 3 per cent. greater than British; in 1935, they were 40 per cent. greater. Is it to be expected that British exporters will ever regain more than a very small fraction of this tremendous loss?

The value of British exports of cotton piece goods has, as might be expected, fallen even more sharply than the quantity: exports in 1935 represented 47 per cent. by quantity, but only 36 per cent. by value, of the exports in 1927. A second striking feature of the decline in British exports of cotton goods is its persistence. The first columns of the first and third of the above tables show this clearly. In 1932, exports of piece goods were larger both in value and quantity than in 1931 as a direct result of the under-valuation of sterling. But the gain so made is being rapidly lost. There has been a fall in both the value and the quantity of exports in each year since 1932. These falls have, it is true, been small, and they have not yet, therefore, reduced the exports to their 1931 dimensions, but if they persist, they must certainly do so in a short time. The cotton export industry was, as the result of this persistent decline, almost the only British industry with a smaller output in 1935 than in 1932. The effect of this is shown in the second column of the third of the above tables. In 1935 exports of cotton piece goods formed a smaller proportion of Britain's total exports than in 1931. In 1927, when post-war exports of cotton manufactures were at their peak, exports of piece goods formed 15½ per cent. of total British exports; this proportion fell steadily to 9·6 per cent. in 1931; rose to 12 per cent. in 1932—undervaluation provided, apparently, a greater stimulus to cotton than to most other exports—and then fell continuously to 9·3 per cent. in 1935. In 1935, total British exports were valued at £425·9 millions compared with £709·1 millions in 1927—a decline of 40 per cent.; but of this greatly diminished total export, cotton piece goods formed only 9·3 per cent. compared with 15·5 per cent. in the earlier year. Or, to put the same thing in another way, in 1935, British exports of all commodities except cotton piece goods were

lower in value by $36\frac{1}{2}$ per cent. than in 1927; exports of cotton piece goods, on the other hand, had declined in value between 1927 and 1935 by no less than 64 per cent. If, therefore, exports of cotton piece goods had fallen only by as much as exports of other commodities, their value in 1935 would have been £71 millions instead of £39.5 millions and total British exports would have been larger by over £30 millions. From the point of view of the balance of payments this is the minimum figure which can be assigned to the loss of the cotton export trade. The export surplus on current account has been permanently diminished by at least £30 millions a year for this single reason.

In considering the balance of payments of Great Britain over the next few years, we must therefore assume that her export surplus is likely to be reduced as compared with 1927 by about £30 millions on account of the loss of export trade in cotton goods. For various reasons discussed in Chapter XIV we must assume a further reduction of similar magnitude on account of the decline in receipts from overseas investments.¹ In 1928 Britain's favourable balance of payments on current account was estimated at £123 millions. Thus if we confined our attention to the two items that have been mentioned, we should have to expect that the export surplus of Great Britain during the next few years would not exceed about £60 millions, or one-half of the 1928 level. In ordinary circumstances, it is true, we might reasonably expect some compensating improvement under other headings; a growth of export trade, for example, in newer commodities. Under the conditions which actually confront us, such compensations are likely to be more than offset by the third major factor to which we have already referred, namely, the rearmament programme of the British Government. This programme will not only increase directly the volume of British imports: it is likely to increase their money value still more by causing a rise in the prices of many of the materials imported for armament purposes. It will also tend to diminish British exports both by reducing the capacity of certain industries to produce for export and more generally by raising the level of wages and costs of production in Great Britain. It is impossible to attempt any quantitative estimate of the effects of these various influences, but it is reasonable to conclude that Great Britain's favourable margin on the balance of payments on current account is likely to remain small for at least several years to come.

¹ This may be regarded as a conservative estimate. The refunding of the Australian Government debt alone involved a reduction in Great Britain's interest receipts of nearly £4 millions a year.

This supplies an important reason, supplementary to those mentioned in the last chapter, why the future international investment of Great Britain is likely to take increasingly such forms as export credits and the establishment of branch factories. As has already been shown, the condition of the balance of payments imposes no limit to the extent of international investment of these types. On the other hand, Great Britain's prospective position in regard to the balance of payments is unlikely to be strong enough to enable her to indulge on a large scale in types of international investment which are not directly associated with the export of goods.

In the United States a very different picture presents itself. This may be conveniently summarized in the following table:¹

(\$ millions)

	<i>Investments of the United States in foreign countries</i>	<i>Investments of foreigners in the United States</i>
1 July 1896 . . .	500	2,500
1 July 1914 . . .	1,500	4,500
31 Dec. 1922 . . .	18,583 ^a	2,278
31 Dec. 1929 . . .	25,723 ^a	6,846
31 Dec. 1933 . . .	25,202 ^a	4,557

^a Including war debts of approximately \$10,000 millions.

Before the war the United States was a net debtor on international account and an importer of foreign capital. During the war this position was completely reversed. About half of the investments of foreigners in the United States were liquidated and, in addition, American investments in foreign countries increased between 1914 and 1922 by \$6,779 millions, excluding war debts. Thus, from being a net debtor to the extent of about \$3,000 millions in 1914, the United States became a net creditor, being owed on balance \$6,000 millions by foreigners. Throughout the post-war years—up to 1930—Americans continued to lend to foreigners and, although foreigners' investments in the United States also increased, that country became an even larger creditor.

The composition of the post-war balance of payments of the United States was very different from that of Great Britain. Instead of an unfavourable balance of merchandise trade, the United States had a favourable balance which averaged \$712 millions in the eight years 1922-9. This was, however, more than offset by an unfavourable

¹ Summarized from statistics in a published letter from George N. Peek, Special Adviser to the President on Foreign Trade, to President Roosevelt, 30 August, 1934.

balance of invisible items¹ in the current account of \$871 millions a year over the same period, leaving an average unfavourable balance on account of the two items of \$159 millions. But the net receipts of the United States on account of the interest on her foreign investments, including war debts, was much greater than this—an average of \$602 millions during 1922 to 1929—leaving an average favourable balance on current account of \$443 millions.

During these years the United States was a net lender on long term to a slightly greater extent than the favourable balance on current account would permit—an annual average of roughly \$473 millions, or an average of \$30 millions a year more than the balance on current account. But there were imports of short-term capital considerably in excess of this figure, so that, although she is a gold producer, the United States was a net importer of gold to the extent of \$78 millions a year between 1922 and 1929.

The United States has still a favourable balance on current account, the annual average for 1930 to 1934 being \$320 millions and, although it declined to \$147 millions in 1935,² it must be expected that, in the immediate future, the result of the international transactions of the United States on current account will be a favourable balance of the order of \$300 to \$400 millions a year. Yet, paradoxically enough, the United States is now, and has been since 1931, a net *importer* of long-term capital,³ so that, despite considerable exports of short-term capital in the first four years, there have been gold imports which averaged \$548 millions a year during the six years 1930 to 1935. These gold imports were concentrated principally in the years 1934 and 1935, when there were imports of \$1,351 millions and \$1,839 millions respectively, and they continued throughout 1936. The United States, in other words, possesses an export surplus which would be consistent with a considerable volume of foreign lending, but at present her citizens, discouraged by the experience of the recent past, are not in a mood to lend abroad. This is a position which, so long as it continues, is liable to cause monetary difficulties either in the United States or in other countries. Sooner or later, in one way or another, equilibrium must be restored, but there are really three different ways in which this may be done: by a resumption of foreign lending by the United States; by a

¹ Excluding interest and dividend payments and receipts.

² Statistics are complicated by the fact that silver movements, having no monetary significance, were included in merchandise trade prior to 1934. If this is done for 1935, the favourable balance on current account becomes unfavourable to the extent of \$189 millions.

³ The reasons for this are considered in some detail in Chapter XIV, below.

decline in her export trade; or by an increase in the volume of her imports. This is the essence of the dilemma expressed in Mr. Henry Wallace's well-known slogan—'America must choose'.

It remains to consider shortly the problem of borrowing countries. A country which borrows from abroad is enabled thereby to sustain for the time being an excess of imports over exports, and an import surplus is in fact the normal condition of a country which is borrowing largely from abroad. But a country which borrows renders itself liable thereby to meet in future years the service charges (interest and sinking fund) on the sums borrowed; and the more largely it borrows the more do these service charges pile up against it. In order to meet these charges without recourse to fresh borrowing, it will eventually need an export surplus on the balance of commodity trade.

It is, therefore, a fundamental condition of sound international finance that a country should only borrow from abroad for the purpose of its capital development if this development is of a type which is likely to improve its balance of payments in future. This condition was fulfilled, as has been argued earlier in this book, in the case of most of the borrowing of overseas agricultural countries before the war. By raising a loan in London for railway or other developments these communities were able to increase greatly their output of primary products, and, as these found a ready sale in the market of the lending country, the power of the agricultural communities to export was thereby correspondingly increased. Such loans, in other words, earned a return which was easily convertible into the currency of the lending country. Owing, however, to the altered population outlook in the western world, and to the rapid development of agricultural technique, this condition of things has largely changed. The presumption that a country which borrows from abroad to finance an improvement in its system of communications will find its capacity to export materially increased as a result is not nearly so strong to-day as it used to be.

When, however, borrowing from abroad does nothing to increase a country's capacity to export, it does not necessarily follow that the borrowing is fundamentally unsound, for the borrowing may contribute to improve the country's future balance of payments, not by increasing its exports, but by reducing its imports; and this, though less satisfactory from the standpoint of the development of world trade, is equally efficacious for the purpose of meeting the service of foreign loans.

There has been during recent years a marked tendency in hitherto agricultural countries towards the development of domestic industries

to produce goods formerly imported from abroad. In some cases this tendency has gone so far that a considerable export trade in manufactured goods has already developed. Thus India's exports of cotton piece goods are considerable, and it is worth noting that 43 per cent. of Canada's exports (in the year ended 31st March 1935) were officially classified as wholly or chiefly manufactured. Many influences have combined to cause this tendency towards industrialization in hitherto agricultural countries, but strong among them is a sense of the dangers to which a country is exposed under modern conditions if it is largely dependent on the export of primary products to world markets. The tendency is marked in many South American countries, in Canada and in Australia, and it seems likely that it will persist after the world has recovered from the depression of recent years, and will be supported by protective measures. The replacement of imports of manufactured goods by home production contributes, just as much as an increase of exports, to improve the balance of international payments on current account. There is no reason, therefore, why this tendency should not be associated with international investment, though for technical reasons the investment is likely to take increasingly such forms as the establishment of branch factories by an industrial concern in the lending country.

CHAPTER VI

EXCHANGE STABILITY AND INTERNATIONAL INVESTMENT

'During the latter half of the nineteenth century the influence of London on credit conditions throughout the world was so predominant that the Bank of England could almost have claimed to be the conductor of the international orchestra. By modifying the terms on which she was prepared to lend, aided by her own readiness to vary the volume of her gold reserves and the unreadiness of other Central Banks to vary the volume of theirs, she could to a large extent determine the credit conditions prevailing elsewhere.

'This power to call the tune, coupled with certain other characteristics of the period . . . put Great Britain in a position to afford a degree of *laissez-faire* towards foreign lending which other countries could not imitate . . .'¹

'The principal duty of the Central Bank is to maintain in the interests of the community the stability of the national monetary unit, or, in other words, to maintain and to take custody of the central reserves on which the integrity of the national monetary unit depends.'²

The previous chapter showed that a continuous disequilibrium in the balance of payments must lead ultimately to disequilibrium in other spheres. Unfortunately, the statistics of the balances of payments of most countries are so inadequate that they are no guide to the true position in the short period unless the disequilibrium is very marked indeed. In most countries there is still no more satisfactory criterion of whether a country is over-borrowing or over-lending than that afforded by the actual movements of the foreign exchange rates. If in a lending country, for example, the exchanges are weak, that is evidence that the net amount that it is lending abroad in one form or another is for the time being greater than its favourable margin or the balance of payments on current account. But the forms in which a country may lend abroad are so various that this throws a very uncertain light on the important question of whether the underlying position of the country is sound or unsound. It is now generally agreed that, in the sense of the term that matters, Great Britain was over-lending during the years 1926 and 1927. But the over-lending was confined to investments of a long-term character. There was at the same time a large movement of short-term funds to London from European countries. The tendency of the sterling exchanges during these years was accordingly strong rather than weak and gave no

¹ J. M. Keynes, *A Treatise on Money* (London, Macmillan, 1930), vol. ii, pp. 306-7.

² Evidence of Sir Ernest Harvey before the Macmillan Committee. Committee on Finance and Industry, *Minutes of Evidence* (1931), Question 3.

warning of the unsoundness of the position that was developing beneath the surface. Conversely the exchange rates may undergo a fairly prolonged period of weakness, owing to an outflow of short-term funds, although the underlying position is perfectly sound. The movements of exchange rates are indeed a far less reliable barometer of the balance of payments position to-day than they were before the war.

Under gold standard conditions, the problem of maintaining equilibrium in the balance of payments resolved itself into that of keeping the foreign exchanges stable. This was done by the central bank, an institution whose primary duty it was to protect the gold reserve. This reserve would diminish if the exchanges were weak, and the exchanges would be weak if the balance of payments was in disequilibrium. In order, therefore, to protect the gold reserve, the central bank had to regulate the balance of payments position. It is probable that few central banks realized that this was, in fact, their task, but they managed, nevertheless, to perform it with considerable efficiency.

The Bank of England was never concerned, before the war, with the regulation of internal or external credit conditions as ends in themselves, but only in so far as they were related to the problem of maintaining the gold reserve. If bank rate was raised, it was done in order to stem an outflow of gold, not to check an internal inflation. From time to time the Bank increased the efficiency of its principal weapon—bank rate—by supplementary measures such as changes in its buying price for gold and open market operations; but these were always considered to be of minor importance. The Bank's discount policy was used principally to regulate gold flows and only secondarily to control internal and external credit conditions. That this was so is shown by the evidence given to the United States National Monetary Commission in 1910 by the Governor and Directors of the Bank of England.

'Q. When and under what conditions is the bank rate changed ?

A. The bank rate is raised either with the object of preventing gold from leaving the country, or of attracting gold to the country, and lowered when it is completely out of touch with the market rate and circumstances do not render it necessary to induce the import of gold.¹

A high bank rate stopped gold exports or encouraged gold imports

¹ United States National Monetary Commission: *Interviews on Banking in England, Scotland, France, Germany, Switzerland, and Italy*. Publications of the National Monetary Commission, i (Washington, 1910), p. 26.

partly by attracting short-term funds to London and partly by discouraging overseas borrowers on both short- and long-term. The Governor and Directors of the Bank have testified to the sufficiency of these methods:

'Q. Do you regard prompt and adequate increase in the bank rate as the most effective measure to protect the bank's reserve?

A. Yes.

Q. Does the raising of the bank rate ever fail to attract gold and change the course of the exchanges?

A. Experience seems to prove that the raising of the bank rate never fails to attract gold, provided the higher rate is kept effective.¹

That the attraction of short-term balances was also important is implied in the following:

'Q. Is the raising of the bank rate more effective in controlling gold movements now than at the time of the last suspension of the Bank Act in 1866?

A. Yes.

Q. To what do you attribute this increased efficiency?

A. To the increased and more rapid means of communication between financial centres.¹

Consciously or unconsciously, the chief concern of the Bank was, in fact, the maintenance of equilibrium in the British balance of payments. Usually, this was done by operations which tended to affect internal credit conditions and, consequently, the relative sizes of imports and exports of goods; in other words, to bring the balance into equilibrium by altering the size of the balance on current account. But the Bank's operations also affected the size of foreign balances in London, or, in our terminology, on the capital account side of the balance of payments. The Bank, of course, was not always successful; but its mechanism was usually so good that it was not until after the war that more direct measures to control the balance of payments were undertaken. These took the form of a control of new issues for foreign borrowers in London, and they will be discussed in the next chapter.

The corollary of the pre-war gold standard system was that the level of discount rates and the volume of credit within Great Britain, which necessarily exert an important influence on trade activity, were determined by gold movements. In other words, the internal credit policy of the Bank of England was subordinated to exchange requirements.²

¹ *Ibid.*

² Cf. Keynes, *op. cit.*, *passim*, esp. ch. 36.

This situation was accepted without question, partly because it was the traditional system, and partly because fluctuations in trade activity were regarded as being due to mysterious influences outside human control, since the effects of credit conditions on trade were not fully appreciated. Moreover, serious curtailment of credit was seldom necessary in order to prevent gold exports, because of the peculiar position of London as an international 'lender of last resort'. Short-term capital movements took place in response to changes in rates of interest in different centres; they were only caused by fear on rare occasions and, in any case, there was never any doubt that London was a safe depository for foreign funds.

In the post-war period the working of the British credit system aroused increased criticism. Serious attention was given by statesmen and economists to the study of trade fluctuations. There was an increasing insistence that everything possible should be done to mitigate these fluctuations and an increasing appreciation of the fact that the regulation of internal credit conditions was a vital element in any policy of control. This led to a growing revolt against the principle of subordinating internal credit conditions to the exchange position—a revolt which gathered force from the controversy over the return to a gold standard in 1925, and the widespread belief that the parity then selected was too high.

Since the departure from gold in 1931, opposition to any return to an international metallic standard has been fortified both by a realization of the increased importance of short-term capital movements in the post-war international economy and by a belief that frequent movements of the Bank's discount rate might be necessary in order to maintain any selected parity under modern conditions. The merits of these questions have been discussed in other publications of this Institute.¹

Whatever the eventual outcome of this controversy may be, it is unlikely that Great Britain will return to a gold standard of the old type—at any rate for some time to come. Meanwhile, most of the countries of the world have paper monetary standards, and their authorities are concerned to prevent very wide fluctuations in exchange rates under this system. For this purpose the mechanism of bank rate is ineffective, because movements of $\frac{1}{2}$ or 1 per cent. in discount rates do not influence owners of short-term money when there is a serious risk that they might incur a much greater

¹ *The International Gold Problem, 1932, Monetary Policy and the Depression, 1933, and The Future of Monetary Policy, 1935*, all published for the Royal Institute of International Affairs by the Oxford University Press.

exchange loss if funds were transferred from one centre to another in response to such changes in short-term rates of interest. In the face of this failure of orthodox methods, other means of controlling exchange rates by buying and selling foreign exchange have been evolved. This is the function of exchange equalization accounts.

When there is a considerable risk of exchange fluctuations, all forms of international financial and commercial intercourse are affected in some degree. Trade which is financed by short-term credit is not seriously hindered except in very extraordinary circumstances, because merchants can usually insure themselves against adverse fluctuations at a small cost through the forward exchange market and in other ways. But exchange risks cannot be avoided by such expedients in the case of those branches of trade which entail contracts spread over a long period, nor can they be avoided in the case of long-term investment. When exchange fluctuations are to be expected, an international loan necessarily entails an exchange risk which must be borne either by the lender or (as is more usual) by the borrower.

In practice a considerable measure of exchange stability is likely to be secured by the operation of exchange equalization funds working in concert with each other. It should be noted, however, that it is only with the exchange rates between the principal currencies, i.e. the pound, the dollar, and the franc, that the exchange equalization controls are directly concerned. These are the currencies of creditor countries. From the standpoint of international investment, however, what is important is not the stability of exchange rates between the different lending countries, but exchange stability between lending countries on the one hand and borrowing countries on the other. If the pound-dollar-franc ratios were to be finally stabilized, but the exchanges of borrowing countries were to fluctuate widely, the exchange conditions requisite for international investment would not be established. It is true that certain types of international capital movements, such as the traffic in securities between the Stock Exchanges of London, New York, and Paris might derive a stimulus. But this would not help to promote a flow of capital from developed to undeveloped countries, which was the essence of the international investment of the pre-war period.

It is thus to the prospects of exchange stability between borrowing and lending countries that it is necessary to turn our attention. A country which wishes to borrow abroad may tie its currency to that of the particular lender from whom it wishes to borrow.

This is, in effect, what most borrowers did before the war when Australia, for example, although nominally on a gold standard, was, in fact, on a sterling one. Since 1931, most of the British Dominions and the Scandinavian countries have tied their currencies to sterling. Other countries—including one British Dominion, Canada¹—have attempted to maintain fixed rates of exchange on New York. Both British and American investors, however, look upon such attempts at stability with a certain distrust. They feel that, if any of these borrowing countries should desire in future to devalue their currencies in terms of sterling or dollars, they will not hesitate to do so, as they have done in the past. It is not to be expected that any country would make such strong efforts to maintain a sterling or a dollar exchange standard as it would to support a gold standard. Further, there are many persons to-day in all countries who advocate experiments in currency manipulation as a means of fostering increased trade, and who would strongly deplore the establishment of any rigid exchange parity.

For these reasons it seems probable that for at least a considerable period to come less confidence will be felt than formerly in the stability of the foreign exchange rates between borrowing and lending countries. This must be expected to constitute a further obstacle to the revival of long-term international lending. Different types of lending will be affected by it in different degrees. Investments of an 'equity' character are not likely to be seriously prejudiced by the possibility of moderate exchange fluctuations. But the deterrent effect may be important in the case of investments in fixed-interest-bearing securities issued either by public authorities or private undertakings. For the attractiveness of this type of investment depends in a large degree on the tacit assumption of exchange stability.

If the revival of a large-scale flow of international investment of this type were urgently desirable on other grounds, this consideration would supply an important argument for an attempt to reconstitute the international gold standard system. But, as has been argued in Chapters III and IV, tendencies of an entirely different character are diminishing the scope for advantageous international lending of the fixed interest type. Indeed a recognition of the restricted opportunity in the modern world for this form of international lending is perhaps one of the underlying reasons for the widespread movement of opinion away from the rigid gold standard system in borrowing and lending countries alike. The forms of international investment which appear

¹ Although the 'pegging' in this case is not absolutely rigid, neither is it official.

to have an important future, such as the establishment of branch factories in new countries, do not depend in the same degree on the assurance of perfect exchange stability. In these circumstances it would seem unreasonable to deprecate new developments in monetary policy on the ground that they may entail exchange uncertainties which are prejudicial to international investment.

CHAPTER VII

THE STATE AND INTERNATIONAL INVESTMENT

From time to time, and to an increasing extent in recent years, governments in most countries have considered it necessary to regulate in one way or another the external lending or borrowing of their nationals. International investment has been encouraged or discouraged by state action. It has been forced into certain channels or in certain directions for various reasons, economic and non-economic.

Government control of international investment is usually an attempt to regulate balances of payments without inflicting undue hardships in the shape of credit restrictions upon domestic industries. Thus it is a result of the conflict mentioned in the previous chapter between the different requirements of internal and external equilibrium. State intervention for this purpose has become increasingly important in recent years, and most often takes the form of attempts by the governments of lending countries to prevent exports of capital by controlling new issue markets.

If it is considered necessary to prevent the external value of a currency from depreciating, or to provide especially cheap capital for domestic industries, the government of a lending country may attempt to discourage capital exports in various ways. The taxation at a special rate of income received from overseas investments is an effective method of achieving this end, since the difference between the rate of tax on domestic and foreign income offsets the difference between the rates of interest which may be received on home and foreign investments. Such control, however, cannot prevent all capital exports, since there are usually ways in which taxes can legally be avoided, and it also suffers from the further disadvantage that the degree to which capital exports are discouraged cannot be changed quickly as circumstances alter. It is, however, a suitable means of discouraging international investment more or less permanently. If more stringent measures are required, or if it is desirable to be able easily to alter the degree of control from time to time, the control of new issues is more effective. This control may be extended in a well organized capital market to cover other forms of capital movements, such as the purchase of securities already issued on foreign stock exchanges.

In Great Britain the control of capital exports has been exercised, not by statutory authority, but by 'requests' to the capital market

by the Treasury and the Bank of England. Throughout the post-war period this control has been almost entirely confined to the flotation of new issues, but since May 1933 it has been extended to cover purchases of large blocks of foreign securities. Since the control is non-statutory, it is necessary to ascertain the sanctions which can be applied to those who fail to comply. One of the weapons which can be used by the Bank of England in order to enforce its wishes derives its effectiveness from the fact that the largest issuing houses in London combine acceptance business with their loan activities. Such institutions are, therefore, ultimately dependent on the willingness of the Bank to rediscount bills accepted by them, and if they should incur its serious displeasure for any reason, they can be placed in the unenviable position of being denied such facilities. The influence of the Bank with the joint-stock banks provides an additional weapon by which the issuing houses may be deprived of credit on the initiative of the central institution. There is thus little likelihood that the Bank of England's wishes would be overlooked. Moreover, even should official wishes in this matter be gainsaid, there is always the ultimate sanction that the Stock Exchange Committee may refuse permission to deal in any issues which have not received the approval of the authorities.

It is not suggested that there is normally any need to employ such devices. It has long been the practice of the issuing houses to notify and consult with the Bank about any proposed flotation. Good relations are also preserved by the fact that certain partners in the issuing houses may also hold positions as Directors of the Bank. Furthermore, it is clearly in the interests of the issuing houses to keep on good terms with the authorities so that they may be favourably considered in connexion with any business which the Treasury or the Bank may have the power to allot. Only those whose behaviour meets with official approval will be suggested as suitable agents to conduct the loan operations of local authorities or of other bodies whose securities have trustee status. Altogether, the control of the new issue market is effectively exercised by the Bank and the Treasury with the minimum of statutory regulation or of dislocation of the capital market. This control may be both quantitative and qualitative in that it may discriminate, as was done in the case of overseas issues, between different classes of borrowers, and different types of transactions.

The partial embargo which had been placed by the Government on foreign issues in 1930 was intensified in 1931 and, combined with the uncertainties of the period, served effectively to diminish the

volume of long-term capital exports. The first public appeal to the capital market to refrain from floating new issues was made by the Chancellor of the Exchequer in June 1932, just before the War Loan conversion operations were undertaken.¹ This 'request' prevented any new issues, domestic, Empire, or foreign, from being made. The first relaxation of this total prohibition was permitted three months later, in September 1932, when domestic and Empire borrowers were again allowed to enter the market. The embargo still applied to 'issues on behalf of borrowers domiciled outside the Empire, or issues the proceeds of which would be remitted directly or indirectly to countries outside the Empire'. It also applied to operations involving underwriting or invitation to the public to subscribe new capital for optional replacement of existing securities by new issues. Other conversion operations were permitted, and later optional replacements also, except of trustee securities. Empire governments were permitted to conduct conversion operations from September 1932 onwards, and Australia immediately took advantage of this relaxation. The first conversion operation by a foreign government was the funding during 1933 of the Austrian League Loan and of the short-term credit which had been granted to Austria in 1931 by the Bank of England. Apart from this, foreign government conversions were not permitted until March 1934, when Iceland conducted a small refunding operation. The first substantial foreign government conversion was that undertaken by the Argentine Government in June 1934.

Thus, between September 1932 and July 1934, the situation was that Empire borrowers, both public and private, were permitted, with the approval of the Treasury in each case, to convert old issues and to raise new money in London. Practically no conversion operations by foreign borrowers were permitted until 1934, when private companies (in February) and governments (in March) were first allowed to conduct refunding operations. They were, however, forbidden to raise new capital, though an exception was made in the case of the Danish Government, which, in April 1933, was granted special permission to raise a loan of £1,000,000 in London to finance the construction of a bridge by a British firm using British steel. The next step was taken in July 1934, when the Chancellor of the Exchequer announced that the embargo would be relaxed in favour of two classes of foreign borrowers: members of the sterling bloc, and any other foreigners

¹ On the regulation of new foreign issues from 1931 to Feb. 1936 see J. H. Richardson, *British Economic Foreign Policy* (London, Allen & Unwin, 1936), pp. 69-75.

who would agree to use the proceeds of their loans in such a way as to benefit British industry directly. Thus, in fact, the embargo on overseas lending has been relaxed in favour of Empire and sterling bloc¹ countries, and other foreign countries may also borrow in London if their borrowings are correlated with increases in British exports. But the Government, through the Treasury and the Bank of England, have continued to maintain a stringent control over the capital market.

There was a new departure in April 1936 when the Chancellor of the Exchequer announced the appointment of a Foreign Transactions (Advisory) Committee to report to him from time to time on the general scope of the restrictions on foreign lending and on their particular application.² The terms of reference and instructions given to the Committee recapitulate the steps which have been taken to control the issue market since 1931. It is pointed out that the primary object of the restrictions is to protect the sterling exchange rate³ and that they apply to purchases of large blocks of securities from foreign holders as well as to new issues. The Committee is to consider applications for loans from foreign governments and other public authorities; offers of share or loan capital to the public, which involve the remittance of funds directly or indirectly to countries outside the British Empire;⁴ offers of this kind, not to the public but in respect of which permission to deal may be sought from the Stock Exchange Committee; and the acquisition of blocks of securities from abroad. In considering whether to recommend that exports of capital under these headings should be permitted, the Committee are to give favourable consideration to sterling bloc countries, and to take into account the volume of capital available for the purpose, the exchange position of Great Britain, the volume of Empire borrowing and the movement of securities between British and other stock exchanges. They will also consider any financial or other questions at issue between Great Britain and the country of the borrower. An important point is that

¹ The first of such loans was one of about £1,150,000 in August 1934 to the Union Company of Oslo, which had the effect of strengthening the Norwegian exchange.

² Cf. *The Times*, 8 April 1936.

³ It should be noted that this reason for the continuation of the embargo is not entirely compatible with the policy of according preferential treatment to Empire borrowers, for, except in so far as Empire borrowers may be expected to spend a larger part of the proceeds in the United Kingdom, loans to the Empire are not less likely to cause a weakening of the exchanges than loans to foreign countries.

⁴ It appears that Canada—not being a member of the sterling bloc—is treated as a foreign country by the Committee.

the Committee is to consider at an early date whether it can give general sanction, subject to specified conditions, for issues of particular types which involve remittances to foreign countries which are both small in themselves, and small in relation to the total issue.

No change of policy was envisaged when the Committee was set up, but specific machinery now exists and a body of experts is available to deal with problems which were formerly considered by a section of the Treasury. If control of the capital market has become a permanent feature of London's financial system, which seems very likely, the appointment of the Foreign Transactions (Advisory) Committee is a first step towards the very necessary rationalization of British methods. It is important to realize that control of new issues alone will not suffice if a drain of long-term capital is to be avoided. This point was emphasized in the instructions to the Advisory Committee. It has become clear that it is insufficient to control overseas issues if those who desire to invest abroad are permitted to purchase securities on foreign stock exchanges or to remit large sums overseas by other methods. It was for this reason that the embargo was extended, in May 1933, to cover purchases from foreign holders of large blocks of securities for re-sale in Great Britain. This, like the ban on new issues, was made effective by a 'request' that financial houses should endeavour to dissuade their customers from undertaking such purchases. Since companies were involved which, like the issuing houses, are directly or indirectly dependent upon the goodwill of the banking authorities, it was almost completely effective. Treasury sanction was necessary before British companies were permitted to repatriate blocks of their securities which were held abroad, and it is clear that several proposed transactions of this sort were prohibited.¹ Purchases of securities by private individuals, on the other hand, were not restricted, although it was stated that they were not in the public interest. In these circumstances British investors have purchased large quantities of securities in New York since the recovery of prices began on that Stock Exchange.² Many such purchases have been made by insurance companies and other financial institutions not so dependent upon the goodwill of the Bank of England as are issuing houses or industrial companies which require short-term credit from the banking system.

¹ A more liberal attitude was adopted in 1935 than in previous years and about £6 millions was involved in permitted transactions undertaken by several large companies.

² British long-term investments in the United States were estimated at £275 millions at the end of 1935, and probably increased by over £50 millions during 1936.

The unofficial methods employed in London have not proved entirely effective in preventing exports of capital. There has been an effective control of the new issue market and of conversion operations. Large industrial undertakings have been prevented from importing blocks of their own or of foreign securities for re-sale through the medium of the Stock Exchange, because it is known that the authorities can influence the Stock Exchange Committee to refuse permission to deal in such securities. But it has been less easy to prevent British companies from using the proceeds of their exports to buy securities on foreign stock exchanges provided that no attempt has been made to introduce them into Great Britain for re-sale, and it has been impossible to prevent exporters from using such proceeds in order to expand their 'direct' investments abroad. Finally, it has been found extremely difficult, especially when a London bank or broker is not involved, to prevent private individuals, insurance companies, &c., from buying securities abroad or dealing on foreign stock exchanges. Such transactions could only be stopped if a vigorous exchange control were imposed on the German model, requiring reasons to be given for all purchases of foreign currency.

The scope and efficiency of British methods of control are thus limited by technical considerations; but this is not the only criticism which may be made of the system. The unofficial nature of the control itself may at times give rise to friction and misunderstanding, more particularly as the public does not know either what sanctions can legally be applied in the last resort or with whom rests the responsibility for the authorities' decisions. In this connexion it may be remembered that when British interests proposed in 1935 to establish a cheap transatlantic passenger service and to purchase for this purpose two American ships, the Treasury refused to permit the necessary export of capital. This decision caused considerable confusion and misunderstanding and the view was widely held that the Treasury was more concerned to prevent competition with the state-subsidized Cunard-White Star Line than to protect the British economy from the effects of a small export of capital. When the question was raised in Parliament, it was announced on behalf of the Treasury that the supposed ban had been nothing more than an 'informal expression of opinion' and to the question whether the Treasury would take further action to oppose the promoters the answer was, in the first instance, in the negative. A few days later the Treasury appears to have changed its mind and to have decided that it would take further action. The whole project was accordingly dropped and the ships in question were sold

for the same purpose to a German firm. This lack of precision, which may cause a good deal of annoyance and wasted energy, seems to be an inherent defect of the unofficial type of control.

In the United States, control over capital exports has been maintained for different reasons and by different methods. An element of control, somewhat similar to that in Great Britain, has been exercised by the State Department ever since 1922, when a statement was issued requiring that all those who wished to make foreign loans should consult the Department 'on account of the bearing of such operations upon the proper conduct of foreign affairs'.¹ This general supervision was not exercised, as in Great Britain, for reasons connected with the financial position of the lending country. Its chief purpose was to provide the State Department with a weapon for compelling war-debt settlements and payments to the United States, and it achieved this object with a fair measure of success for a number of years. The Johnson Act of 1934 was designed for a similar purpose, namely, 'to prohibit financial transactions with any foreign government in default on its obligations to the United States'.² This Act does not prohibit issues for foreign private borrowers, and it permits loans to adjust existing indebtedness. The Act is couched in very wide terms: it is now unlawful, not merely for loans to be issued to foreign governments and political subdivisions of states in default on their obligations (including war debts) to the United States, but 'for any person to purchase or sell the bonds, securities, or other obligations' of these public authorities. Nevertheless, during 1934 and 1935, foreign securities to the value of \$880 millions were, it is estimated, purchased by Americans. A considerable amount of foreign investment still, therefore, proceeds by this method, and it seems clear that the terms of the Johnson Act have not been rigidly observed, for it is doubtful if such an amount of investment could have taken place without the purchase of securities of some government, e.g. the British, which has defaulted on its war debt obligations to the United States. Although, therefore, certain types of capital exports are prohibited by statute in the United States, it does not appear that the control has, in fact, been much more stringent than that in Great Britain.

The most severe of all contemporary examples of control is that maintained in Germany. Here, the logical conclusion of this form of state interference has been realized: complete exchange control has been established and the domestic as well as the foreign capital

¹ See below, Chapter XI, pp. 180-1.

² *Ibid.*, p. 196.

markets are strictly regulated. Issues for foreign borrowers and the export of currency are prohibited. The purchase of foreign securities is illegal. Circumvention of the control by exporters is prevented by the requirement that a permit shall be necessary before any export takes place, which provides the authorities with a means of ascertaining whether the proceeds of exports have been remitted to Germany or deposited abroad. Only the purchase of German bonds on foreign stock exchanges has been encouraged. These bonds, which are in many cases heavily depreciated because of Germany's default, can be bought cheaply and provide a stimulus to exports through the 'additional' exports device. The efficiency of the German control cannot be doubted, but the multiplicity of its provisions, the extent and ramifications of its regulations, the ingenuity of its devices and the number of points at which it has been necessary to exercise bureaucratic control, emphasize the extent to which the state must interfere in economic life if a complete control of exports of capital is to be maintained.¹

Broadly speaking, attempts by governments to restrict exports of long-term capital are usually initiated for one or both of two main reasons. These are, first, because it is feared that the exports of capital which would take place in the absence of control would cause the external value of the lender's currency to depreciate, and, second, because it is feared that if such capital exports were permitted, rates of interest within the lending country would remain higher than is desired, or, as a corollary, that if internal rates of interest were forced down, capital exports which are undesirable for the first reason would take place. It is evident that these factors are usually inextricably interconnected.

The control of new issues in most countries has probably been successful in so far as the prevention of a rise in internal rates of interest is concerned; but there are, on other grounds, three main criticisms which may be made against it. These are, briefly: that there is no method by which it can discriminate between proposed investments on the basis of the purposes for which they are to be used, and their probable liquidity at a later date; that discrimination on the basis of the nationality of the borrower has, usually, little

¹ The importance which the German Cabinet attaches to the maintenance of this control is shown by the following law passed on 1 Dec. 1936:

'A German citizen who, knowingly and unscrupulously, from motives of gross self-interest or other motives, removes or leaves property abroad, thereby causing gross injury to the German economic system, will be punished by death. The criminal is also punishable if the crime is perpetrated abroad. The competent Court for the offence will be the People's Court. The law hereby promulgated comes into force immediately.'

(*The Times*, 2 Dec. 1936.)

economic justification; and that small investments made via a foreign stock exchange cannot be prevented.

During the post-war period many issues were floated in London, New York, and Paris for purposes which were clearly 'unproductive'. Such loans could not be expected to earn their service payments even in terms of the currency of the borrower. Some loans, though themselves used for productive purposes, nevertheless enabled the borrowers to use other funds in their possession for unproductive purposes. Finally, there were cases in which, although no single issue could have been termed unwise for the above reasons, the total volume of issues was so great as to render ultimate transfer difficulties inevitable. It may be argued with some truth that no such issues have been floated in any capital market in recent years; but the fact remains that those who exercise control have, apparently, no means of judging whether this is the case. Any permanent system of control, an 'Investment Board' for example, should, if possible, provide itself with such means, and it should employ the following criteria when judging a proposed issue: whether the purpose of the issue is sound and is likely to be profitable to the borrower so that he can make service payments; whether the issue, even though itself used for productive purposes, is likely to enable the borrower to embark on some unsound enterprise; whether the industry in which the money is to be invested is in danger of becoming over-developed; whether the balance of payments of the borrowing country is likely to be adversely affected; and whether transfer difficulties may arise because the country as a whole has been over-borrowing.

Secondly, the British system has tended to prefer Empire and sterling-bloc borrowers; the United States has attempted to ban exports of capital to all countries that have defaulted on their war debt obligations; and the French have favoured potential allies. There may be sound arguments in support of such preferences. As regards the first, risks of war or political disturbance within the British Empire are slight, and transfer difficulties are minimized if the currencies of both lender and borrower fluctuate together. These considerations are not without force, but it is easy to exaggerate the weight which popularly attaches to them. War risks may be no higher in the case of other countries with which Great Britain has intimate commercial relations, and transfer difficulties may be slight even when the borrower's currency is not pegged to the lender's. Indeed, the chief motive which has led to the British discrimination in favour of Empire countries is not an economic but a political one: the desire to cement the political solidarity of the Empire.

Political motives are equally apparent in the cases of the United States and France.

Finally, it is very difficult for any system of control to prevent entirely the purchase by individuals of securities already issued on foreign stock exchanges. This may have three sets of undesirable consequences: it may cause a stock exchange boom in the receiving country (although this might be prevented by appropriate action in that country); it may cause the external value of the currency of the lending country to depreciate if more than the whole of the available export surplus on current account is used in this manner; and it may deprive worthy borrowers of capital, for, if a country has lent a great deal abroad by this method, the authorities may find that lending through other channels has to be curtailed. When considering a proposed new investment, the authorities must investigate the balance of payments position of the lending country, and they will be severely handicapped unless they can control all the long-term capital items in that balance. That no existing control can do this constitutes one of the most serious defects of present systems.

This discussion of state intervention has so far been concerned with that of the governments of lending countries, but control over international capital movements may also be directly exercised by the governments of borrowing countries. Certain debtor countries have, for example, established loan councils whose business it is to supervise public borrowing. The outstanding instance of this form of control has been that exercised by the Australian Loan Council.

This body was created during 1923-4 on the initiative of the Commonwealth Government in order to prevent competition in the loan market. It functioned at first on a voluntary basis, but was vested with full constitutional authority in 1928, and since that date has had power to limit the borrowings of public authorities and to impose upon them policies designed to reduce expenditure and control deficits. The Loan Council is not concerned exclusively with foreign borrowing, but with all loan operations of the States, internal as well as external. A council with somewhat similar functions has also been proposed in Canada, but the plan has met with considerable opposition from the provinces.

In Germany, the control of foreign public borrowing was at first compulsory, and a law requiring all the foreign loans of States and municipalities to be approved by the Reich Finance Minister was passed in November 1924. But this measure was resented as unconstitutional, and an Advisory Foreign Loans Council (Beratungsstelle

für Auslandskredite) was established instead, to which practically all State and municipal loans were submitted. The Council did succeed in reducing these borrowings, for the total projects submitted to it amounted to \$410,949,000, of which only \$289,444,000 or about 70 per cent. were approved. Some evasions, though probably not very substantial ones, there undoubtedly were, and the Council did not succeed in checking the increase in the volume of public indebtedness as effectively as might have been wished. Nevertheless, coupled with the warnings expressed and the supervision exercised by the Agent-General for Reparations, Mr. Parker Gilbert, the Council proved effective in a minor way. A vast amount of reckless borrowing was permitted, not because the machinery by which it could be checked was inadequate, but because those who worked the machine were not sufficiently impressed with the necessity of stopping that flow of capital which brought such tangible, if ephemeral, prosperity in its wake.

Wholly speculative schemes for which foreign capital is required can be prevented by loan councils, and they are likely to be used to prevent minor abuses of capital facilities rather than to carry out a long-term policy. A determined effort by a far-sighted loan council to restrict borrowing would be extremely unpopular, and the main function of loan councils will probably be to exert a not too strict censorship over the projects for which foreign capital is desired, and to regulate through time and to centralize for cheapness the borrowings of public authorities.

Although many governments have thought it desirable to attempt to restrict exports of capital in recent years, they have, in other circumstances, directly encouraged overseas investments of various kinds. The ways in which the state may encourage or promote overseas investments may be conveniently divided into five classes, viz.:

1. The provision of facilities whereby purchasers of a country's exports may obtain short- or medium-term credit from the exporter at reasonable rates.
2. Direct investment by the state, e.g. British interests in the Suez Canal and the Anglo-Iranian Oil Company, and the expenditure of the United States Government in Panama, as well as similar investments by all the Colonial Powers in their dependencies. Such investments are often made largely for reasons of national defence, and many of them are uneconomic in the sense that it would not pay private enterprise to undertake them.

3. The encouragement of investment in certain (non-colonial) areas for political purposes, accompanied or followed, in some cases, by the use of force to protect the investor. The pre-war loans to Russia by France were very largely political in origin, and the same country's more recent loans to members of the Little Entente were inspired by similar considerations. Some of the United States investments in Central America were accompanied by many chauvinistic acts on the part of the Taft and other administrations.
4. Loans for stabilization and relief purposes which are sometimes guaranteed and sometimes merely encouraged by the governments of the lending countries. Among these should be mentioned the Dawes and Young Loans and the League Loans.
5. The encouragement of investment in colonial possessions either by direct government guarantee of the securities of colonial governments or of private firms in the colonies, or by giving special preferences to issues of colonial securities, e.g. the Colonial Stock Acts, and the policy of the Chancellor of the Exchequer regarding overseas issues in London during the past four years.

We shall discuss export credits, stabilization and relief loans, and loans to colonies in some detail; since, however, direct investments by the state and loans for political purposes involve mainly non-economic considerations, they have been neglected. It should, nevertheless, be remembered that the economic arguments which we put forward when we consider the fourth and fifth of the above categories apply, *mutatis mutandis*, in the case of the second and third.

The reasons for the increasing importance of medium-term export credits as a method of international investment were discussed in a previous chapter. At the present time, when the risks of exchange fluctuations are very great, private institutions often find that they are unable to provide such credits. Export credits are, however, a great stimulus to industry and various governments have established departments to underwrite them, for private firms are always willing to finance a credit which is guaranteed by their own government. Facilities of this nature have been provided in Great Britain, Germany, France, Belgium, Holland, Czechoslovakia, Denmark, Japan, Austria, Norway, Sweden, Finland, Latvia, Poland, Italy, and Spain.¹

¹ For an account of the various schemes see Elia M. Shankman, *Insurance Against Credit Risks* (London, P. S. King, 1935).

In Great Britain this work is undertaken by the Export Credits Guarantee Department of the Board of Trade. This Department was organized shortly after the war in an attempt to stimulate British trade with various countries which had been forced to obtain goods from other sources during the preceding four years. Originally, its business was confined to the granting of short-term credits in respect of exports to a number of specified countries. Later, it was permitted to grant credits for exports to any country, and for periods of time up to ten years.

The Department's medium-term credit business was not, however, very large before 1931, partly because its Advisory Committee wished to move slowly in a new field, but this side of the work has become much more important in recent years. Treasury control of new issues has practically closed the market to foreign borrowers and, in addition, the depression has severely limited the number of borrowers who could present sufficiently attractive prospectuses to potential lenders. In these circumstances, medium-term credits have come to form the principal channel through which capital-importing countries finance their purchases of machinery and other producers' goods. In the case of many such countries, the risks involved have been so great as to deter private institutions, and exporters have therefore turned to the Export Credits Guarantee Department for the necessary facilities. When the foreign importer is a private firm, the risk covered is that of insolvency but, in certain cases, transfer risks are also included in the guarantee. When the importer, on the other hand, is a public authority, the risk of insolvency does not usually arise. In such cases the Department guarantees payment in sterling to the exporter: this covers the risks of default, of undue delay, and of transfer difficulties. Most of the Department's medium-term business is concerned with exports of capital goods to foreign public authorities.

There is one similarity between long- and medium-term credit operations. The Department employs criteria of the same kind as those adopted in the new issue market to determine the worthiness of a borrower, but, in other respects, there are considerable differences between the two sorts of transactions. In the first place an exports credit guarantee is given only in respect of British exports. Borrowers, in other words, are not permitted to purchase goods where-soever they will. Secondly, no direct appeal to the public is involved; the only persons concerned are the borrower, the Department, the British exporter, and the latter's financial associates. Thirdly, the amount risked at any one time under the British scheme is likely to

form only a part of the total credit, for repayment usually begins before all the goods are exported, and the exporter is able to withhold deliveries if default takes place or appears to be imminent.

The advantages of export credit guarantees over long-term capital issues arise from these differences. The former help directly to encourage British exports, and since exports of capital are correlated with exports of goods, initial exchange difficulties are minimized. Secondly, export credits may be floated at times when it would be impossible to obtain subscriptions to a new issue, because the technical conditions under which the credits are granted tend greatly to reduce the risks involved. It may be contended that these are 'depression arguments'; that they are based on the assumption that the exporting country is not possessed of a sufficiently favourable balance on current account to permit the export of long-term capital, and that export credits may become unnecessary when international trade recovers from its depression levels. This may be correct, but there is as yet no sign that export credits are becoming less important; on the contrary, improvement in international trade has been accompanied by a tendency for the number of these credits to increase more rapidly than before.

Although the Department may guarantee credits up to ten years in length, it has not usually given its guarantee for periods of more than five years. The majority of its medium-term credits appear to be for periods of two or three years, and a considerable volume of business in capital goods has been done, with Russia for example, on the basis of eighteen months' credit. This limitation of the length of the credit is a most important factor in reducing the risks involved. But another aspect of this question must be borne in mind, namely, the foreign exchange aspect. It is appropriate that a business which is purchasing capital goods with a long period of life should be able to finance them by long-term borrowing. But it does not follow that the country to which this business belongs can prudently borrow from the country which supplies the capital goods on credit of an equally long period. Whether such borrowing is possible or not depends on whether the capital expenditure is likely to improve the balance of payments of the borrowing country to the extent required for the service of the loan. This, however, is by no means generally the case, and, as has been argued in an earlier chapter, it is far less common nowadays than it was in the nineteenth century. The capital expenditure may be economically sound from the point of view of the internal structure of the borrowing country: it may earn a return, that is to say, which represents a substantial rate of interest on the sum

invested. But unless this return is of a kind which either promotes exports or replaces imports it will not thereby become any easier for the borrowing country, regarded as a whole, to remit across the exchanges the sums required to meet the service on the loan. In such a case, the prospective length of life of the capital goods is really irrelevant from the international standpoint: it can be argued that medium-term credits, which enable the borrowing country to spread its exchange remittances over several years, are the most appropriate form of international finance, and that undue strain on the resources of the borrowing business should be prevented by internal credits in the borrowing country. This is not an argument which should be pressed very far, for in many of the countries concerned internal borrowing is a matter of great difficulty, and it is seldom possible to say how far an economically sound capital expenditure is likely to improve a country's balance of payments. None the less, it supplies a reason for proceeding with caution in extending the period for which export credits are guaranteed.

During 1936 the work of the Department was extended in two different ways. Through its mechanism, a credit of £10 millions was advanced to Russia for the purchase of British exports—a proceeding which has met with some criticism on grounds of policy from the unfortunate holders of pre-war Russian bonds and others.¹ The details of this transaction are interesting. Russia agreed to place orders up to the whole amount of the credit within fourteen months and to use it exclusively for the purchase of goods (excluding munitions of war) which would give rise to a considerable amount of employment within Great Britain. For this credit the Soviet Government is to pay interest at the rate of 5½ per cent. per annum, payable half-yearly. The money will be raised by the sale to the market, after endorsement by the Export Credits Guarantee Department, of five-year 5½ per cent. notes. Since these are guaranteed by the British Government, they are sold at a substantial premium, and this premium constitutes the Department's earnings on the transaction.² Exporters who take advantage of the scheme will be paid in cash within thirty days of the shipment of the goods.

There were rumours that a similar credit was to be advanced to the Chinese Government; these were incorrect, but the Department has taken other measures to deal with the problem of credit to that country. It announced, in October 1936, the appointment of a representative in China, whose functions are to examine proposals involving

¹ Cf. *House of Commons Debates*, 4 Nov. 1936.

² The first notes were sold at a premium of about 15 per cent.

credit for the sale of British goods, to make all necessary inquiries and to forward recommendations to the Department in London. Although it has been expressly stated that it is not part of his business to secure orders for British exporters, it is very probable that his work will help to increase the demand for their goods, and although the Department has never considered it to be its duty actively to encourage British exports, this appointment may be a sign that this policy is to be modified.

These special arrangements for Russia and China are among the most interesting and important developments of the work of the Department in recent years. Other countries, however, have not been neglected and there has been at the same time a rapid growth in the amount of credits guaranteed in respect of exports to a large range of countries, including practically every country which maintains a system of exchange restrictions or is subject to an unusual degree of exchange uncertainty.

Various criticisms of the work of the Export Credits Guarantee Department have been made, and these must be considered with some care. Some exporters, for example, point to the systems in operation in other countries and say that the Department's charges are too high. This is, perhaps, true—at any rate the Department has accumulated substantial reserves—but it is officially maintained that the business of the Department is not to grant a subsidy to British exports, and that there must be an attempt to assess risks on a commercial basis as far as possible, a policy which is not followed by corresponding institutions in certain continental countries. Another complaint comes from banks and exporters, who point out that the guarantee of the Department does not cover the whole amount of the credit. Firms appear to have no difficulty, however, in obtaining credit from their bankers when up to 75 per cent. is covered by a government guarantee, and the Department believes that it is desirable that exporters should retain some incentive to fulfil the terms of their contract to the letter, an incentive which would be absent if they bore none of the risks of the transaction.

Other criticisms concern the countries to which credits are granted and the length of the credit. Most borrowers in the British Dominions and colonies and in the countries of the sterling area are able to obtain ample credit in London through the ordinary commercial channels. The Department's business has therefore been concerned principally with credits to countries which possess worse records as borrowers or which have instituted exchange control causing a consequent increase in transfer risks. It is significant that those borrowers

who have had access to the market have tended to go directly to it. There is thus a danger that the Department will find that all the good risks will be handled privately and that it will be left to furnish credit only to countries of a lower credit standing.

This danger is increased by the consideration that because the Department will only grant credits for relatively short periods the borrower is forced to make heavy amortization payments which he will endeavour to escape whenever possible by borrowing on longer terms from other sources. In many cases the shortening of the credit period must be uneconomic. A three-year credit, for example, would be inappropriate for capital goods which have a normal life of twenty years, for it would compel the borrower to repay his debt in full before he had received any substantial return from his equipment. This has two disadvantages. In the first place, it may involve the borrower in default. Secondly, if the resources of the borrower are absorbed in paying for one piece of equipment because the period of his credit is too short, he may be prevented from buying further equipment which, if his business is not to suffer, he should obtain without delay. The Department might greatly assist the development of some overseas country, and at the same time do sound business, if it could provide credits of adequate length for exports of machinery and other capital goods. If, however, as may sometimes happen, the period of the credit is too short, both the borrower and the Department may suffer. Railways, to take an extreme example, cannot be built on the basis of five-year credits. On the other hand, it must be remembered that the demand of the modern world is chiefly for less durable goods than railways; the durability of these goods must, in many cases however, be greater than the average length of the credits guaranteed by the Department.

In 1935 the Department's medium-term credit business was twice as large as in 1934, and it appears that a similar rate of progress was maintained in 1936. This represents a remarkable rate of growth and even though this rapid development is partly attributable to monetary uncertainties and difficulties throughout the world, which it may be hoped will eventually become less acute, there is no prospect of any early or substantial reaction. Moreover, there are reasons which have been elaborated in a previous chapter, for expecting that the part played by export credits in the system of international investment will tend over a long period to become increasingly important. This lends additional significance to the fact that the British export credits system is, in effect, an enterprise conducted by the state. The principle involved is criticized in some quarters and it is desirable to

consider some of the criticisms that are commonly made. It has been suggested that the Department might discriminate between exporters for non-economic reasons, and that certain firms might thereby receive undeserved advantages. Up to the present there has been no evidence of such discrimination and it seems improbable that it would ever occur. The work of the Department is supervised by a Statutory Committee of bankers and business men and, ultimately, by Parliament, so that any unduly arbitrary actions could easily be checked and remedied.

Another criticism is that the Department has usurped functions which properly belong to acceptance houses, insurance companies, and certain other institutions. At present, however, most of the Department's business could not be undertaken by private firms for two reasons. First, the risks are too high for a small institution to spread them adequately. Secondly, the underwriting of medium-term credits combines the two techniques of financing exports of consumers' goods on short-term credit and of making issues of long-term capital. Business of this mixed type is not done by private institutions in London—although this may not always be the case—and it must therefore be carried on for the time being by the Department. A Government Department must always, moreover, enjoy certain advantages over private firms in this type of business. Like any commercial institution, it must offer better services or charge less for the same services than its competitors if it is to continue to do business on its present scale. But this it can easily do. It has unrivalled facilities for the collection through diplomatic channels of information about the status of borrowers. It may, in certain cases, be able to use diplomatic pressure to secure favourable treatment of the debts which it has guaranteed. Finally, it can remain liquid on a smaller margin than a private firm since it has the whole taxable resources of the community at its back. The Department can, in fact, never become bankrupt. It appears, then, that if private firms did wish to undertake this type of business, they would find that the Department was a most serious competitor; transfer risks are, however, so great today that there is little reason to fear that the Department is taking much business away from private firms.¹

In so far as the Export Credits Guarantee Department cannot completely eliminate the risks which it bears by offsetting one against the other, there must remain a residuum of risk which is borne

¹ The establishment in Dec. 1936 of a new company—Compensation Brokers, Ltd.—which will, in effect, grant export credits to British exporters to Germany, shows that the City realizes the value of export credit business.

ultimately by the taxpaying public. At the moment, the Department has accumulated reserves which amount to about £2 millions, a considerable sum, which would be used to meet losses before it was necessary to call upon the taxpayer. (This argument is not invalidated by the fact that the Department's annual surpluses are absorbed by the Exchequer. The taxpayer now receives an unexpected windfall which he may later have to repay.) The credit of the country is pledged in order to assist export industries and thereby, it is assumed, to benefit the community as a whole. It remains to be seen, of course, whether public opinion would permit a Government Department to continue in the credit underwriting business if that business were to become unprofitable. On the whole, however, it seems likely that the Department has come to stay and that its business will continue to grow.

Direct external investment by the state for defence and similar purposes, loans for colonial development and loans to political allies are all of a type whose usefulness is determined by political and military rather than purely economic considerations. Of such criteria the economist cannot judge and, provided that his government guarantees the loans, the investor loses only in his capacity as a taxpayer if the borrower defaults. The chief criticism of such loans is the ethical one that, in some cases, e.g. French loans to Russia, the government of the lending country encourages but does not guarantee the loans, and, in the event of default, the investors are left to bear a burden which should more equitably have been carried by the taxpayers as a whole.

This argument applies also, in part, to stabilization, relief, and reconstruction loans. Of the large number of such loans which were contracted after the war, only a few are free from default at the present time. British holders of the Dawes and Young Loans still receive service payments in full in sterling, though other holders are not so fortunate, and service charges on the League Loans to Danzig and Estonia are still fully met in lenders' currencies. The League Loan to Austria has been replaced by an issue bearing a lower rate of interest and guaranteed in the same way as the original. All the rest of the League Loans are in some stage of default and many other reconstruction loans are in a like position. Thus, in only a few cases has the lender received the return which was promised him when the loan was issued.¹

This is not altogether surprising, since the risks attached to these

¹ See below, Chapter XIV, pp. 297-8 and 304.

issues were considerable, although many lenders appear to have overlooked them. In the case of the League Loan to Hungary, for example, there was a large element of risk. The issue was offered to the British public at 88 and the interest promised was $7\frac{1}{2}$ per cent., so that the yield to maturity (twenty years) was about £8 16s. per cent. On the day that the issue was offered (2 July 1924) the price of Consols was $56\frac{1}{4}$, giving a yield of about £4 8s. per cent. and, if these may be assumed to be riskless securities, the risk premium on the Hungarian Loan was therefore about £4 8s. per cent. The issue was heavily over-subscribed, and there were a 'large number of applications from small investors' many of whom 'enclosed currency notes or bank notes in payment of the application money'.¹ Thus it appears that most of the subscribers to the issue, a number of whom were 'not altogether used to investment', thought that this was an over-estimate of the risk involved (for it cannot be assumed that the small investors deliberately preferred a loan of such a risky nature). This is to be explained partly by the belief that the loan, being under the auspices of the League, was also guaranteed by the League, which, as an international organization of states, was assumed to be at least as creditworthy as the soundest of its constituent parts. There was, further, a belief that the loan was, in effect, guaranteed by the governments of the lending countries, as the Austrian Loan had been. This belief was fostered by such statements as the following by the City Editor of *The Times*:

'A well-informed correspondent points out that although the loan is not guaranteed by any of the Allied Governments, as was the case with the Austrian issue, the reparation and relief bond charges still exist, though these, of course, are subordinated to the service of the reconstruction loan, which has a definite priority over every other obligation of Hungary. The existence of these second charges—reparations and relief loans—means that a number of creditor Governments are vitally interested in the recovery of Hungary, and it may be assumed that these creditors will support the League in the enforcement of the obligations which Hungary has assumed. In this sense, our correspondent says, the position is theoretically almost as strong as if these Governments had given guarantees.'²

A further explanation is that the subscribers to the loan were very anxious to assist 'in the great work of European reconstruction'; but much stress cannot be laid on this factor, since it can hardly be assumed that the larger investors, at least, were greatly influenced by philanthropic considerations.

¹ These quotations are from *The Times*, 'City Notes', of 3 July 1924.

² 3 July 1924.

There appears to be *prima facie* evidence that the British investing public was induced to make an unduly low subjective estimate of the risks involved in this issue¹ and that, although the Government took no active part in this propaganda, it gave its implied approval. If this is the case, it would have been better if the issue had been guaranteed by the Government, and better still if the loan had been made directly by the governments of the lending countries. It is in the interests of the whole nation that less fortunate countries should be assisted in their endeavours to restore a semblance of economic equilibrium. If, then, the loan is unsuccessful, the individuals who contributed to it should not be made to suffer alone. If the government of the lending country is directly interested, the public as a whole bears the burden of failure, just as it would reap the benefit of success. Like the other types of loans mentioned at the beginning of this section,² stabilization and relief loans, which are never intended primarily to be used for the purpose of purchasing or erecting revenue producing assets, are best made, not by private individuals, but by governments.

There is a further argument in support of this conclusion. If, as is usually the case, the commercial risk premium required on loans to states which need foreign credit for reconstruction purposes is high, the cost of their borrowing may be considerably reduced if the loan is guaranteed by the government of the lending country. This reduction in the cost of the loan will, in itself, reduce the risk involved, since the borrower may be able more easily to obtain the supplies of foreign exchange necessary to meet service payments, and will therefore be more likely to avoid default. Both ethical and economic considerations, therefore, lead to the conclusion that, unless a reconstruction or stabilization loan can be raised on ordinary commercial terms at reasonable rates, it should be guaranteed by the government of the lending country.

The government of a creditor country, by giving special privileges to owners of certain classes of securities issued by overseas borrowers, can stimulate investment in such securities and thereby enable the issuer to borrow more cheaply. In Great Britain this has been done

¹ These risks were not entirely overlooked, however, for *The Economist* stated: 'The yield, allowing for redemption in twenty years, works out at approximately £8 16s. per cent. This is a high yield and indicates to some extent the measure of risk involved' (5 July 1924). But compare this with *The Times*, 2 July 1924: 'The other prominent feature is the high yield obtainable on the issue. Owing to the scarcity of capital, all European loans have necessarily to give a good yield, but, in view of the type and class of this security, the return on the loan must be regarded as generous.'

² See above, p. 94.

by giving trustee status to certain Dominion and colonial issues. The relevant statutes are the Trustee Act, 1925, and the Trusts (Scotland) Act, 1921. These Acts permit trustees to invest, *inter alia*, in any capital stock issued by the Secretary of State in Council of India or any other securities, payable in sterling, which are an obligation of the Government of India; in certain government-guaranteed, Indian railway securities; in stocks, funds, or securities authorized under the Colonial Stock Acts, 1877 to 1934; and in any securities the interest on which is for the time being guaranteed by Parliament.

The Colonial Stock Acts permit the securities of Dominions and colonies to be registered as trustee securities, provided that the Dominion or colony concerned complies with certain conditions. The chief of these is that the Imperial Government shall have the power to veto any Dominion or colonial legislation which appears to be disadvantageous to the holders of the securities.¹ In accordance with the provisions of these Acts, a large number of governments have issued securities in London. The outstanding total of these in January 1936 was about £858 millions.² In addition, a number of governments have, at various times, issued securities which are

¹ After the passing of the Statute of Westminster the British Government, at the request of the Union of South Africa, obtained statutory authority to accept, in lieu of a statement that legislation tending to prejudice the interests of stockholders might be disallowed, a statement confirmed by South African legislation in which that Dominion would undertake to submit such legislation for the Royal Assent only after agreement with the British Government had been reached, and would promise to obtain such amendments as might be necessary to legislation that had been passed inadvertently. The Governments of Canada, Australia, and New Zealand have informed the British Government of their willingness to abide by the original condition which, though anomalous in constitutional theory, is regarded as a business obligation that does not detract seriously from equality of status.

² These had been issued by the following governments:

Australia	Jamaica	Sierra Leone
British Guiana	Kenya	South Africa
British Honduras	Mauritius	South Australia
Canada	Natal	Southern Rhodesia
Cape of Good Hope	Newfoundland	Straits Settlements
Ceylon	New South Wales	Tasmania
Cyprus	New Zealand	Trinidad
Federated Malay States	Nigeria	Uganda
Fiji	Northern Rhodesia	Victoria
Gold Coast	Queensland	Western Australia

Northern Rhodesia and Uganda, being protectorates, come within the provisions of the Colonial Stock Acts by virtue only of Orders in Council under section 3 of the Colonial Development Act, 1929. By Order dated 1 Oct. 1935, the said provisions are made to apply, subject to certain modifications, to stock issued after the passing of the last-mentioned Act and forming part of the public debt of the Federated Malay States. (*Stock Exchange Year Book*, 1935, pp. 3429-31.)

guaranteed either wholly or in part by the British Government. At the end of 1935 there were about £59 millions of long-term securities of this nature outstanding.¹ Finally, there were, at the same time, outstanding trustee securities of the Government of India to the value of £293 millions, and of Indian railways, £25 millions. The total of these outstanding trustee securities of Dominion, colonial, and foreign borrowers was, therefore, about £1,235 millions, to which must be added a small amount for colonial borrowing through the Local Loans Fund. Default has only occurred on a small fraction of this amount. In no case have the investors suffered, and no Dominion or colony has defaulted. This is a quite remarkable record and appears to justify the preferences given in this way to Dominion and colonial borrowers.

Because their securities had trustee status, most Dominions and colonies were able to borrow more cheaply in London than would otherwise have been the case.² Unfortunately, this led to some abuse, for, although no default occurred, it was evident in 1929 that Australian governments had borrowed considerably more than was warranted by their economic position. This sort of difficulty may often arise if particular types of investment are fostered or discouraged for political or sentimental rather than economic reasons.

It is not easy to determine what part a state can or should play in attempting to collect debts which are owed to its nationals by foreign states. Each case has to be judged on its merits, and is usually decided in terms of expediency. If, of course, lenders know in advance that their government will intervene to assist them if their debtors default, the risks which they bear are greatly diminished.

In the nineteenth century, when Great Britain was the principal international lender, her Government usually adopted the traditional *laissez-faire* attitude towards foreign (as opposed to colonial) investment. This is typified by a circular sent by Palmerston to the British diplomatic representatives abroad in 1848: 'The British Government', he said, 'has considered that the losses of imprudent men who have placed mistaken confidence in the good faith of foreign governments would prove a salutary warning to others, and would prevent any other foreign loans being raised in Great Britain, except

¹ The governments of the following countries were the borrowers:

Austria	Mauritius	Sudan
The Egyptian	Newfoundland	Tanganyika
able on the	Nyasaland	Transvaal
necessarily	Palestine	Turkey
Free State		

security, etc.
² See above, Chapter X, pp. 135-7.

by governments of known good faith and ascertained solvency.¹ But the Government did not always rigidly adhere to such a policy, for Palmerston on one occasion sent a note to a defaulting country stating 'that the patience and forbearance of H.M.'s Government . . . have reached their limits, and that if the sums due to the British . . . claimants are not paid within the stipulated time and in money, H.M.'s Admiral commanding on the West India Station will receive orders to take such measures as may be necessary to obtain justice from the — nation in this matter'.²

There have been other instances in the past of the use of force or threats of force by a strong creditor country against a weaker debtor; but the situation has been very different in recent years. Whether through increased goodwill, lack of opportunity, or other reasons, attempts to recover international debts through direct coercion have almost entirely disappeared. The recent depression has caused new methods to be invented. Economic rather than political pressure has been used to force debtors to meet their obligations. The significant feature of this is, since some countries are in a much stronger economic position than others, that the principle that all holders of a loan should be treated alike has been ignored. If this is to continue in the future, it will have most profound effects on the trend of international investment.

The operation of the new methods may be illustrated by reference to the German debt negotiations.³ In the middle of 1933 the German Government announced a moratorium on the transfer of interest payments on Germany's foreign debts. After negotiation between the creditors and Dr. Schacht, President of the Reichsbank, an agreement was reached by which, in effect, the foreign creditors received payment in foreign currencies equivalent to 75 per cent. of the amount due. This arrangement did not, however, satisfy the Dutch or the Swiss, and, since Holland and Switzerland import much more from Germany than they export to her, they were able to insist on more favourable terms in return for trade concessions. Protests were made, and some concessions were secured by other creditors, but the discrimination remained.

¹ Max Winkler, *Foreign Bonds*, p. 136, quoted by A. K. Cairncross, 'Did Foreign Investment Pay?' in *The Review of Economic Studies*, October 1935, p. 67.

² Hartslet, *Recollections of the Old Foreign Office*, p. 84, quoted by Cairncross, *loc. cit.*

³ this see C. R. S. Harris, *Germany's Foreign Indebtedness* (Oxford City Press for the Royal Institute of International Affairs, 1935), pp.

Great Britain had joined in the protest against discrimination, but in due course she demanded discriminatory treatment for herself:

'On the 15th June, some two weeks after the conclusion of the Berlin Conference, Germany declared a six months' moratorium, expiring 31st December, 1934, on all Long-term and Medium-term debt, including the Dawes and Young Loans. This action called forth a prompt and strong reply from the British Government and led to the passing of legislation empowering the Government in case of necessity to set up a Clearing Office as a means of securing fair treatment of British Nationals. At the same time, the British Government invited Germany to send a delegation to London to discuss matters. This invitation was accepted and on the 4th July the terms of an Anglo-German Transfer Agreement were announced whereby in consideration of the British Government agreeing not to set up a Clearing Office, the German Government undertook to pay full interest on Dawes and Young Bonds in beneficial ownership of British holders on 15th June, 1934, and, in respect of non-Reich debt, to honour the agreement reached at the Berlin Transfer Conference in the previous May. This understanding with the British Government came into force as from the 1st July and had a currency of six months. It is worthy of note that nationals of those countries which have not made special arrangements with Germany are at present receiving only part payment of their Dawes and Young coupons.'¹

There can, of course, be no objection to state intervention in the case of a loan which was encouraged by the government when it was issued, and it has already been shown that it is usually best for the government to take a direct part in such loans, in which case it has a perfect right to do all it can to protect its own interests. But in general, if the state is to be expected to help investors in time of crisis by bringing pressure to bear on foreign debtors, its right to veto dubious issues before they are made must be acknowledged. State control over new issues has already been discussed, and the opinion was advanced that it should be exercised only in rather urgent circumstances and, conversely, the state can only be expected to intervene for the collection of debts in a few cases. Such intervention may, however, be expected to continue, since, if it is successful, it is very popular in countries in which the interests of the rentier are predominant.

Political or military considerations may, then, force a state to intervene to encourage or to discourage particular types of long-term

¹ Council of the Corporation of Foreign Bondholders, *Report for 1934*, p. 35. This arrangement has been renewed from time to time and is now in force until 30 June 1937. It has, however, been the subject of much recent criticism in Great Britain.

overseas investment by its nationals. From the economic point of view, such intervention often has unfortunate results, although it may be justified for non-economic reasons. The intervention of the state may, however, be beneficial if it is part of a policy designed to secure equilibrium in the balance of payments or to maintain exchange stability by international agreement. State control of the activity of the capital market may also be beneficial if its result is to eliminate abuses such as prevailed in New York a few years ago. Finally, in borrowing countries, the state may prevent unwise borrowing from abroad and may thus help to preserve exchange stability. It is unlikely that under modern conditions state intervention in the field of international investment will diminish very much, but one can at least point out that if it were used only for the purposes just mentioned, it would probably be more beneficial in the long run than the indiscriminate intervention of the past.

CHAPTER VIII

CONCLUSION

'As it is the power of exchanging that gives occasion to the division of labour, so the extent of the division must always be limited by the extent of that power, or, in other words, by the extent of the market. When the market is very small, no person can have any encouragement to dedicate himself entirely to one employment, for want of the power to exchange all that surplus part of the produce of his own labour, which is over and above his own consumption, for such parts of the produce of other men's labour as he has occasion for.'¹

BOTH in creditor and in debtor countries, the problems of international investment are often misunderstood. Extreme views, diametrically opposed to each other, are frequently advanced. There are, on the one hand, those who believe that international movements of long-term capital are always undesirable, and, on the other, those who regard a large annual flow of capital between different countries as an essential feature of a healthy economic system. The former hold that exports of capital deprive the industries of the lending country of the means of obtaining the necessary factors of production and thereby tend to lower the standard of living, that sums lent abroad are nearly always lost in the long run, that they stimulate unsound economic developments in the borrowing countries, and contribute generally to international friction. The latter maintain that it is impossible to raise the standard of living in industrial countries without international investments which enable raw materials and foodstuffs to be obtained more cheaply from the borrowing countries, and that debtor countries can never develop their export industries sufficiently to enable them to buy the products of the industrial nations without the use of capital from external sources. Public opinion is confused by such extreme statements, for the protagonists seldom meet on a public platform and neither side is ever forced to concede that the other may be even partially right.

We hope that this survey will have shown that both these extreme views are false and that the correct approach is a middle road. There has undoubtedly been a certain amount of unwise lending and unsound borrowing in the past; but, taken as a whole, the overseas investments made by Great Britain during more than a century have been profitable to investors and advantageous in a larger sense both to the lending and borrowing countries. Much of the post-war lending of British and American investors is now earning no return; but the losses which they have suffered may easily be

¹ Adam Smith, *The Wealth of Nations*, Book I, chapter 3.

exaggerated. Many overseas investments have been more successful than some of the post-war investments in domestic industry, for example. Again, many of the loans that were made in the earlier part of the period to the countries of central and eastern Europe, though they have proved disappointing to the investor, filled none the less an invaluable social function. They enabled these countries to recover from the devastation of the war and to regain a measure of international stability far more quickly than would have been possible without this aid. Reconstruction lending cannot be condemned outright by those who bear in mind the possible alternatives of widespread social disorder and human suffering which would have occurred if the war-stricken countries had been left to recover as best they could without foreign aid. Moreover, even in the light of after-knowledge, it does not appear to be a foregone conclusion that the investor in reconstruction loans should have suffered the losses that have fallen upon him. Given a slightly more favourable conjunction of political and economic circumstances, the sequel might have been very different.

The dynamic economic world of the future will present innumerable opportunities for new industrial development in different countries, and so long as the savings available to finance such progress are unevenly distributed between countries, international investment must play an important part in world economics. Provided that the investment takes forms suitable to the circumstances of each particular case and that the limiting conditions connected with the balances of payments of creditor and debtor countries are observed, there is no reason to deprecate and every reason to encourage it.

But the economic world of to-day and the immediate future is and will be different in many ways from that of the past, and these differences may be expected to have considerable effect on the direction and volume of new international investment. One of the most fundamental changes which may be expected to occur soon is the reversal of the trend of increasing populations in western Europe and North America. There will tend to be a decreasing number of mouths to be fed, which, even if they are fed better, must have serious effects on food-producers all over the world. The products of some of the largest debtor countries are primarily foodstuffs and such a change is bound to have serious repercussions on their principal export industries.

On top of this, there has been a revolution in agricultural technique which has greatly increased the efficiency of the factors of production employed. Food-producers in both debtor and creditor countries are now able to produce larger quantities of foodstuffs with the same

amount of labour and capital. This has been one of the important causes of the present low levels of prices of these commodities. Food-producers in debtor countries, then, are faced both with a less rapidly increasing demand for their products than they experienced in the past and with much more serious competition, which keeps down the prices at which they have to sell their output.

Finally, creditor countries—Great Britain in particular—and other large importers of raw materials and foodstuffs, especially the countries of western Europe, have all attempted in recent years to make themselves less dependent upon foreign sources of supply. The economic reasons for this attitude are three in number: the desire to find employment—even at uneconomic tasks—for all their own citizens; the desire to be able to produce all essential commodities, or substitutes therefor, at home in case of war; and the desire to conserve the scanty proceeds from their exports for the purchase of the materials needed for armament purposes. Economic nationalism, then, is a further factor tending to diminish the value of the exports of many debtor countries. In its most extreme aspects, it may be merely a passing phase; but it is bound to remain important for many years to come.

But any factors which tend to restrict the exports of debtor countries, tend *ipso facto* to diminish the opportunity of profitable investment in those countries. Interest can only be paid to external creditors in the long run by exports of goods or services, but few debtor countries are large exporters of services, and if their exports of goods are unlikely to expand they will find difficulty in meeting increased external obligations except by curtailing the volume of their imports. New investment in such countries will be unsound, except in so far as it makes possible economic activities which provide, directly or indirectly, the foreign exchange necessary for interest payments.

Considerations of their positions on international account will also affect the creditor countries. Compared with pre-war years, Great Britain's exports have very seriously diminished, and many overseas markets are now lost for ever to British exporters. In particular, Britain's income from her exports of cotton goods, of coal, and of shipping services, and from her overseas investments has fallen very heavily. Moreover, the present rearmament programme tends further to diminish her exports and to increase her imports. It is difficult to imagine how these losses can be made good in the long run; it is impossible in the short. The amount of foreign exchange obtained by British exporters is thus much smaller than it was some years ago,

whereas that required by importers has not declined by nearly so large a proportion. The result is that Britain's export surplus on current account is very considerably smaller than it was even in pre-depression years. In other words, the volume of foreign exchange available to would-be British investors is smaller, and unless these investors restrict their activities correspondingly, they will bring trouble both to themselves and to the world as a whole. Although the process of lending may itself create some exports, there is no guarantee that it will do so to an extent commensurate with the full amount of the capital exported, and at a time when the demand for armaments is absorbing the attention of industry in the lending country, there is every probability that capital exports will be used to purchase goods, not from Britain, but from other countries.

A similar situation has arisen in France. French exports of manufactured goods diminished very considerably between 1930 and 1936, and there is little hope that they will soon expand to their former dimensions, partly because former purchasers of these goods are now producing them at home behind tariff walls, partly because effective substitutes (such as rayon for silk) have been developed, and partly because many markets have been captured by other producers who can manufacture more cheaply. Great Britain and France, then, can only lend abroad on a substantial scale if they either increase their exports of goods and services or borrow the foreign exchange required by their investors. The former is likely to occur only to a limited extent, and the latter would most probably end in disaster.

The position of the United States, the other great creditor country, is in this respect different from that of Great Britain and France. Although the United States export surplus on current account has been diminishing, it is still sufficient, and is likely to remain sufficient, to permit a fairly substantial volume of long-term foreign lending. Yet, paradoxically enough, the United States has been a net importer of long-term capital since 1931. Her small exports of new capital through new issues and purchases of foreign-owned securities have been more than offset by the repurchases by foreigners of the securities which were issued in the United States on their behalf in the past, by the purchases by British and other investors of American industrial securities, and by amortization and sinking-fund receipts. The psychology of American investors imposes a formidable obstacle to long-term capital exports by the United States, and one, moreover, which may remain formidable for some time to come. Americans had purchased foreign bonds only to a negligible extent before 1924, and the subsequent experiences of many of them were unfortunate.

Although default (including partial default) on interest payments affects to-day less than 40 per cent. of the total outstanding foreign dollar bonds, the publicity which defaults have received has turned the experience of the few into an object-lesson for the many, and American investors will probably continue to prefer American securities, even though the returns from such investments are considerably smaller than those offered by foreign borrowers.

There are, thus, three forces which are now operating and which may be expected to continue in the future in such a way as to keep down the volume of new international investment. The first will tend to make investments in primary-producing countries less remunerative than in the past and so to discourage new investors; the second will limit the volume of new investment which may safely be made by Great Britain and France; and the third will restrict the activities of American investors. These are the general conclusions reached by this survey regarding the influences which may be expected to act upon the quantity of new international investment in the future; but there may also be qualitative differences between the past and the future and these must also be recapitulated.

In earlier pages these differences have been divided into two groups: those connected with the channels through which new investment will be conducted, and those which arise out of the present-day attitude of governments towards economic activity, but this distinction is not always very clear and it will not be necessary rigidly to adhere to it.

The most important channel for new investment in the past has been the new issue market; the relative importance of this channel seems, however, likely to decline. There are three other types of international investment which will, to a certain extent, tend increasingly to replace issues of long-term securities by external borrowers in New York and London.

The first are exports of capital by corporate rather than private individuals, i.e. 'direct' investments. These are likely to be favoured by investors in the future for several reasons. One of these is operative mainly in Great Britain, but also, to a lesser degree in the United States and France as well. In so far as the governments of lending countries find it necessary to control exports of capital for any reason, that control must be most effective in the case of new issues and it may be found very difficult to prevent new direct investments, especially those which are made by the process of 'ploughing back' profits to reserve, although attempts to regulate even this are being made in the United States. Moreover, that economic nationalism to

which reference has already been made is especially favourable to such investment, because it causes the erection of high tariff walls in order to prevent imports of foreign goods and thereby offers an opportunity to the manufacturers of such goods to establish a factory for their production behind the tariff. A further encouragement to 'direct' investment is to be found in the attitude of American investors towards foreign securities. They will prefer new issues by American companies, even when the capital so raised is to be used in foreign countries, to new foreign securities, and in this they will be supported by the present legal restrictions upon foreign borrowing in the United States.

Secondly, medium-term credits may be expected to continue partly to displace long-term capital raised through the new issue market. The most important advantage to be derived from the use of medium-term export credits is that exports of capital are directly correlated with exports of goods so that the process of lending imposes no strain upon the exchanges of either borrower or lender. From the lender's point of view, moreover, they are welcomed because the technical conditions under which they are granted, even without a government guarantee, are such that the risks attached to the transaction are relatively small. When, in addition, a large part of the value of each credit is guaranteed by the lender's government, this form of capital export becomes even less risky. Finally, medium-term export credits are convenient to borrowers, despite the heavy amortization charges, because debtor countries no longer require large amounts of the most durable forms of capital goods which can only be financed by long-term capital. They require, in the main, goods which can be purchased without undue strain with credits of less than ten years in length.

Thirdly, exports of capital by means of the purchase of securities already issued on foreign stock exchanges are and may be expected to be increasingly important. There were, of course, movements of securities between European centres even before 1914; but in recent years such movements have been taking place on a scale so large at times as to dwarf the international movements of capital through other channels. They have taken the form, chiefly, of French purchases in London and New York during the flight from the franc, and of British purchases in New York of both American and foreign dollar securities. As far as Great Britain is concerned, the exports of capital which are at present taking place by this method are the result partly of the Treasury control of the new issue market which prevents exports through that channel, and partly of the increasing

commercial activity in the United States which is expected to cause a considerable appreciation in the market values of American industrial securities. So long as there are important differences in the possibilities of capital appreciation and the rates of interest to be expected from investments in different countries (making due allowance for differences in risk), capital will flow between such countries, and if it is prevented from flowing through the channel of the new issue market, it will go in the first instance to those countries in which an organized capital market exists. Both private and institutional investors will seek by these means to increase their incomes, and the resources of insurance companies and investment trusts are now so large that it may be assumed that very considerable quantities of capital will move from centre to centre by this method.

Under the conditions which we expect to be present in the future, 'direct' investments and medium-term credits have a definite and useful part to play. Even though there is no longer any opportunity to employ large sums of money in the opening up of new territories, capital equipment may be required on a smaller scale for the development of industries or for public works projects, and it can often, with advantage to both borrower and lender, be obtained by one or other of these two methods rather than through the new issue market of the lending country.

But the same advantages cannot as a rule be claimed for the international movement of securities. Such transfers have usually involved a movement of capital into countries which are abundantly supplied with savings and have no need whatever to borrow from abroad. These transactions may, moreover, involve a movement of capital from countries whose balances of payments on income account are too weak to permit of large capital exports and may serve thereby to undermine the stability of the international monetary system. It is true that a large movement of capital from one stock exchange to another is likely to be followed in due course by a movement in the opposite direction and such movements may help to preserve rather than destroy international equilibrium. None the less, the rapidly growing traffic in international securities is fraught with serious dangers.

Finally, we have noted the new position of the state in regard to international investment. Governments all over the world, in both borrowing and lending countries, have felt it necessary in recent years to control and regulate the volume and direction of new investment activity. State control of the new issue market and of capital exports through other channels, and state control of borrowing

through loan councils have come to stay. The continued attempts of the governments of so many countries to perfect their systems of control is deprecated by many, and sound arguments can be advanced in support of their views. But these attempts constitute a recognition of the difficulties in the way of the international investors of the future and of the pitfalls which must be avoided if international movements of capital are not to end in disaster. It cannot, of course, be assumed that governments possess a greater degree of foresight than individuals, but the fact that government control is necessary must be a warning to investors to exercise more care than they have been accustomed to do in the past.

The key to the economic progress of the nineteenth century was the development of international trade based on international specialization, i.e. division of labour between nations. In this development, large-scale international investment played an essential part; without this investment the present standard of living throughout the world could not have been attained. The tendencies of the present day are unfriendly, however, to a further extension of the international division of labour. In part, as the argument of this book suggests, these tendencies reflect the fact that the mutual advantages which further international specialization has to offer are less conspicuous than they formerly were. In part, the tendencies may be attributable to the present disposition throughout the world to subordinate economic considerations to those of national security. But, whatever the explanation, the force of these tendencies is indisputable and the scope for international investment, the primary function of which has been to stimulate the growth of international trade, is correspondingly reduced. So long, indeed, as some countries are rich and highly developed while others are poor and ill-equipped with capital, international investment will have a valuable and constructive rôle to play. But, under the new economic conditions which have been examined in this volume, it becomes increasingly important that it should be conducted with care and through appropriate channels.

PART II

CHAPTER IX

PRE-WAR INTERNATIONAL INVESTMENT

THE extent to which the principal creditor countries had invested capital overseas before 1914 is not easily measured statistically. Some attempts to do so have been made, notably by Dr. Herbert Feis,¹ by C. K. Hobson,² and by L. H. Jenks,³ from whose books many of the estimates in the present chapter have been taken. As their authors would be the first to admit, these estimates are subject to a wide margin of error. They do, however, help to present a picture of the importance of international investment during the period when its advantages were most marked.

Great Britain.

In the field of overseas investment, Great Britain was by far the largest lender, and there were three main reasons for her dominance. In the first place, the industrial revolution had come earlier to Great Britain than to any other country, and she had been able to concentrate more and more on the production of manufactured goods, and to import an ever-increasing proportion of her requirements of primary products from overseas. Secondly, years of expanding internal activity and of political peace had enabled the savings of her people to increase, and had provided an incentive for the growth of a capital market in London which became, in a remarkably short period, more important in world finance than the older centres of Hamburg and Amsterdam. Finally, her overseas Empire provided a field for investment in which the risks were considered to be lower than in other areas, partly because political control was retained by the home government, and partly because the uses to which the capital was put were determined by British engineers and British managers and the requirements of British law.

It is very difficult to estimate the extent to which British investors had purchased overseas assets in the early years of last century. Some data are, however, available: Jenks, for example, gives British investments in European securities at £57 millions at the end of 1825;⁴ in 1824 *The Times* estimated that £47,815,000 had been lent by

¹ *Europe, the World's Banker, 1870-1914*, published by the Council on Foreign Relations (New Haven, Yale University Press, 1930).

² *The Export of Capital* (London, Constable, 1914).

³ *The Migration of British Capital to 1875* (New York, 1927).

⁴ Jenks, *op. cit.*, pp. 356-7.

Great Britain to foreign governments;¹ and in 1830 a letter to *The Times* suggested that about £5 millions had been invested in trade with Latin America, and that mines and governments in this area had absorbed £48 millions and £17 millions respectively of British capital.² From this data it is, perhaps, permissible to infer that the total of British overseas investments between 1825 and 1830 was probably not more than £100 millions.

In 1843 the nominal value of certain types of securities quoted on the London Stock Exchange was as follows:

*Nominal Value of certain quoted Securities, 1843**

	£
Loans to foreign governments and American States	121,501,410
East India Company	6,000,000
South Sea Company	3,662,734
24 foreign mining companies	6,464,833

* From A. F. Spackman, *Statistical Tables of the United Kingdom and its Dependencies* (London, 1843), quoted by Jenks, op. cit., p. 373.

Spackman also gives the nominal value of investments in seventy railway companies as £57,447,903; but he does not, unfortunately, distinguish between home and foreign undertakings. Taking these into consideration, the total of overseas investments at this date would not have been less than £150 millions.

For the year 1854 Jenks has made the following estimate of British overseas investments. It will be noted that his total of £195-230 millions is much lower than Professor Bowley's estimate of £434 millions for this date. It seems fairly clear, from earlier and later estimates, that Professor Bowley's figure is too high.

*British Overseas Investments, 1854**

	£ millions
United States	50-60
French, Belgian, Dutch, and Russian government securities	45-55
Spain and Portugal	35-45
Latin America	35-40
French railways	25-30
Belgian railways	5
Total	195-230

* Jenks, op. cit., p. 413.

The next available estimates relate to the end of the 'seventies. Giffen in 1878 estimated that the total of British overseas investments

¹ *The Times*, 24 Oct. 1824, quoted by Jenks, loc. cit.

² *Ibid.*, 10 May 1830, quoted by Jenks, loc. cit.

was £1,300 millions. The figure given by Nash for 1880 is slightly lower; his estimate was:

British Overseas Investments, 1880^a

	<i>£ millions</i>
Foreign government loans and guarantees	500
Railways in Europe, the United States, and South America	240
United States Debt	200
Indian Railways	90
Indian Debt	70
Colonial government loans	50
	<u>1,150</u>

^a Jenks, *op. cit.*, p. 413.

To this must be added a considerable sum for mining and other investments which have been omitted.

From the foregoing, and from later estimates by Hobson¹ and Feis,² the following table has been constructed:

British Overseas Investments

	<i>£ millions</i>
1825-30	100
1843	150
1854	210
1880	1,300
1885	1,302
1895	1,600
1905	2,025
1909	2,332
1913	3,763

There was, of course, little overseas investment in the latter part of the 'seventies,³ and the great increase between 1854 and 1880 must therefore have taken place in the 'sixties and early 'seventies. The two following tables show that this was the case, and give some indication of the types of securities which most attracted the British investor at this time:

¹ *Op. cit.*, p. 207.

² *Op. cit.*, p. 23.

³ The following description of the depression of the later 'seventies is of interest. With a few slight changes it might be made to describe much more recent events: 'Trade became stagnant. The continued accumulation of capital was allowed to glut the money market causing the Bank of England rate to remain for a long period at 2 per cent.; or was invested in gilt-edged securities, the price of which was driven steadily up. Municipalities (and railway companies) at home found borrowing a pleasant diversion, and loans were issued to large amounts. British foreign investment, it is true, was not suspended in every direction in this period. . . . In general, the purposes for which loans were required were carefully scrutinized and good security insisted on. . . . But even during the depression there was a considerable amount of speculative activity which manifested itself especially in South African and West Australian gold mining shares.' (Hobson, *op. cit.*, pp. 150-1.)

Issues for Overseas Borrowers in London, 1860-76^a(*£ millions*)

	<i>European government loans</i>	<i>Colonial and Indian loans (including guaranteed railway securities)</i>	<i>Foreign and Colonial railways and other companies</i>	<i>Total</i>
1860 . . .	5.8	13.2	6.7	25.7
1861 . . .	0.6	12.7	4.8	18.1
1862 . . .	22.5	12.4	7.4	42.3
1863 . . .	8.9	7.9	12.9	29.7
1864 . . .	13.5	5.4	14.2	33.1
1865 . . .	22.0	9.6	20.9	52.5
1866 . . .	8.0	11.6	11.0	30.6
1867 . . .	11.4	9.4	6.5	27.3
1868 . . .	22.1	11.9	9.7	43.3
1869 . . .	20.1	10.8	8.8	40.7
1870 . . .	35.0	6.4	9.8	51.2
1871 . . .	40.1	4.9	15.3	60.3
1872 . . .	43.3	2.6	31.2	77.1
1873 . . .	16.5	4.8	29.8	50.1
1874 . . .	27.0	17.7	26.0	70.7
1875 . . .	20.4	13.0	10.6	44.0
1876 . . .	3.5	7.6	6.4	17.5
Total . . .	320.7	159.9	232.0	712.6

^a Jenks, *op. cit.*, p. 425.*Issues of Private Companies Operating Abroad, London, 1860-76^a*(*£ millions*)

	<i>European private railways</i>	<i>Colonial railways</i>	<i>United States railways</i>	<i>South American railways</i>	<i>Other foreign companies^b</i>	<i>Total</i>
1860 . . .	1.8	1.2	1.0	0.9	1.8	6.7
1861 . . .	2.3	0.1	..	1.3	1.1	4.8
1862 . . .	3.0	0.3	..	0.2	3.9	7.4
1863 . . .	4.0	..	0.2	0.4	8.3	12.9
1864 . . .	2.7	0.3	1.3	0.6	9.3	14.2
1865 . . .	4.6	..	2.7	1.0	12.7	20.9
1866 . . .	1.3	0.1	2.0	0.7	6.8	11.0
1867 . . .	2.2	..	1.0	0.4	2.9	6.5
1868 . . .	5.2	..	1.6	1.1	1.7	9.7
1869 . . .	3.3	0.3	1.8	0.5	2.9	8.8
1870 . . .	0.5	0.5	3.9	0.1	4.5	9.8
1871 . . .	0.9	1.0	6.1	1.3	5.9	15.3
1872 . . .	1.1	1.2	12.0	3.2	13.7	31.2
1873 . . .	0.2	2.7	14.3	3.2	9.2	29.8
1874 . . .	0.8	2.4	14.3	2.8	5.6	26.0
1875 . . .	0.4	1.1	4.7	1.3	3.4	10.6
1876 . . .	0.1	0.5	3.6	0.1	2.0	6.4
Total . . .	34.4	11.7	70.5	19.1	95.7	232.0

^a Jenks, *op. cit.*, p. 426.^b Jenks comments: 'Of the "Other foreign companies" it may be noted that the bulk of these were to do business in Europe or the Near East. However, while in the 'sixties the remainder were mainly located in some part of the British Empire, in the 'seventies it was the United States and South America which ranked after Europe as a field of opportunity.'

In the earlier years of the nineteenth century, British overseas investment was directed mainly towards the continent of Europe, where it hastened the industrial revolution; but with the development of this area, and the increasing opportunities for investments farther afield, the British investor began, after 1870, as is clearly shown in the above tables, to pay more and more attention to the undeveloped countries of the world. By 1914, therefore, British investments in Europe formed only 6 per cent. of the total overseas investments, whereas the great agricultural producing countries, Canada, the United States, Argentina, Australia, New Zealand, and India, had absorbed respectively 14 per cent., 20 per cent., 9 per cent., 11 per cent., and 10 per cent.

Statistics of the yield on overseas investments show the forces which caused British investors to alter the distribution of their holdings in this manner.

Yield on British Overseas Investments, 1870-80^a

A. Governments Bonds

Bonds of	Market value £ millions	Total annual yield ^b	
		£ millions	Per cent.
United States	160	12.00	7.5
India	55	2.42	4.4
British Colonies	50	2.70	5.4
Russia	50	2.95	5.9
France, Holland, &c.	30	2.10	7.0
Turkey	20	-0.40	-2.0
Egypt	17½	0.96	5.5
Peru	17½	-1.05	-6.0
Spain	15	0.50	3.3
Brasil	11	0.69	6.2
Italy	7½	0.90	12.0
Portugal	6	0.87	14.5
Argentina	5	0.33	6.6
Chile	4	0.19	4.8
Honduras	3	-0.18	-5.9
Mexico	3	-0.15	-5.0
Other S. American States	4	-0.04	-1.0
Total	458½	25.11	5.5
Total (excluding the United States)	298½	13.11	4.4

^a A. K. Cairncross, 'Did Foreign Investment Pay?' in the *Review of Economic Studies*, Oct. 1935, pp. 73 and 74.

^b Includes both interest paid and capital appreciation or depreciation. There was a net capital depreciation of the whole portfolio of 0.15 per cent. or, if United States bonds are excluded, of 0.98 per cent.

B. Other Securities

<i>Type</i>	<i>Market value £ millions</i>	<i>Total annual yield</i>	
		<i>£ millions</i>	<i>Per cent.</i>
Indian rails . . .	80	5.04	6.3
U.S. rails . . .	40	3.72	9.3
Continental rails . . .	35	1.93	5.5
S. American rails . . .	10	0.87	8.7
Canadian rails . . .	10	0.21	2.1
Total . . .	175	11.77	6.7^a
Telegraph, cables, &c. . .	15	0.80	5.3
Colonial banks . . .	10	1.24	12.4
Foreign banks . . .	5	0.29	5.7
Land and mortgage . . .	5	0.80	16.0
Total . . .	210	14.90	7.1^b

^a Dividends, 4.93 per cent., and capital appreciation, 1.79 per cent.

^b Dividends, 5.39 per cent., and capital appreciation, 1.70 per cent.

Mr. A. K. Cairncross has made a most comprehensive analysis of the yields on various kinds of investments during the decade 1870-80. This is given above; while reading the table, it should be remembered that the average yield on Consols during this period was 3.84 per cent.

An investor who held foreign government securities during these ten years would, then, have been able to get an average yield of $4\frac{1}{2}$ to $5\frac{1}{2}$ per cent.—1 to $1\frac{1}{2}$ per cent. more than the yield on Consols. American government bonds were the most profitable, but a selection of European and South American bonds would have yielded at least $4\frac{1}{2}$ per cent. In foreign and colonial railways the yield was more than $6\frac{1}{2}$ per cent., but similar sums could have been earned on investments in home railways. The average yield from a representative holding of British railway debentures would have been about 5.3 per cent., on preference shares the yield was 6.5 per cent., and on ordinary stocks it was very high, 9.3 per cent.¹ The highest yield shown in the table is that on investments connected with real estate, 16 per cent.

The relatively low yield on foreign government securities made them less attractive to the British investor, and there is evidence that holdings of foreign government bonds declined between 1875 and 1914. Indian and colonial government securities remained popular, however, because they were practically gilt-edged. The British investor turned more and more to overseas industrial securities, railways being, of course, particularly attractive.

Some estimates of the yield on overseas investments at later dates may be of interest. The average return (including yield on

¹ Cairncross, *op. cit.*, p. 74.

redemption) promised by certain groups of borrowers in the two periods 1900-4 and 1905-9 is given below.¹

	<i>Home per cent.</i>	<i>Colonial per cent.</i>	<i>Foreign per cent.</i>
1900-4	3.18	3.33	5.39
1905-9	3.61	3.94	4.97

These returns are much lower than those actually received in 1870-80, but there remained a great difference between the yield on Consols and that offered by foreign borrowers. In the period 1900-4 the yield on Consols was 2.7 per cent., and foreign borrowers offered 5.39 per cent.; for the period 1905-9, corresponding figures are 2.88 per cent. and 4.97 per cent. For the year 1907, Sir George Paish estimated that the average yield on British holdings of the quoted securities of overseas borrowers was 5.2 per cent. At this time the yield on Consols was approximately 3 per cent., and the overseas securities with the lowest yield were Indian Government Loans at 3.21 per cent. Indian railways yielded 3.87 per cent., and colonial and provincial government loans, 3.71 per cent.² It seems certain from these two estimates that Dominion and colonial governments could borrow more cheaply in London immediately before the war than home borrowers (except those whose bonds were trustee securities).

An earlier table has shown how the total size of British overseas investments increased after 1870. The two following tables give some further indication of the rate at which this increase took place:

Great Britain: Annual Average Net Income Available for Overseas Investment, 1870-1913^a

	<i>£ millions</i>
1870-4	61.0
1875-9	1.7
1880-4	23.9
1885-9	61.1
1890-4	45.6
1895-9	26.8
1900-4	21.3
1905-9	109.5
1910-13	185.0

^a From Hobson, *op. cit.*, p. 204, quoted by Feis, *op. cit.*, p. 11. The latter states: 'Some technical shortcomings of Mr. Hobson's computations are pointed out by Sir Josiah Stamp, *British Incomes and Property* (London, 1920), pp. 234-6, which, however, do not invalidate them. The fact that they rest upon the annual estimates of the British balance of indebtedness of the Board of Trade, which contain many doubtful figures, introduces more serious qualifying doubts. But they cannot be improved upon; other published estimates are little more than guesses.'

¹ *Ibid.*, p. 71. ² *Statist.*, supplement, 14 Feb. 1914. See Chapter X, pp. 159-61.

This table shows that the rate at which British overseas investments were increasing was by no means uniform. Capital exports reached a peak of £83.5 millions in 1872, but became smaller in each succeeding year until 1877, when there was a net capital *import* of £15.4 millions. From this position, exports of capital increased erratically to a peak of £82.6 millions in 1896, after which they declined again to £21.3 millions in 1894, and, after a brief recovery, to £11.2 millions in 1902. From that date they increased rapidly to £140.2 millions in 1907 and, after a slight setback in 1908 and 1909 continued to expand still further and must have amounted to considerably more than £200 millions in 1913.

The growing importance of income from overseas investments is shown by the estimates of the Inland Revenue Commissioners. These figures are, however, too low because most of the income derived from abroad from sources other than holdings of publicly issued securities have been excluded.

*British Income from Foreign Investments**

<i>Fiscal years</i>	<i>£ millions</i>
1875-6 . . .	30.0
1880-1 . . .	30.0
1885-6 . . .	39.0
1890-1 . . .	55.5
1895-6 . . .	54.9
1900-1 . . .	60.3
1905-6 . . .	73.9
1910-1 . . .	101.0

* Hobson, *op. cit.*, pp. 199-201.

It is estimated that the total British income from overseas investments increased from about £50 millions in the early 'eighties to more than £200 millions in 1913-14, while, during the same period, the total national income increased from £1,200 to £2,250 millions. In other words, income from overseas investments formed about 4 per cent. of the national income in the 'eighties, and this proportion increased to 7 per cent. in 1908 and 10 per cent. in 1913.

The rate of growth of British holdings of the securities of overseas borrowers was so great that the total of these exceeded £3,750 millions in 1913. If other investments of a kind not represented by negotiable securities were included, the total of British overseas investments could not have been far short of £4,000 millions at the outbreak of the war. The following tables, which give the distribution by countries and classes of British overseas investments in December 1913, show clearly that the preference for investment in food and raw material producing countries had been intensified after 1880.

In these circumstances it was to be expected that a very large part of the investment should be in government and railway securities since these must inevitably be the biggest borrowers in a developing country.

*British Overseas Investments in Publicly Issued Securities,
December 1913—by countries^a*

	£ millions	Per cent.
Canada and Newfoundland	514.9	13.7
Australia and New Zealand	416.4	11.1
South Africa	370.2	9.8
West Africa	37.3	1.0
India and Ceylon	378.8	10.0
Straits Settlements	27.3	0.7
British North Borneo	5.8	0.2
Hongkong	3.1	0.1
Other British Colonies	26.2	0.7
British Empire	1,780.0	47.3
United States	754.6	20.0
Argentina	319.6	8.5
Brazil	148.0	3.9
Mexico	99.0	2.6
Chile	61.0	1.6
Uruguay	36.1	1.0
Peru	34.2	0.9
Cuba	33.2	0.9
Other Latin American States	25.5	0.7
Latin America	756.6	20.1
Russia	110.0	2.9
Spain	19.0	0.5
Italy	12.5	0.3
Portugal	8.1	0.2
France	8.0	0.2
Germany	6.4	0.2
Austria	8.0	0.2
Denmark	11.0	0.3
Balkan States	17.0	0.5
Rest of Europe	18.6	0.5
Europe	218.6	5.8
Egypt	44.9	1.2
Turkey	24.0	0.6
China	43.9	1.2
Japan	62.8	1.7
Other countries	77.9	2.1
All foreign countries	1,983.3	52.7
Grand total	3,763.3	100.0

^a Feis, op. cit., p. 23. Investments in shipping are excluded.

By 1913 industrialization in the United States had proceeded only a little way, and Russia was still untouched, so that it is probably true to say that less than 3 per cent. of British overseas investments were placed in countries which were not essentially producers of primary products, and that more than 80 per cent. was invested in countries which were largely dependent upon their exports of primary products.

The distribution of British pre-war investments as between governments and the more important industries is given below:

*British Overseas Investments in Publicly Issued Securities,
December 1913—by classes**

	£ millions	Per cent.
Dominion and colonial governments	675.5	17.9
Foreign governments	297.0	7.9
Overseas municipalities	152.5	4.1
Government and municipal	1,125.0	29.9
Dominion and colonial railways	306.4	8.1
Indian railways	140.8	3.7
United States railways	616.6	16.4
Other foreign railways	467.2	12.4
Railways	1,531.0	40.6
Electric light and power	27.3	0.7
Gas and waterworks	29.2	0.8
Canals and docks	7.1	0.2
Tramways	77.8	2.1
Telegraphs and telephones'	43.7	1.2
Other public utilities	185.1	5.0
Coal, iron, and steel	35.2	0.9
Breweries	18.0	0.5
Other commercial and industrial	155.3	41.0
Commerce and Industry	208.5	5.5
Mines	272.8	7.2
Nitrates	11.7	0.3
Oil	40.6	1.1
Rubber	41.0	1.1
Tea and coffee	22.4	0.6
Raw materials	388.5	10.3
Banks	72.9	1.9
Financial, land, and investment	244.2	6.5
Banks and finance	317.1	8.4
Miscellaneous	8.1	0.3
Total	3,763.3	100.0

* Feis, op. cit., p. 27. It will be noted that no estimate is given for investment in shipping.

The preponderance of railway securities in the British portfolio is clearly shown in the above table. It has, for instance, been estimated that of the £754.6 millions invested in the United States, £616.6 millions represented British holdings of the securities of American railways. Total British investment in overseas railways in 1913 was estimated at £1,531 millions, or just over 40 per cent. of all British holdings of overseas securities.¹ Next in importance were government and municipal securities valued at £1,125 millions or 30 per cent. of the total. The securities of Dominion and colonial governments amounted to £675.5 millions, and those of Dominion and colonial municipalities to £152.5 millions. Thus, of the £1,780 millions invested in Empire countries, £828 millions or 46.5 per cent. was represented by holdings of government and municipal bonds. At the same time, Empire railway securities accounted for £447.2 millions (£140.8 millions in India) or 25 per cent. of the total, so that less than 30 per cent. of British investment in the Empire was in other forms of enterprise. It is safe to say that fully 80 per cent. of British investment in government, municipal, and railway securities was in countries in which the incomes of the borrowers were directly dependent upon the profitability of agriculture as an export industry.

France.

The second most important creditor nation in the pre-war world was France. The savings of the French people were considerable even before 1870, as is shown by the speed with which the Prussian war indemnity was paid off, mainly through the mobilization of foreign securities. But it was not until after 1885 that France began to fill an important rôle as a capital exporting country. The following table shows how these exports gradually increased:

*France: Annual Average Net Income Available for External Investment, 1871-1913**

	<i>Francs, millions</i>
1871-5	Very little
1876-80	-50 to +50
1881-5	None or very little
1886-90	443-533
1891-6	519-619
1897-1902	1,157-1,257
1903-8	1,359-1,459
1909-13	1,239-1,339

* From Feis, *op. cit.*, p. 44.

¹ See also Chapter X, pp. 153 and 154, and Chapter XIII, pp. 228 ff.

The most rapid growth in French foreign investments occurred in the period 1890 to 1900. This decade began with the fall of Bismarck and the Russo-German *détente* which was followed by the Franco-Russian understanding of 1891, and marked the beginning of a long series of French loans to Russia. The growth of French foreign investment is shown below:

*Total French Foreign Investment**

<i>Year</i>	<i>Amount</i> <i>(Francs, milliards)</i>
1870	12-14
1880	15
1890	20
1900	28
1905	34
1910	40
1912	42
1914	45

* Feis, *op. cit.*, p. 47. These figures are *gross*, i.e. no deduction has been made for foreigners' investments in France.

France's income from her foreign investments was also increasing with similar rapidity.

*Net Income from French Foreign Investment**

<i>Year</i>	<i>Annual average</i> <i>(Francs, millions)</i>
1876-80	500-600
1881-5.	480-580
1886-90	515-615
1891-6.	640-740
1897-1902	915-1,015
1903-8.	1,315-1,415
1909-13	1,705-1,805

* Feis, *op. cit.*, p. 48. See also Moulton and Lewis, *The French Debt Problem* (New York, Macmillan, 1925). These figures are *net*, deductions have been made for amounts paid to foreign holders of French securities.

The income from foreign investments represented about 2½ per cent. of the French national income in the years 1875-80, and this proportion was approximately 3½ per cent. in the years 1895 to 1900, and about 5 per cent. immediately before the war.

The following estimates of the geographical distribution of French foreign investment show the predominance of Europe, and particularly Russia, as a field for French investment, and that comparative neglect of her colonies which has often been deplored by French statesmen.

*Geographical Distribution of French Foreign Long-term
Investment^a*

<i>Country</i>	1900	1914
	<i>(Francs, milliards)</i>	
Russia	7.0	11.3
Turkey (in Asia and Europe)	2.0	3.3
Spain and Portugal	4.5	3.9
Austria-Hungary	2.5	2.2
Balkan States	0.7	2.5
Italy	1.4	1.3
Switzerland, Belgium, and Netherlands	1.0	1.5
Rest of Europe	0.8	1.5
Europe	19.9	27.5
French colonies	1.5	4.0
Egypt, Sues, and South Africa	3.0	3.3
United States and Canada	0.8	2.0 ^b
Latin America	2.0	6.0
Asia	0.8	2.2
Total	28.0	45.0

^a Feis, op. cit., p. 51.

^b Includes Australia.

The most outstanding change in the distribution of French investments between 1900 and 1914 was the increasing relative importance of the French colonial empire and Latin America as fields for new investment. Russia, of course, continued to head the list of borrowing countries, and loans to Turkey and the Balkans increased in an endeavour to weaken German influence in those quarters. Nearly 60 per cent. of French foreign investment was in areas in which it might be expected to bring some political benefits to the lending country. French investors did, of course, receive service payments on this capital until 1914, but a very large part of it fell into default during the war and much of the remainder was rendered valueless by post-war inflation.

That this investment was politically advantageous cannot be denied; but its economic effects were not so clearly beneficial to the lending country. Despite the conditions attached to the loans, the French iron and steel industry received little direct benefit from Russian rearmament, because British heavy industry was incomparably more efficient, and the loans did not give Russians greater spending power with which to purchase other French exports. Nor did French imports become cheaper. British investments usually resulted in exports of British products, chiefly steel and cotton

goods, and caused eventually a decline in the prices which had to be paid for British imports of food and raw materials. But France was not in need of the products of Russia or Turkey or the Balkans. On the whole, British exports of capital were correlated with exports of British manufactured goods, and the payment of interest on this capital was effected by imports of goods from abroad which were rendered progressively cheaper by the increasing use of capital as a factor in their production. Only in rare cases did such results follow from French capital exports.

Germany.

By 1871, after a century of untiring labour, that heterogeneous collection of princedoms, duchies, and free towns, called by courtesy, Germany, had been welded together into an empire under the supervision, in the final stages, of Prince Otto von Bismarck-Schönhausen. From the 18th January 1871 to the 30th July 1914, this Empire was at peace and the genius of its people was concerned with economic rather than political development. Industrial progress, long delayed by military necessity, became cumulatively more rapid. The savings of the people were readily absorbed, and the rate of interest was permanently higher than in France or Great Britain. In such circumstances there was less incentive for Germans to invest abroad than there was for Frenchmen or Englishmen because the differences between the returns to be expected from home and from foreign investment were smaller. Nevertheless, Germany was a substantial foreign lender, and her long-term investments in other countries are estimated to have amounted to Rm. 25 milliards (£1,223 millions) in 1914.

A very large part of this foreign investment was the result of the actions of the German banks in fostering international business. This was done both by the old private international German bankers who had carried on this type of business for many years, and by the newer joint-stock banks, the Deutsche Bank and the Dresdner Bank in particular. Indeed, Germany lent abroad before the war considerably in excess of her export surplus of merchandise and services, so that these banks found much of their money by borrowing in London and Paris on short-term. Thus Germany, particularly before 1900, but to a substantial degree even after that date, had adopted the British post-war policy of 'borrowing short and lending long'.

The volume of German foreign investment at various dates has been estimated as follows:

German Foreign Investment^a

	<i>Rm. milliards</i>
1883	5
1893	10-13
1905	15-18
1914	22-25

^a Feis, *op. cit.*, p. 71.

The geographical distribution of this investment was roughly as follows in 1914:

Geographical Distribution of German Long-term Foreign Investment, 1914^a

	<i>Rm. milliards</i>
Austria-Hungary	3.0
Russia	1.8
Balkan countries	1.7
France and Great Britain	1.3
Spain and Portugal	1.7
Turkey ^b	1.8
Rest of Europe	1.2
Total Europe	<u>12.5</u>
Africa ^c	2.0
Asia ^c	1.0
United States and Canada	3.7
Latin America	3.8
Other countries	0.5
Total	<u>23.5</u>

^a Feis, *op. cit.*, p. 74.

^b Including Turkey-in-Asia.

^c Including German colonies.

This distribution shows that German investments were dictated in the main neither by political expediency—as were the French—nor by colonial ambition; although both these factors were important. Investments in Central Europe, the Balkans, and Turkey to the value of Rm. 7 milliards were probably made to a great extent in an effort to increase the potential efficiency of these countries as military allies, and this is particularly true of investments in the Austro-Hungarian Empire and in Turkey. In her own colonies, German investments must have been very small, since Feis estimates that only Rm. 3 milliards were placed in the whole of Africa and Asia (excluding Turkey) together. In North and South America a total of Rm. 7.5 milliards was invested, and these investments could have had no political or imperial significance. They were, in fact, dictated by the same motives as those which induced French and British

investors to place considerable sums in these areas, viz. the high returns to be expected from capital used to develop new primary producing countries. But the proportion of German capital which was used to develop such countries was only 47 per cent. in 1914,¹ whereas corresponding figures for British and French investments in 1913 were 94 per cent. and 61 per cent. respectively.

The United States.

The United States began to invest capital in foreign countries to an increasing extent after 1890, although she remained a net debtor until after the war, since investments by foreigners in the United States were also growing very fast during this period, her largest foreign creditors being Great Britain and Germany. An estimate of the distribution of American long-term foreign investment before the war follows:

*United States: Geographical Distribution of Long-term Foreign Investment, 1913**

	\$ millions
Canada	750
Cuba	100
Mexico	1,050
Central America	50
South America	100
Europe	350
China and Japan	100
Philippine Islands	75
Porto Rico	30
Total	<u>2,605</u>

* Dunn, *American Foreign Investments* (New York, The Viking Press, 1926), p. 3.

This distribution calls for little comment as it shows exactly what one would have expected—a preference for investment in North and South America, which has characterized the investments of the United States ever since. The volume of investment in Mexico has been considerably reduced since the date of the above estimate, largely on account of default. In all other cases, investments have, of course, increased

considerably. In many other countries were international lenders to any appreciable extent before the war, although several countries which were net debtors

The volume of all investments outside Europe to total foreign and colonial investments has been estimated

debtors had made small foreign investments in various places—Canadians, for example, had investments in Newfoundland, the British West Indies, and Mexico. But these investments were very small, partly because the savings of the citizens of debtor countries were not large, and partly because, in any case, the returns from home investments might be expected to be almost as high as those from foreign investment.

The nature of pre-war international investment may be summed up in one sentence: apart from some loans for political and military purposes by France and Germany, the main body of investment was directed towards undeveloped primary producing countries, and the chief borrowers were those who could offer the highest returns.

As a result of the war, this position underwent a considerable change. The United States became a net creditor on a large scale and the foreign investments of most European countries were greatly diminished, so much so in the case of Germany that she became a debtor nation.

During the first three years of hostilities Great Britain was the chief source of credit for the allies. Before the entry of the United States all capital raised in America came from private sources, and it was only after that date that the United States Government made those direct advances to other belligerents which constitute the war debts proper. Prior to the spring of 1917, Great Britain had borrowed about £200 millions in the United States and had lent some £760 millions to her allies, nearly half of which was advanced to Russia. France re-lent almost the whole of the sums which she borrowed in Great Britain, but obtained in addition loans to the total of some £100 millions in America.

After the United States entered the war, on the 6th April 1917, she became the principal source of financial aid to the other allied powers, and the virtual pooling of resources that followed resulted in the creation of that huge volume of credits which has formed the foundation for the post-war indebtedness of the old world to the new. Such credits amounted to over £1,400 millions, of which some £740 millions were granted to Great Britain, £400 millions to France, and £200 millions to Italy. But the advances did not stop with the cessation of hostilities; they were followed by post-armistice loans under the Liberty Loans Act, which remained in force until July 1921, to the extent of about £500 millions, and relief loans and sales of surplus stores on credit which amounted to nearly another £150 millions. The total governmental indebtedness to the United States thus amounted to roughly £2,000 millions. The amount owed

to Great Britain was about twice as large as her debt to the United States, and France was a net debtor to the extent of about £500 millions. All the other allies were net debtors, in many cases to France, Great Britain, and the United States.

Apart from the flotation of public issues in America and direct advances from the United States Government, another source of credit for the belligerents was provided by the sale of American and other securities which had been purchased before the war. In 1914 the United States was a net debtor to the extent of between £400 and £600 millions. During the war, however, American foreign investments increased by about £1,400 millions and foreign investments in the United States declined by about £500 millions. By 1922, therefore, the United States had become a net creditor to the extent of about £1,200 millions, excluding inter-governmental debts.¹

The mobilization of foreign investments began in Great Britain in July 1915 but was, in the first instance, voluntary. As the requirements of the Treasury increased, an additional income tax of 10 per cent. was introduced on listed securities, and in January 1917 owners were compelled to sell or lend specified holdings on demand. In this way £251 millions of United States stocks and bonds and £34 millions of Canadian issues were made available and sold abroad. In addition a large volume of holdings were disposed of privately, the bulk of them before 1917. The total reduction in British overseas investments through such sales amounted to about £850 millions by 1921, of which more than two-thirds represented sales in the United States. Similarly in France the disposal of specified holdings through the Bank of France was made compulsory in 1916, and it is estimated that about £180 millions was made available in this way. In addition, Americans bought British securities to the value of £190 millions, French to the total of £140 millions, and, in the early days of the war, £32 millions of Russian bonds and £9 millions of German. The investments of the United States thus increased by about £470 millions in all.

Sales of securities to America were not the only means by which the total of British and French investments were reduced. In both cases large amounts had been invested in enemy countries and, of those securities which remained, many had suffered a heavy depreciation. M. Meynial has estimated these losses in the case of France:

'At the end of 1919 it can be established that about 20,000 million francs of foreign securities had become worthless (12,000 million of Russian

¹ George N. Peek, *Letter to the President on International Credits, &c.*, 30th Aug. 1934, p. 2 (Washington, Government Printing Office, 1934).

bonds, 3,000 million Austro-Hungarian, 2,000 million Turkish, 1,000 million German, 1,000 to 2,000 million Bulgarian, Roumanian, and Greek); in addition 3,000 million had undergone a very severe depreciation (Italian bonds and miscellaneous holdings in Turkey, Serbia, Bulgaria, Roumania, and Greece); and about 3,000 million of American, British, and Egyptian securities had been sold abroad. Hence there remained in the French portfolio about 19,000 million francs of foreign investments in a sound condition.¹

Great Britain lost over £100 millions which had been invested in Russia, as well as a very large part of her investments of £24 millions in Turkey, £17 millions in the Balkans, £8 millions in Austria, and £6 millions in Germany. Reckoned in terms of their pre-war value, French foreign investments fell by more than 55 per cent. and those of Great Britain by more than 25 per cent.

In the case of Germany the decline was of course even more striking. In 1914 she had upwards of £1,000 millions invested abroad, but her long-term assets in other countries can barely have reached £100 millions by the end of the war. About £150 millions were sold, largely in the United States, before 1917, and additional investments in allied countries were seized which, according to official German estimates, accounted for a loss of £585 millions, so that those securities which remained represented almost entirely capital exported to Russia, Austria-Hungary, Turkey, Roumania, and other countries whose obligations had depreciated severely. Thus, even apart from the obligations which were imposed upon her as a result of the war, Germany had ceased to be a creditor nation.

Such are the bare facts of the rise of the United States as a foreign investor, of the decline of Great Britain and even more so of France, and of the complete obliteration of Germany's foreign assets. A tremendous increase in the volume of international indebtedness had been accompanied by a vital change in its ownership. The capacity of debtors to meet their obligations had been impaired, not merely by the physical destruction which the war entailed, but also by the economic distortion which resulted from the direction of all productive resources towards the necessities of combat, and later, towards rehabilitation. It is against this background that international capital movements have taken place since the war. These movements form the subject of the next four chapters.

¹ Pierre Meynial, *La Balance des comptes des quelques grands pays industriels* (Paris, 1926), p. 126.

CHAPTER X

THE CREDITORS—GREAT BRITAIN

The British Capital Market since the War.

THE acknowledged leader of world finance before the war, London yielded pride of place to no other centre either in the volume of its investments in overseas countries, or in the net addition it made to them every year. But the redistribution of international lending power, which occurred as a result of the war, seriously impaired the ability of Great Britain to export capital on the pre-war scale. Although the annual increment of new investment has been smaller than it used to be—and when allowance is made for the fall in the value of money this decline is even greater than appears at first sight—the outstanding volume of British capital abroad is probably as large now as it has ever been and, so far as the figures are sufficiently accurate to permit of comparison, as large, war debts apart, as that of the United States. The great change which the war introduced is that business in which London used to possess a virtual monopoly has now become competitive, and certain classes of borrowers can normally obtain funds as easily, if not more easily, in New York.

London is probably the best-equipped centre in the world for granting foreign loans. By virtue of their experience and of a desire to safeguard their reputations which has not always been equally marked elsewhere, the British issuing houses have developed a body of traditions and rules of practice which place them in a position second to none for conducting overseas business. In the words of the Macmillan Committee¹:

‘When he [the investor] is investing abroad he has the assistance of long-established issuing houses, whose reputation is world-wide. When subscriptions to a foreign issue are invited by means of a public prospectus, it is almost certain that that issue will be vouched for by one of these issuing houses whose name will be evidence that it has been thoroughly examined and the interests of the investors protected as far as possible. For the issuing house’s issuing credit, which can easily be affected, is involved, and it is very highly to its own interest to make sure that the issue is sound. If, as must from time to time happen, something goes wrong with the loan or the borrower, the issuing house regards it as its duty to do everything it can to put matters straight, and, indeed, to watch continuously the actions of the borrower to see that the security remains unimpaired. These duties are

¹ Cmd. 3897 of 1931, para. 387.

sometimes very onerous and involve a great deal of labour and expense, as well as judgment, skill, and experience.'

The complaint of the Committee was not that these houses had failed in their duty, but that virtually no comparable institutions existed to assist the financing of domestic enterprise, which could consequently obtain funds in London less easily than could enterprise abroad.

That British issuing houses have been less open to criticism in recent years than their American contemporaries is partly due to differences in the organization of the capital markets of London and New York. But the fundamental difference is that there exists in London a body of experienced professional investors who are in daily contact with one another and who examine every proposed issue with great care. Large issues of foreign bonds practically depend for their success on the appeal which they make to these professional investors and their terms must be settled accordingly.

The issue of foreign securities in New York after the war had to be undertaken by houses which had had little or no experience in the business, and there were no other persons with a thorough knowledge of the matter who could help to guide the investing public. That London's professional investors have made mistakes cannot be denied, but their guidance has prevented British purchasers of post-war issues of foreign securities from making many of the mistakes which were only too common in the United States.

There has been a substantial decline in overseas lending by Great Britain since the war. The figures on p. 134 are of new capital issues as given by the Midland Bank for the post-war period,¹ and by C. K. Hobson for the years 1910-13.² Although they do not afford an accurate measure of net exports of capital, they show the volume of this type of business which has been conducted through the City.

Since the war the decline in the proportion which issues for overseas borrowers have formed of all the new capital raised in London has been much greater than the fall in the absolute amount of such issues. When, however, account is taken of the rise in the price level since 1913, the absolute fall is more marked, for the average for the years 1910-13, if revalued in accordance with changes in wholesale prices, is some £194 millions, a figure which has not been approached since the war. Whereas during the years 1910-13 three-quarters of the new issues floated in Great Britain were on overseas account,

¹ December-January numbers of the *Midland Bank Monthly Review*.

² *The Export of Capital*, p. 219.

only in one year since 1920 was as much as two-thirds directed abroad, and even before the depression this figure had fallen to less than one-half.

New Capital Issues in London on Overseas Account. (Refunding excluded)

	Amount (£ '000)	Overseas issues as a percentage of total issues
Average 1910-13	133,720	75.6
1920	59,659	15.5
1921	155,722	53.6
1922	135,200	57.4
1923	136,176	66.8
1924	134,223	60.0
1925	87,798	39.9
1926	112,404	44.4
1927	138,671	44.1
1928	143,384	39.5
1929	94,347	37.2
1930	108,803	46.1
1931	46,078	52.0
1932	29,211	25.9
1933	37,810	28.5
1934	43,449	28.9
1935	20,890	11.4

An unofficial embargo was placed upon new overseas borrowing during the war and this was not, in fact, withdrawn until November 1925. It was applied stringently until 1919, only issues which were necessary for defence purposes being allowed by the government, but in 1920 a small amount of Empire borrowing was permitted. In 1921 three issues on behalf of foreign countries took place which totalled £6½ millions, and during the next two years a number of issues were made by both Empire and foreign borrowers. Currency disorganization in many parts of the world, however, effectively kept down the volume of borrowing during these years, especially by ex-enemies, the only notable exception being the League Loan to Austria. During 1924, preparatory to the return to the gold standard, the control of new issues was resumed, and during the eighteen months prior to November 1925, only refunding issues and certain loans to Empire countries and for financial restoration in Europe were permitted. A partial embargo was again placed on borrowing by foreign countries in 1930, although refunding issues such as the Japanese loan were permitted as well as loans to Austria, Brazil, and Germany, which were made in an attempt to stave off

the crisis. In 1931 the prohibition of new issues was first extended to all foreign borrowers and then to Empire countries.¹

But the decline in the importance of overseas investment in the national economy of Great Britain since the war was the result, not of this control, but of the general conditions affecting the money and capital markets. The leadership in world finance which London possessed before the war has been challenged, but not because of any inefficiency in the conduct of overseas investment, nor through any set of special circumstances tending to reduce the volume of new issues in particular years. The change has been the result of difficulties, largely caused by the war, which put the London capital market in a relatively disadvantageous position *vis-à-vis* other centres, and especially New York.

The table below shows the relationship between interest rates and the price of new capital as determined by the yield to maturity at the price of issue on certain classes of bonds floated for external

Interest Rates and the Price of New Capital

	1 U.K. Yield on Consols ^a	2 U.K. Weighted average of price of all new public overseas bor- rowing ^b	3 U.K. Price of new Dominion and colonial public bor- rowing ^b	4 U.K. Price of new foreign pub- lic borrow- ing ^b	5 U.S.A. Price of all new foreign bonds ^c
	Per cent.	Per cent.	Per cent.	Per cent.	Per cent.
1921 . . .	5.2	6.5	6.42 ^d	7.49 ^d	7.54
1922 . . .	4.4	6.1	5.68	7.21	6.63
1923 . . .	4.3	5.6	5.07	6.96 ^d	6.42
1924 . . .	4.4	6.1	5.02	7.57	6.56
1925 . . .	4.4	5.1	4.99	8.00 ^e	6.51
1926 . . .	4.5	6.2	5.11	7.32	6.51
1927 . . .	4.6	5.5	5.09	7.07	6.14
1928 . . .	4.5	5.5	5.05	6.73	6.09
1929 . . .	4.6	5.2	4.99	7.20 ^d	5.81
1930 . . .	4.5	6.1	5.56	7.14	

^a Calculated from the annual average price in the *Statistical Abstract for the United Kingdom*.

^b Public borrowing defined as borrowing by Dominion, colonial and foreign governments, States and municipalities. Figures from the *Economist*.

^c See Chapter XI, p. 170.

^d No municipal borrowing.

^e No government borrowing.

¹ For a more complete description of the control of new issues see above, Chapter VII, pp. 76 ff.

borrowers in Great Britain and in the United States. Column 1 shows the yield on Consols in Great Britain as a guide to the long-term rate of interest; column 2 shows the weighted average of the price all public overseas borrowers paid for their loans; columns 3 and 4 are the constituent indices of column 2; and column 5 gives the yield to maturity at issue price on all new foreign bonds floated in the United States.

The long-term rate of interest as represented by the yield on Consols was remarkably steady, fluctuating slightly about $4\frac{1}{2}$ per cent. from 1922 to 1931. All the other indices show much greater movements than this. Thus, for instance, the price of new borrowing by official bodies overseas ranges from 0.6 per cent. more than the yield on Consols to nearly three times that margin.

Turning, however, to the geographical situation of the borrowers it becomes apparent that it is very misleading to speak of any single rate of interest for overseas lending at any particular moment. The advantages of the cheaper rates which Empire borrowers can obtain are apparent from a comparison of columns 3 and 4 in the above table. Between 1922 and 1930 foreign governments and municipalities had to pay at least $1\frac{1}{2}$ per cent. and sometimes as much as $2\frac{1}{2}$ per cent. more than similar borrowers within the Empire (1925 being excluded as the sample is inadequate). The average difference between the rates charged on Empire loans at their price of issue and the yield on Consols fell from over 1 per cent. to about $\frac{1}{2}$ per cent. between 1921 and 1924, and remained at about that magnitude for the next six years. Comparable foreign borrowers, on the other hand, could only obtain loans at rates which, between 1922 and 1930, were only once as low as $2\frac{1}{2}$ per cent. above the yield on Consols, and were more usually about 3 per cent. above it. If this margin may be treated as the risk-premium attached to lending abroad, it is seen that between 1922 and 1930 the risk-premium attached to foreign official borrowing was, at least, three times as great as that on loans to Empire governments and municipalities.

The yield on new foreign bonds issued in the United States may be compared with the yields on Empire and foreign government loans raised in Great Britain. For, although in one case all foreign bonds whose yields are known and in the other only public borrowings have been included, it is certain that public borrowers in New York, who enjoy advantages not open to private corporations, would not have to pay *more* than the rates shown on p. 135, and it is therefore permissible to treat these figures as the maximum prices that governments and municipalities would be charged for loans.

The extent to which New York could successfully compete with London in granting loans to non-Empire borrowers is thus apparent. In every year between 1922 and 1929 it was cheaper on the average by $\frac{1}{2}$ to $1\frac{1}{2}$ per cent. for such loans to be issued in the United States instead of Great Britain. Only Empire borrowers still found it consistently to their advantage to come to London, for the cost of borrowing in New York, even for foreign governments and municipalities, was not as low as the rate at which most of the Dominions and colonies could float new issues in London.

Canada, and Australia to a lesser extent, have been exceptions. The weighted average index of the yield of *all* new Canadian bonds floated in the United States has, in most years since the war, been below the rate at which official borrowers within the Empire could obtain accommodation in Great Britain, and the yield on Canadian government and municipal bonds alone was, of course, even lower than this average. Public authorities in Canada, therefore, turned to New York for funds, and could easily afford to sacrifice the advantages which the Colonial Stock Acts conferred on Dominion borrowers in London. During 1928 and 1929, however, as rates rose steeply in New York, the price charged to Canadian borrowers rose also and for the first time since the war it became cheaper for Canada to borrow in London. It is thus not surprising that the largest part of Canadian post-war borrowing in Great Britain was done in 1928 and 1929.

The maintenance in London of rates of interest so high as to deter many overseas borrowers was chiefly the result of the overvaluation of sterling in 1925, which rendered it necessary to control exports of capital if the gold standard were to be maintained. Stabilization at the pre-war parity was accomplished only with difficulty; the strengthening of the embargo on new foreign capital issues during 1925 is evidence of this. When control of the capital market ceased there was a continual dilemma facing the monetary authorities: to avoid the Scylla of domestic deflation and the Charybdis of external depreciation demanded contradictory movements in the rate of interest. The eventual compromise was a rate low enough to permit a substantial volume of foreign lending, but which also attracted considerable short-term deposits to London in 1926 and 1927. The maintenance of the sterling-dollar parity was, moreover, facilitated by the co-operation of the Federal Reserve System which lowered its rate of discount in 1927 in order to prevent a drain of these short-term funds to New York, even though internal considerations warranted a rise rather than a fall in short-term rates. This

action was effective, at least for the time being, but it tended to increase the advantage of obtaining foreign loans in America rather than in Great Britain.

A further factor, which may have been of some importance, was that the difference between the yield on all foreign securities and on gilt-edged domestic securities appears to have been smaller than before the war. Sir George Paish estimated that the average yield on overseas investments in 1907 was 5·2 per cent., at which time the yield on Consols was about 3 per cent., a difference of 2·2 per cent. Sir Robert Kindersley's estimates of the yield on outstanding overseas capital for the five years 1929 to 1933 are 6·2, 5·6, 4·6, 4·3, and 4·3 per cent. Since the corresponding yields on Consols were 4·6, 4·5, 4·4, 3·7, and 3·4 per cent. respectively, the differences were much smaller than in 1907, viz. 1·6, 1·1, 0·2, 0·6, and 0·9 per cent. Unfortunately comparable figures for the years before 1929 are not available, but it is perhaps safe to estimate that the average yield on British overseas investments after the war was never higher than 2 per cent. above the yield on Consols.¹

The Balance of Payments.

There has been considerable discussion at various times since the war as to whether Great Britain was investing abroad more than was safe in view of the position of the balance of payments. Those who held that there was overlending pointed to the fact that, in several years, a decline in the export surplus on current account had not been accompanied by any comparable reduction in the volume of new issues for overseas borrowers. This argument in its crudest form was undoubtedly based upon an over-simplification of the data, as will be seen from a more detailed study of the balance of payments figures on pages 139 and 140; it is, however, true that there was a continual tendency to overlend especially during the years 1924 to 1927.

For the years 1913, 1920, and 1922 to 1928 only the Board of Trade's estimates of the items in the 'current account'² and the Midland Bank's estimates of new issues for overseas borrowers are given; but for the years 1929 to 1935 an attempt has been made to show changes on 'capital account' in more detail. It should be noted that the items 'overseas issues' in the two tables are not comparable.³

¹ But see below, pp. 161-2, for a criticism of Sir Robert Kindersley's estimates.

² No estimate was made for the year 1921.

³ The complete estimates of the Midland Bank are given above, p. 134.

The estimates for the years 1929–35 serve to emphasize the importance of capital items, other than new long-term issues for overseas borrowers, in the British balance of payments. The sources of these estimates are shown in footnotes, and a discussion of their probable accuracy in the years 1930 to 1933, for which greater details are available, is to be found in Appendix I.

The balance on current account represents—in the absence of gold or other capital movements—the foreign funds in the hands of British persons which are available for lending to borrowers overseas. If this balance is negative, it shows a surplus of sterling in the hands of foreigners and indicates that there must have been a net *inflow* of capital (or an export of gold) during the year in question. The balance is negative only in four of the sixteen years shown in the tables, viz. 1926, 1931, 1932, and 1934. In 1926 this was the result of the Coal Strike and other disturbances which caused an exceptionally large surplus of imports of merchandise. In 1931 it was caused partly by the overvaluation of sterling during the first three-quarters of the year, which caused a decline in exports and a consequently larger import surplus, and partly by a sharp fall in British income from the 'invisible' items in the current account. In 1932 this last factor was combined with a fall in the government's receipts from overseas, so that the payment of £29 millions on account of war debts to the

*Balance of International Payments of the United Kingdom
1913, 1920, and 1922 to 1928.^a*

(£ millions)

	1913	1920	1922	1923	1924	1925	1926	1927	1928
Current Account:^b									
Merchandise	-122	-380	-176	-208	-328	-322	-468	-386	-352
Government transactions	- 12	- 7	- 5	- 25	- 25	- 11	+ 4	+ 1	+ 15
Shipping	+ 94	+340	+110	+133	+140	+124	+120	+140	+130
Income from overseas investments	+210	+200	+175	+200	+220	+250	+250	+250	+250
Interest on short-term investments, commissions, &c.	+ 25	+ 40	+ 30	+ 30	+ 60	+ 60	+ 60	+ 83	+ 65
Other services	+ 10	+ 15	+ 10	+ 10	+ 15	+ 15	+ 15	+ 15	+ 15
Balance	+196	+208	+144	+140	+ 72	+ 48	- 14	+ 83	+122
Capital Account:									
New overseas issues (excluding refunding)	-198	- 60	-125	-123	-124	- 88	-112	-139	-145
Gold movements	- 14	+ 44	+ 10	+ 13	- 14	+ 8	- 12	- 4	- 13
Errors and omissions	-212	- 15	-125	-123	-120	- 80	-124	-142	-156
	+ 17	-192	- 19	- 17	+ 48	+ 34	+138	+ 60	+ 53
Balance	-196	-208	-144	-140	- 72	- 48	+ 14	- 83	-122

^a + = export of goods and services, - = import of goods and services.

^b Board of Trade estimates.

^c Midland Bank estimates.

*Balance of International Payments of the United Kingdom
1929-35.**

(£ millions)

	1929	1930	1931	1932	1933	1934	1935 ^b
<i>Current Account:</i>							
Merchandise	-381	-386	-408	-287	-268	-294	-261
Government transactions	+ 24	+ 19	+ 14	- 24	- 2	+ 7	- 2
Shipping services	+130	+105	+ 80	+ 70	+ 65	+ 70	+ 75
Income from overseas invest- ments	+250	+220	+170	+150	+160	+175	+185
Interest on short-term invest- ments, commissions, &c.	+ 65	+ 55	+ 30	+ 25	+ 30	+ 30	+ 30
Other services	+ 15	+ 15	+ 10	+ 15	+ 10	+ 10	+ 10
Balance	+103	+ 28	-104	- 51	0	- 2	+ 37
<i>Capital Account:</i>							
New issues for overseas borrowers .	- 96	- 98	- 41	- 37	- 83	- 63	- 30
Capital repayments	+ 49	+ 39	+ 27	+ 48	+ 67	+ 42	+ 20
Changes in other long-term invest- ments abroad	- ?	0	+ 10	+ 5	+ 5	- 20	- 10
Changes in London's short-term liabilities to foreigners	- 52	- 16	-200	+ 67	+133	+ 15	+ 25
Changes in the amount of accep- tances held in the United King- dom for account of foreigners . . .	+ 25	+ 15	+ 35	+ ?	- ?	- ?	- ?
Bank and Treasury advances, 1931 .	..	..	+ 74	-123	..	..	..
Balance of 'known' capital items	- 74	- 60	- 95	- 40	+122	- 26	+ 5
Movements of gold coin and bullion	+ 15	- 5	+ 35	- 14	-195	-134	- 71
Estimated hoarding of gold in Lon- don for account of foreigners . . .	..	..	..	+ 3	+ 65	+ 79	+ 35
Apparent sales of sterling for gold	+ 15	- 5	+ 35	- 11	-130	- 55	- 36
Balance of gold and capital items	- 59	- 65	- 60	- 51	- 8	- 81	- 31
Errors and omissions	- 44	+ 37	+164	+102	+ 8	+ 83	- 6
Balance on capital account	-103	- 28	+104	+ 51	0	+ 2	- 37

* For an explanation of these statistics see below, Appendix I, p. 333. + = exports of goods and services, - = import of goods and services.

^b These figures are subject to revision in varying degree; the capital items are little more than guesses.

United States caused a net outflow on this item of £24 millions. In 1933 and 1934 the current account was practically balanced largely by an increase in 'invisible' income.

Between 1920 and 1930, then, the normal state of the current account was that the import surplus of merchandise was more than equalled by receipts from the 'invisible' items, so that there was a positive balance in every year except 1926. This positive balance was so large in the earlier years that new overseas issues were insufficient to absorb all the foreign exchange available and Britain was also exporting capital in other forms. From 1924 to 1927, however, long-term capital exports were usually so large that foreign currency was borrowed to effect a balance, and it was during this period that Great Britain was 'lending long and borrowing short', a process which could not go on indefinitely and which created large foreign balances in London which formed a potential danger to the whole financial

structure of the country. It should be noted that the figures in the 'errors and omissions' item for the years 1924 to 1928 almost certainly over-estimate the extent of Britain's short-term borrowing because they include the receipts of British investors in the form of amortization payments, &c. These, however, were probably offset in part by other exports of capital such as the purchase of securities already issued on foreign stock exchanges, direct investments by British firms, and private purchases of mortgages, &c., in other countries, especially Germany. Moreover, the 'errors and omissions' item is too large for another reason: the figures given for 'new overseas issues' exclude conversion operations, but they do not exclude those proportions of the new issues which were subscribed by overseas lenders—probably 5 to 10 per cent.—so that this item over-estimates the extent to which sterling was exchanged for foreign currencies as a result of new issues and the 'errors and omissions' item is also overstated.

It is therefore not possible to determine from the figures available the extent to which short-term funds were being accumulated in London in these years, though it is probable that there were net additions to London's liabilities in each year, the largest being in 1926 and 1927 when the French balances were increasing very rapidly. There is, therefore, *prima-facie* evidence for the assertion that Britain was overlending in these years in that new overseas issues greatly exceeded in amount the foreign exchange made available by current transactions, and that the balance was completed by imports of short-term funds.

More detailed figures are available for the later years. They show that the withdrawal of short-term funds began in 1929, partly as the result of the repatriation of French balances after the franc stabilization, and partly of the high interest rates in New York which attracted funds to that centre. This outflow continued at a slower rate in 1930 and reached its peak, of course, in September 1931, since which date there has been an inflow of balances, chiefly from the United States in 1932 and 1933,¹ but also from most of the 'sterling bloc' countries and, latterly, from France. The volume of long-term capital exports through new issues has declined steadily; the principal issues for overseas borrowers have been for refunding purposes and have resulted, therefore, in no outflow of funds. Partly as a result of the embargo on capital exports, Britain was actually a net importer of long-term capital in 1931 and 1932. One of the causes of this paradoxical position was the repatriation of the depreciated securities of

¹ Most of the American balances were, however, withdrawn in 1934.

their governments and industrial enterprises by the nationals of various debtor countries.¹ This has continued in more recent years, but it appears to have been more than offset by purchases by British investors of foreign (chiefly American) securities. Britain is thus once more a net exporter of long-term capital despite the fact that the balance on current account has been negative almost continuously since 1931.

The Geographical Distribution of the Investment.

The table on the opposite page shows in some detail the geographical distribution of 85 per cent. of Britain's long-term investment overseas in 1930. Sir Robert Kindersley has also given a rough indication of the way in which the remaining 15 per cent. is distributed,² and from this information the following table has been constructed:

*Geographical Distribution of British Long-term Investments Overseas,
December 1930*

	<i>£ millions</i>	<i>Per cent.</i>
Australasia	494	13.3
India and Ceylon	540	14.5
Canada	525	14.1
South Africa	263	7.1
New Zealand	123	3.3
Malaya (including non-British)	108	2.9
British West Africa	46	1.2
British West Indies	40	1.1
Other British countries	48	1.2
British Empire	2,187	58.7
Europe (including all of Turkey)	295	7.9
Argentina	450	12.1
Brazil	190	5.1
Chile	49	1.3
Rest of South America	84	2.3
Mexico and Central America	59	1.6
United States	201	5.4
Japan	72	2.0
China	47	1.2
Other Asiatic countries	55	1.5
Non-British Africa (including Egypt)	34	0.9
Foreign countries	1,539	41.3
TOTAL	3,726	100.0

¹ See below, Chapter XIV, for further details.

² *Economic Journal*, June 1933, pp. 199-200.

Geographical Distribution of 85 per cent. of British Long-term Capital Invested Overseas, December 1930^a

Area	Government and municipal				Other Investments								Total		
	Amount	Percentage of total investments in each area	Percentage of total investments in the British Empire	Percentage of total overseas investments	Railways	Public Utilities	Mines	Miscellaneous	Total			Amount	Percentage of total investments in the British Empire	Percentage of total overseas investments	
									Amount	Percentage of total investments in each area	Percentage of total investments in the British Empire				
	£ millions				£ millions				£ millions				£ millions		
Australia and South Sea Islands	482	87.5	21.8	13.5	2	9	9	42	62	12.5	3.1	1.9	494	24.9	15.5
New Zealand	110	89.5	5.5	3.5	..	..	..	13	13	10.5	0.7	0.4	123	6.2	3.8
Canada and Newfoundland	97	21.7	4.9	3.0	218	32	2	102	349	78.3	17.6	10.9	446	22.5	14.0
South Africa	118	52.7	5.9	3.7	20	3	50	33	106	47.3	5.3	3.3	224	11.3	7.0
India and Ceylon	281	56.9	13.1	8.2	90	12	14	31	197	43.1	9.9	6.2	458	23.0	14.4
Malaya	4	3.7	0.2	0.1	..	4	3	92	104	90.3	5.2	3.3	108	5.4	3.4
British West Africa	65	43.5	3.3	2.0	29	3	9	23	69	51.5	3.5	2.2	40	2.3	1.4
West Indies													40	2.0	1.3
Other Colonies													48	2.4	1.6
British Empire	1,087	..	54.7	34.0	354	68	92	391	900	..	45.3	23.3	1,937	100.0	62.3
Europe ^b	120	49.0	..	3.8	30	18	6	71	125	51.0	..	3.9	245	..	7.7
South America	134	20.8	..	4.2	353	54	6	96	509	79.2	..	16.0	643 ^c	..	20.2
United States ^d	2	1.5	..	0.1	49	29	10	41	129	98.5	..	4.0	181	..	2.5
Mexico and Central America ^e													150	..	1.6
China	83	80.5	..	2.6	..	5	1	14	20	19.4	..	0.6	40	..	1.2
Japan													133	..	2.0
Other Asiatic countries													48	..	1.5
Non-British Africa ^f	14	13.2	..	0.5	2	3	3	55	63	31.3	..	2.0	78	..	1.0
Foreign countries	353	29.4	..	11.2	434	109	26	277	846	70.6	..	26.5	1,199	..	37.7
WORLD TOTAL	1,440	..	..	45.2	788	172	118	668	1,746	..	..	54.3	3,186	..	100.0

^a Compiled from estimates of Sir Robert Kindersley, *Economic Journal*, June 1933, p. 201.

^b Refers to the whole Malayan Archipelago, including non-British territory and the Dutch East Indies. In particular, the 24 millions of government securities represent British holdings of the bonds of the Dutch East Indies Government.

^c Includes Turkey-in-Asia.

^d The total amount of long-term British capital in the U.S., including the subsidiaries and branches of British companies, and securities not dealt with in the United Kingdom, is roughly estimated at £200 millions nominal value.

^e The total for Mexico does not include a considerable amount of capital long in default.

^f Including Egypt.

^g Of which: Argentina \$306 millions, Brazil \$151 millions, Chile \$49 millions.

Comparison may be made between these figures and those already given for pre-war years.¹ The percentage distribution of all British overseas investments in 1913 and 1930 was:

	1913 <i>Per cent.</i>	1930 <i>Per cent.</i>
British Empire	47	59
United States	20	5
Latin America	20	21
Europe	6	8
Rest of the world	7	7
	100	100

The most noteworthy changes have been an increase in the importance of the Empire as a field for overseas investment, and a decline both absolute and relative in investments in the United States.² The latter is due chiefly to the volume of British investments which were requisitioned during the war in order to create the foreign exchange with which to purchase supplies in America. Less than half the volume of British investment in the United States is in the form of external issues, and the remainder consists of bearer bonds and private holdings purchased in America, whose magnitude cannot be precisely determined.

Although the Empire as a whole has absorbed a larger proportion of British capital exports during and since the war than previously, the increase in indebtedness has not been evenly spread over all the Dominions and colonies. Investments in Australia and New Zealand, which in 1914 were less than those in Canada and Newfoundland, have since the war increased by £200 millions, making Australasia the chief debtor of Great Britain. One-third of the outstanding capital now invested in Australia and New Zealand has been exported since 1914. In India and Ceylon the increase has not been as great, just over one-sixth of the total borrowings being of post-war origin.

Investments in Canada were given as £515 millions in 1913 and as £525 millions in 1930. But it is improbable that this represents an increase in the volume of British capital employed in that Dominion. For it is almost certain that amortization payments between 1914 and 1930 and sales of British-owned Canadian securities during the war considerably exceeded the amount of new investment. If this is correct, the increase of £10 millions in the nominal value of invest-

¹ See above, Chapter IX, especially p. 121.

² But see below, Chapter XIV. One of the features of the recent depression has been an increase in British investments in the United States.

ments in Canada must be due chiefly to the use of more comprehensive statistical material. The actual total of British investments in Canada probably declined slightly over the period in question.

Investments in South Africa were valued at £370 millions in 1914 and at only £263 millions in 1930, a decline of over £100 millions. This is the only Empire country in which such a change has taken place; but it is important to note that new investments in gold-mines since 1932 have partly offset this difference, although, on the other hand, a considerable amount of external public indebtedness has been paid off by the South African Government.

The amount of British investment in Latin America has declined absolutely, but has remained a relatively stable proportion of the total of British overseas investment. This is in striking contrast to the growth of United States investment in this area, but it is probable that the considerable volume of new capital issues in London on behalf of South American countries since the war has been partly offset by the fall in the nominal values of older loans. The indebtedness of both Argentina and Brazil to Great Britain has increased, whilst that of Chile has diminished; other countries in South America have retained very much their previous relative positions. In Europe (including Turkey) £295 millions of British capital was outstanding in 1932 as against £243 millions in 1914, but of this pre-war total about one-half was in Russia. The importance of other European borrowers in the London capital market has thus increased—a marked reversal of the trend which had been typical of almost the whole of the latter half of the nineteenth century. Nearly £40 millions was subscribed to the League Loans with encouragement from the British Government, and large amounts were lent to German borrowers between 1925 and 1930. For the rest there have been few changes of any considerable importance; the volume of capital in Japan and China remains at almost the 1914 figure, and only in Egypt has there been any appreciable reduction in British investments.

The increase in Empire indebtedness has been marked by a preponderance of new capital issues to the Dominions and colonies in every year since 1920, except 1926, when the raising of the embargo, on foreign borrowing which had been operative during the greater part of the previous year caused a sudden increase in the effective demand of non-Empire countries for the facilities offered by London. Of a total of £1,423 millions of new overseas issues floated in Great Britain between 1920 and 1934, 64 per cent. was on behalf of Empire borrowers.

Turning to individual years we find that the period during which non-Empire borrowers were received most favourably in London was from 1922 until 1926, although they were excluded by the embargo in 1925. During this period new issues on account of overseas countries amounted to £606 millions, of which £260 millions was for foreign countries. Although new capital for foreign countries amounted to £51 millions in 1927 and £57 millions in 1928, such sums represented a smaller proportion of the total volume of new issues in London, since Empire countries, especially Australia, were borrowing much more heavily. The general trend of capital exports from Great Britain since the war has been increasingly in the direction of Empire countries. In the years 1921-3 Empire borrowing, though quantitatively large, had not reached the relative importance it was to occupy in later years, although there were heavy exports of capital to India and Ceylon, which together borrowed £91 millions compared with only £17 millions in the following five years. Since 1930 borrowing by foreign countries has been reduced to an almost negligible amount, and the operation of the embargo has placed the Dominions and colonies in a preferential position.

New flotations on European account totalled £160 millions between 1924 and 1930 as against £132 millions for Latin America. Of importance as an indication of the general trend, rather than because of their absolute magnitude, it is useful to study in this connexion the distribution of funds invested by twenty-six British Investment Trusts. The total book value of their securities was about £70 millions in 1930, of which just over one-third was in domestic, and about 10 per cent. in British Empire, holdings. These figures remained almost constant between 1923 and 1929. At the same time, however, investments in the United States declined from 17·7 per cent. of the total portfolio to 9·9 per cent., and those in South America from 23·6 to 18 per cent. These reductions have been almost exactly offset by an increase in investments in Europe, which in 1923 amounted to 4·5 per cent. of the total portfolio as against 17·2 per cent. in 1929.¹ A continuous exchange of American for European securities was going on throughout these years. Germany was undoubtedly the largest single borrower in Europe, but probably absorbed less British capital in the later than in the earlier part of the period, and in the years for which more detailed figures are available we find, during 1926, 1927, and 1928, that she only took some £21 millions out of a European total of £80 millions. This may be interpreted as a sign that British investors were becoming more cautious,

¹ See the *Economist*, 15 Feb. 1930.

but it seems doubtful since, during the same three years, £35 millions was lent to Brazil as against £20 millions to Argentina.

Because rates of interest were relatively high in London throughout the post-war period and because, for various reasons, exports of capital were restricted by official intervention from time to time, many borrowers who had formerly met all their requirements in London turned to an increasing extent to New York. Foremost among these were Canada and several South American countries. There were, however, many borrowers who still found it more profitable to borrow in London, and these included most of the countries of the British Empire, Argentina, and several European states. In this sense, then, the direction of British post-war investment was determined by purely economic considerations, in sharp contrast to French investment.

But this contrast must not be over-emphasized. The legal definition of trustee securities in Great Britain forms a direct encouragement to certain classes of borrowers, and the effects of this have been further reinforced by the actions of the authorities who control issues for overseas borrowers in London.¹ The most important class of borrowers who have benefited from the provisions of the Trustee Acts are public authorities in the British Dominions and colonies. These have been able to borrow on relatively favourable terms in London and, as a consequence, several of them, including Newfoundland and Australia in particular, have tended to borrow more than they would have been able to obtain if the price charged by lenders had been governed by purely economic considerations. Lists of the principal borrowers who were encouraged in this way are given on another page,² and it is there shown that the total amount outstanding in January 1936 of overseas securities which are trustee securities in Great Britain was roughly £1,250 millions. Not all of these are held in Great Britain; but it seems fair to assume that £1,000 millions are owned by British residents. This represents no less than 28½ per cent. of all British overseas investments in quoted securities—a very considerable proportion. It is true that there have been no defaults on these securities, that the vast majority of them represent investments in countries in which the risk of war is small, and that the low rates of interest attached to them have facilitated the continuance of service payments in depression; but it is nevertheless to be remembered that the difficulties of certain borrowing countries have undoubtedly been enhanced by the fact that they tended to over-borrow in London

¹ See above, Chapter VII.

² See pp. 97-8.

because investors were particularly attracted to their securities for legal rather than economic reasons.

Although there was then less 'political' lending in London than in Paris and although fewer issues were made in London than in New York to borrowers who had already over-borrowed, there were features of London's lending which are open to grave criticism on these same grounds.

The Character of the Investment.

There are few types of enterprise in which some British capital is not employed. There have, of course, been changes in the distribution of capital between different sorts of investments since before the war and, to a lesser extent, during recent years. These changes and the extent of British holdings of various sorts of securities are best illustrated by the following statistics.

British Overseas Investments in Quoted Securities—Nominal Values (£ millions)

	<i>Government and municipal</i>	<i>Companies operating abroad</i>	TOTAL
1907-8 ^a	757.4	1,936.3	2,693.7
1913 ^b	1,125.0	2,638.3	3,763.3
1926 ^c	1,068.5	2,827.7	3,896.2
1927 ^c	1,110.0	2,880.1	3,990.1
1928	1,400.5 ^c	1,976.6 ^d	3,377.1 ^e
1929 ^c	1,412.6	2,025.6	3,438.2 ^e
1930 ^c	1,437.3	1,987.3	3,424.6 ^e
1931 ^c	1,440.9	1,969.5	3,410.4 ^e
1932 ^c	1,431.9	1,924.0	3,355.9 ^e
1933 ^c	1,479.6	1,905.6	3,385.2 ^e
1934 ^c	1,499.2	1,914.8	3,414.0 ^e

^a Sir George Paish's estimates; cf. *Economic Journal*, March 1929, p. 20.

^b Dr. Feis's estimates; see *Europe, the World's Banker*, p. 27.

^c Estimates by Sir Robert Kindersley; cf. *Economic Journal*, March 1929, June 1930, Sept. 1931, June 1932, June 1933, Sept. 1934, Sept. 1935, and Dec. 1936. The author very kindly allowed us to use an advance copy of the last-mentioned number, which contains the figures for 1934.

^d *Economist's* estimates; cf. the *Economist*, 1 and 22 March, and 18 and 25 Oct. 1930.

^e Other long-term investments not included in the above were estimated as follows (in £ millions):

1928	. . . 500	1932	. . . 285
1929	. . . 300	1933	. . . 280
1930	. . . 300	1934	. . . 300
1931	. . . 290		

British Investments in Foreign and Colonial Government and Municipal Securities

(£ millions)

	Dominion and colonial			Foreign			TOTAL
	Government	Municipal	Total	Government	Municipal	Total	
1880 ^a	..	..	120	..	..	500	620
1907-8 ^b	531.5	†	531.5	167.0	58.9 ^c	225.9	757.4
1913 ^c	675.5	†	675.5	297.0	152.5 ^c	449.5	1,125.0
1926 ^d	594.2	82.3	676.5	359.2	32.8	392.0	1,068.5
1927 ^d	620.4	82.9	703.3	367.2	39.5	406.7	1,110.0
1928 ^d	944.5	91.5	1,036.0	324.0	40.5	364.5	1,400.5
1929 ^d	970.6	91.0	1,061.6	312.8	38.2	351.0	1,412.6
1930 ^d	985.5	95.0	1,080.5	320.1	36.7	356.8	1,437.3
1931 ^d	1,014.8	88.6	1,103.4	301.9	35.6	337.5	1,440.9
1932 ^d	1,025.4	83.5	1,108.9	289.4	33.6	323.0	1,431.9
1933 ^d	1,061.3	85.8	1,147.1	298.8	33.7	332.5	1,479.6
1934 ^d	1,078.9	84.2	1,163.1	303.6	32.5	336.1	1,499.2

- ^a Estimates by Nash; cf. Jenks, *Migration of Capital*, p. 413.
- ^b Estimates by Sir George Paish; cf. Sir Robert Kindersley in the *Economic Journal*, March 1929, p. 20.
- ^c Estimates by Dr. Feis; cf. *Europe, the World's Banker*, p. 27.
- ^d See note ^c in preceding table.
- ^e Includes Dominion and colonial municipalities.

The first of the foregoing tables illustrates clearly the increase in the relative importance of government and municipal securities as a form of overseas investment. Before the war these formed about 30 per cent. of all British overseas investments, whereas in 1933 this proportion was 40 per cent. Despite the fact that the pre-war estimates were compiled on a rather different basis than the post-war ones, there is here evidence that British investors have tended increasingly to prefer government securities—which are all fixed-interest-bearing—to those issued by private enterprises.

The second table, above, shows the distribution of British holdings of government and municipal securities. Since no distinction was made in the pre-war years between Dominion and colonial, and foreign municipal securities, it is not possible accurately to estimate the distribution of overseas investments as between British and foreign borrowers; a very rough estimate, however, is that Dominion and colonial government and municipal securities accounted for 70 per cent. of the total investments in this class. In 1930 this proportion was about 75 per cent. and it has been rising steadily in more recent years so that it is now probably in the vicinity of 80 per cent. Municipal securities alone form only a small part (about 8 per cent.)

of the total holdings of the issues of public authorities. About 70 per cent. of the total were issued by municipalities in British Dominions and colonies.

*British Investments in Companies Operating Overseas**
(£ millions)

	British companies ^b			Foreign and colonial companies ^c			TOTAL
	Loan capital	Share capital	Total	Loan capital	Share capital	Total	
1907-8 ^d	..	..	..	..	..	..	1,936.3
1913 ^e	..	..	..	..	..	..	2,638.3
1926 ^f	..	..	..	..	..	..	2,827.7
1927 ^f	..	..	..	..	..	..	2,880.1
1928 ^g	307.7	746.5	1,054.2	519.7	402.7	922.4	1,976.6 ^h
1929 ^f	385.2	801.6	1,186.8	402.8	436.0	838.8	2,025.6 ^h
1930 ^f	389.6	815.1	1,204.7	391.5	391.1	782.6	1,987.3 ^h
1931 ^f	397.5	812.8	1,210.3	383.7	375.5	759.2	1,969.5 ^h
1932 ^f	388.6	816.2	1,204.8	375.2	344.0	719.2	1,924.0 ^h
1933 ^f	387.3	823.5	1,210.8	349.8	345.0	694.8	1,905.6 ^h
1934 ^f	387.8	840.3	1,228.1	335.1	351.6	686.7	1,914.8 ^h

* For a statement of British investments in overseas railway companies, which form the largest single category of the above, see below, Chapter XIII, p. 228.

^b i.e. companies registered in the United Kingdom.

^c i.e. companies registered abroad.

^d Sir George Paish's estimate, *Economic Journal*, March 1929, p. 20.

^e Dr. Feis's estimate, *Europe, the World's Banker*, p. 27.

^f Sir Robert Kindersley's estimate, see note ^c, p. 148, above.

^g The *Economist's* estimates, 1 and 22 March, and 18 and 25 Oct. 1930.

^h See note ^a, p. 148, above.

While, then, 40 per cent. of British overseas investments are in government and municipal securities, almost the whole of the remainder is in the quoted securities of companies operating abroad. As is shown in the above table, the nominal value of this investment is about £2,000 millions. This figure is somewhat smaller than that given for the immediate pre-war years and for 1926 and 1927, but there is some doubt whether the statistics are strictly comparable. It is clear, however, that the absolute amount of these securities has tended recently to decline, and that it fell by about £100 millions or 5 per cent. between 1929 and 1933.

Of the total of the investments included in the above table about 60 per cent. consist of the holdings of the securities of British companies operating abroad (i.e. those registered in the United Kingdom). Companies registered abroad account, then, for about 40 per cent. of the total, but it has been a feature of the decline in the amount

of British overseas investments in industrial undertakings that it has been confined to the securities of such companies. 'The growth of this form of investment', writes Sir Robert Kindersley, 'indicated the diminished scope for the direct development of overseas territories by British skill and enterprise, and the desire of Dominion and foreign countries, after a certain stage, to proceed with further developments under their own management. The incidence of British income tax, particularly in post-war years, has been an important factor in this connexion.' There is reason to believe that in more recent years, particularly in 1936, there have been increased purchases by British investors of foreign industrial securities and that these have been of a kind which would not appear in Sir Robert Kindersley's estimates because they are not quoted on British stock exchanges.

Although, due to the preponderance of bearer shares in certain categories, the estimates of British-owned share capital in foreign and colonial companies are admittedly very approximate, they serve to show that investors have tended to hold share and loan capital in these companies in roughly equal proportions. This is in marked contrast to the corresponding distribution in the case of companies registered in the United Kingdom but operating abroad, for more than two-thirds of the holdings of capital in these companies is share capital. More detailed statistics of the amounts of share and loan capital held by British investors in 1930 are given on p. 152.

The following table illustrates very clearly the tendency to prefer share capital to loan capital in British companies operating abroad. This is most noticeable in the case of oil companies, banking and financial institutions, mining companies, and rubber, tea, and coffee plantations. This tendency is also seen in the case of foreign railways—by far the largest single category in this group—where share capital forms 56½ per cent. of the total investment. Only in holdings of securities of Indian and Dominion and colonial railways and tramway and omnibus undertakings does loan capital exceed share capital. Investments in foreign and colonial companies are equally divided between loan and share capital, but this is not true of investments in individual categories within this group. Loan capital, for example, predominates in the case of Dominion and colonial railways and most public utility undertakings, whereas more than half of the investment in most commercial and industrial enterprises, including mining and oil companies, is in the form of share capital.

The next two tables (pp. 153, 154) show the distribution of British overseas investments in quoted securities, as between classes of

*British Investments in Companies Operating Abroad, 1930**

(& millions)

	British companies			Foreign and colonial companies			TOTAL
	Loan capital	Share capital	Total	Loan capital	Share capital	Total	
Dominion and colonial rails ^b	26.9	1.4	28.3	160.5	57.0	217.5	245.8
Indian rails ^b	42.9	21.0	63.9	..	..	..	63.9
Indian rail annuities ^b	25.8	..	25.8	..	..	..	25.8
American rails ^b	0.8	0.8	1.6	12.0	14.6	26.6	28.2
Foreign rails ^b	170.6	220.2	390.8	69.4	0	69.4	460.2
Banks and discount companies	..	26.6	26.6	18.6	26.0	44.6	71.2
Breweries	0.8	4.8	5.6	4	1.3	5.3	6.9
Canals and docks	2.2	1.4	3.6	2.5	1.6	4.1	7.7
Commercial and industrial	20.6	62.3	82.9	24.8	73.8	98.6	181.5
Electric light and power	6.1	7.9	14.0	31.5	11.0	42.5	56.5
Financial, land and investment	25.2	85.6	110.8	28.0	24.0	52.0	162.8
Gas	2.2	8.8	11.0	..	..	..	11.0
Iron, coal, and steel	2.3	8.0	10.3	8.8	28.2	37.0	47.3
Mines	5.7	66.0	71.7	3.6	70.6	74.2	145.9
Nitrates	2.4	6.0	8.4	3.1	..	3.1	11.5
Oil	14.3	112.0	126.3	..	24.5	24.5	150.8
Rubber	5.8	84.2	90.0	..	..	..	90.0
Shipping	6.9	15.2	22.1	1.0	4.2	5.2	27.3
Tea and coffee	2.6	39.5	42.1	..	..	..	42.1
Telegraphs and telephones	4.6	23.9	28.5	14.0	4.8	18.8	47.3
Tramways and omnibus	18.9	14.9	33.8	11.8	9.5	21.3	55.1
Waterworks	2.0	4.6	6.6	1.8	0	1.8	8.4
Total	389.6	815.1	1,204.7	391.5	391.1^c	782.6^c	1,987.3^d

* Estimates of Sir Robert Kindersley, the *Economic Journal*, June 1933, pp. 192 and 195.

^b For additional details see Chapter XIII, p. 228.

^c Precise estimates are not obtainable, due to the preponderance of bearer shares in these three categories; in 1930, approximately £40 millions was invested in this way, and this amount has therefore been included in the totals.

^d Less than £50,000.

securities, before the war, at their post-war peak in 1930, and in the depression year, 1934. The changes which took place between 1913 and 1930 reflect the major events in world economics during this period; the most important were: (a) sales of American railway securities during the war in order to obtain foreign exchange for armament purchases; (b) increased holdings of government securities (despite wartime sales) which partly represented loans to Europe for reconstruction and similar purposes and, to a larger extent, loans to British Dominions and colonies to finance the activities of their governments in, for example, railway construction, which had formerly been carried on by private enterprise; (c) a concomitant decline in holdings of Dominion and colonial railway securities for the same reason; (d) increased investment in certain newer forms of enterprise such as electric light and power, oil wells, and rubber plantations; and (e) a tendency for investments in most public utility undertakings and in banking and financial institutions to decline, partly as a result of the rise of the United States as a capital exporter, and partly because many developing countries had reached a stage at which they desired to control the capital of such undertakings for themselves.

British Overseas Investments in Quoted Securities, 1913, 1930, and 1934

(£ millions)

	1913 ^a	1930 ^b	1934 ^c
Dominion and colonial governments	675.5	985.5	1,078.9
Foreign governments	297.0	320.1	308.6
Dominion and colonial municipalities)	152.5	{ 95.0	84.2
Foreign municipalities)		{ 36.7	32.5
Governments and municipalities	1,125.0	1,437.3	1,499.2
Indian railways	140.8	89.7	88.2
Railways in other British countries	306.4	245.8	250.8
United States railways	616.6	28.2	34.8
Railways in other foreign countries	467.2	460.2 ^d	438.9 ^d
Railways	1,531.0	823.9	812.7
Electric light and power	27.3	56.5	67.3
Gas	29.2	{ 11.0 ^d	11.4 ^d
Waterworks)		{ 8.4 ^d	5.7 ^d
Tramways and omnibus	77.8	55.1	52.6
Telegraphs and telephones	43.7	47.3	37.9
Public utilities	178.0	178.3	174.9
Shipping	•	27.3	21.9
Canals and docks	7.1	7.7	7.3
Shipping, &c. . . . .	..	35.0	29.2
Commercial and industrial	163.4 ^f	181.5	170.2
Iron, coal, and steel	35.2	47.3	22.2
Breweries	18.0	6.9	8.3
Commerces and industry	216.6	235.7	200.7
Mines	272.8	145.9	178.9
Nitrates	11.7	11.5	17.5
Oil	40.6	150.8	129.0
Rubber	41.0	90.0	87.4
Tea and coffee	22.4	42.1	41.7
Raw materials	368.5	440.3	454.5
Banks and discount companies	72.9	71.2	71.1
Financial, land and investment	244.2	162.8	155.1
Banks and finance	317.1	234.0	226.2
Total	3,763.3	3,424.6 ^{d,e}	3,414.0 ^{d,e}

^a Dr. Fols's estimates; of *Europe, the World's Banker*, p. 27.

^b Sir Robert Kindersley's estimates; of *Economic Journal*, June 1933.

^c *Ibid.*, Dec. 1936. The author very kindly allowed us to see an advance copy of this article, so that we might use his latest figures before going to press.

^d Owing to the preponderance of bearer shares it is not possible accurately to estimate the amount of British-owned share capital in colonial and foreign railway, gas, and waterwork companies. In 1930 approximately £40 millions was invested in these three categories, and in 1934 approximately £16.6 millions. These amounts have been included in the totals.

*British Overseas Investments in Quoted Securities, 1913, 1930,
and 1934*

(Per cent.)

	1913 ^a	1930 ^b	1934 ^c
Dominion and colonial governments	17.9	28.8	31.5
Foreign governments	7.9	9.3	8.9
Dominion and colonial municipalities }	4.1	2.8	2.5
Foreign municipalities }		1.1	1.0
Governments and municipalities	29.9	42.0	43.9
Indian railways	3.7	2.6	2.6
Railways in other British countries	8.1	7.2	7.3
United States railways	16.4	0.8	1.0
Railways in other foreign countries	12.4	13.4 ^d	12.9 ^d
Railways	40.6	24.0	23.8
Electric light and power	0.7	1.6	2.0
Gas }	0.8	0.3 ^d	0.3 ^d
Waterworks }		0.2 ^d	0.2 ^d
Tramways and omnibus	2.1	1.6	1.5
Telegraphs and telephones	1.2	1.4	1.1
Public utilities	4.8	5.1	5.1
Shipping	0	0.8	0.7
Canals and docks	0.2	0.2	0.2
Shipping, &c. . . . .	..	1.0	0.9
Commercial and industrial	4.4 ^f	5.3	5.0
Iron, coal, and steel	0.9	1.4	0.7
Breweries	0.5	0.2	0.2
Commerce and industry	5.8	6.9	5.9
Mines	7.2	4.3	5.2
Nitrates	0.3	0.3	0.5
Oil	1.1	4.4	3.8
Rubber	1.1	2.6	2.6
Tea and coffee	0.6	1.2	1.2
Raw materials	10.3	12.8	13.3
Banks and discount companies	1.9	2.1	2.1
Financial, land, and investment	6.5	4.8	4.5
Banks and finance	8.4	6.9	6.6
Other . . . . .	..	1.3 ^d	0.5 ^d
Total	100.0	100.0 ^d	100.0 ^d

^a No estimate is given for this item.

^f This includes 28.1 millions classified as "Miscellaneous".

^d In addition, about 2300 millions was invested both in 1930 and in 1934 in securities not dealt in in the United Kingdom and other forms of investment not examined in detail.

The extent of these changes is clearly shown. Holdings of American railway securities fell from £616 millions in 1913 to £28 millions in 1930, and thus represented less than 1 per cent. of the total investment at the later date, compared with over 16 per cent. in 1913. Holdings of Dominion and colonial government securities (despite war-time sales of Canadian bonds) increased by £310 millions or nearly 50 per cent. and, at the same time, holdings of the securities of railways in British countries overseas fell by £122 millions or 25 per cent. The result of this was that Dominion and colonial government securities represented 29 per cent. of the total holdings in 1930 compared with 18 per cent. in 1913. Investments in foreign government securities also showed an increase, in this case £23 millions, between 1913 and 1930. There is, however, reason to believe that the amount of net new investment in this class of securities between 1920 and 1930 was considerably greater than these figures appear to indicate, because (a) it is known that there were, in 1913, considerable amounts of United States government bonds held in Great Britain and that these were almost entirely repatriated during the war, and (b) the British holdings of securities of the Imperial Russian Government are included in the 1913 figures, but not in the 1930 figures.¹ Investments in electric light and power companies were more than doubled in amount between 1913 and 1930, a development which might have been expected. But no similar increase is seen in investments in other sorts of public utility enterprises; there was, indeed, a considerable fall in investments in tramway and omnibus companies, and there can be little doubt that the principal cause was the enormous development of American direct investments in this class of undertaking. In the case of investments in industries producing raw materials, there has been, as might be expected, an increase in holdings of securities issued by oil and rubber producing companies—a direct result of the development of the motor-car. But there have also been two other changes which are not so easily explained:

¹ British holdings of Russian government bonds in 1913 amounted to roughly £60 millions (see Feis, *Europe, the World's Banker*, p. 21 and p. 23 n.) and, although there are no satisfactory estimates of British holdings of United States government bonds, it is safe to say that these amounted to £25 millions at least. If the sum of these amounts be deducted from the total of British holdings of foreign government securities in 1913, there is left £212 millions. The difference between this figure and that given for 1930 is £108 millions which seems to be a much better estimate of the amount of new British investments in foreign government securities in the post-war period. In this connexion it should be noted that the total amount of new issues (excluding conversions) by foreign governments in London during the eight years 1923 to 1929 was £123.6 millions (see League of Nations, *Balances of Payments, 1927-9*, vol. ii, p. 179.)

a decrease of £127 millions or over 45 per cent. in holdings of mining securities and an increase of £20 millions or nearly 90 per cent. in investments in tea and coffee plantations. Of the first, there are two possible explanations, viz. that a large part of the securities of South African mining companies were repurchased by South Africans (or redeemed) out of the considerable profits which gold producers made during the war and immediate post-war years, and that a part of the British holdings of Canadian mining securities were transferred to United States and Canadian investors during this period. Of the increased investment in tea and coffee plantations, no logical explanation has been offered.¹ Finally, there has been a fall of 25 per cent. in investments in overseas banking and financial institutions; this appears to have been due partly to an increase in American competition in this field, and partly to nationalist sentiment within the borrowing countries which has led them to acquire control of institutions of this type.

The greatest changes in the distribution of British overseas investments, then, have been the increase in the importance of government securities and the concomitant and partly consequent relative and absolute decline in holdings of railway securities. In other directions there has been little change in British investors' choice of securities.

Of the new capital issues floated in London on overseas account between 1920 and 1934 some 52 per cent. represented borrowings by governments abroad, and 6 per cent. of the subscriptions were to the bonds of municipalities and public boards in all parts of the world, making a total for public overseas borrowing of 58 per cent. of the entire sum subscribed. Railway issues were responsible for about 7 per cent. of the capital raised and the remaining body of private enterprises, usually classified as 'industrial',² for a further 35 per cent. The importance of governmental and municipal borrowing is thus clear; apart from the small sums raised for railway construction, the whole body of industry and commerce in the widest sense has only been responsible for slightly more than one-third of British post-war capital exports to all parts of the world. Seventy-seven per cent. of the governmental borrowing consisted of Dominion and colonial loans. Lending to public authorities on a large scale has, moreover, been typical of all but a few of the fifteen years; private enter-

¹ In this connexion it is, however, relevant to note that the apparent consumption per head per annum in Great Britain of tea rose from 6·7 to 9·9 lb., and of coffee from 0·6 to 0·8 lb. between 1913 and 1930.

² Including investments in mines.

prise within the Empire obtained its maximum amount of capital in 1927, when £44 millions was issued on this account, and in foreign countries in 1922, when it obtained £41 millions.¹ Despite large fluctuations from year to year, only in 1929 and 1934 were the amounts raised by Empire governments not in excess of any other class of investment.

New Capital Issues for Overseas Borrowers in London, 1923-34^a

(£ millions)

	<i>Governments</i>	<i>Municipalities and public boards</i>	<i>Railways</i>	<i>Industrial undertakings</i>	<i>Total</i>
1923 . .	89.0	5.4	9.0	32.8	136.2
1924 . .	91.5	8.7	3.9	30.1	134.2
1925 . .	30.5	3.4	5.9	48.0	87.8
1926 . .	46.7	9.3	7.6	48.8	112.4
1927 . .	63.6	13.2	11.3	50.6	138.7
1928 . .	57.7	14.1	13.7	57.9	143.4
1929 . .	30.4	4.3	12.3	47.3	94.3
1930 . .	65.8	2.7	15.3	25.0	108.8
1931 . .	30.7	..	3.9	11.5	46.1
1932 . .	24.6	1.0	1.3	2.3	29.2
1933 . .	30.2 ^b		7.6 ^c		37.8
1934 . .	11.0 ^b		32.4 ^c		43.4

^a From League of Nations, *Balances of Payments*. Excludes conversions.

^b 'Public authorities'.

^c 'Private undertakings'.

In his articles Sir Robert Kindersley has classified British commercial capital abroad under two heads:

- (1) Bonds and shares of companies (as classified in the *Stock Exchange Official Year Book*) operating entirely or mainly abroad and registered in the United Kingdom.
- (2) Bonds and shares of companies in overseas countries quoted and/or dealt in on the Stock Exchanges of the United Kingdom but registered abroad.

Capital invested in companies falling within the first category—roughly designated 'British companies'—remains largely under direct British control. In the latter class, however, some concerns are 'virtually British-owned and controlled while in other instances British participation is insignificant, as, for example, in the case of American Railroad companies'.

In 1933 the volume of capital invested in British companies abroad

¹ *Economist* figures.

was £1,211 millions and in foreign and colonial companies £695 millions. It is indicated, however, that although British companies have in the past absorbed a larger amount of capital than companies registered abroad, there is now a tendency for greater expansion to take place in the latter class. Such a trend has been noticeable ever since the war, for instance, in the newer types of public utilities. In the electric lighting and power group, British companies have absorbed £16 millions as against £43 millions by foreign and colonial companies, and similar figures for telegraphs and telephones are £4½ millions and £18 millions. An analysis of the securities quoted in each class according to the length of time that they have been outstanding would probably show that the average age of bonds and shares in British companies is considerably higher than in the other category. Foreign railways, which were mostly financed during the last century, constitute by far the largest single class of securities in the British companies group, whereas of the total holdings of securities of foreign and colonial companies a much smaller proportion represents investments in railways.

In the case of foreign and colonial companies, just over one-half of the investment is in loan capital and somewhat less than one-half in share capital. In British companies, on the other hand, share capital is more than twice as large as loan capital. This may well be the result of the actions of nineteenth-century investors, who preferred to place their money in concerns which were British-owned and British managed. Equity holdings confer rights of ownership; bond holdings do not; and it was therefore inevitable that the investor should tend to prefer fixed-interest-bearing securities in the case of companies registered abroad, especially if control was in the hands of foreigners. Hence the purchase of bonds rather than of equities became a much more typical feature of investment in foreign concerns than in the older class of domestically controlled enterprise.

Including governmental and municipal borrowing, £2,216 millions of the £3,385 millions of negotiable overseas securities quoted on stock exchanges within the United Kingdom in 1933 was loan capital bearing a fixed rate of interest; nearly two-thirds of British overseas investments, that is to say, are in the form of bonds and debentures. Although accurate figures for purposes of comparison with the pre-war period do not exist, it is certain that fixed-interest-bearing securities have become relatively more important since 1914, and it is probable that loan and share capital used to be much more nearly equal in volume. The growth of governmental borrowing since the war has been the most important single factor in augmenting the

importance of bond indebtedness; the Colonial Stock Acts, which have tended to attract capital into loans for Empire governments, have inevitably had the effect of increasing this proportion, as is shown by the fact that three-quarters of the overseas investment in securities issued by public authorities has taken place within the Dominions and colonies.

British investment in overseas countries after 1920 was, then, a very important factor in the national economy. Investments were not, however, conducted on the same lines or in the same directions as before 1914. Even though Canadian borrowers practically ceased to use the London capital market, while other Empire borrowers made increasing use of the facilities of other markets, the proportion of British overseas lending which was absorbed by Empire countries was rather larger after the war than before it. Investments in overseas railways tended to decline, while those in oil and rubber production increased, chiefly as a result of the development of the motor car as a form of transport. Similarly, investments in electric light and power companies have increased, though those in telegraph and telephone companies have diminished, principally because of American domination in this field. Finally, investments in mines have become less important, partly, again, as a result of American competition. These are the bare facts of the trend of British post-war investments overseas.

The Income from Investments.

The table on p. 160 shows the returns received, in the form of interest and dividends only, on British capital invested in certain classes of securities in 1907-8, 1930, and 1934.

The most interesting feature of these statistics is the marked similarity between the pre-war and the 1930 figures. The average difference between the return in 1907-8 and 1930 is only +0.4 per cent., but individual differences range from -9.8 per cent. in the case of investments in nitrates to +7.9 per cent. in the case of holdings of oil companies' issues. Both these changes are easily accounted for; the former by the increase in the production of synthetic nitrates, and the second by the increased use of internal combustion engines. In 1930 the average return on government and municipal securities was 4.5 per cent. and on railway securities 4.9 per cent.; in both cases this is 0.5 per cent. higher than the pre-war return. The average return on the remaining body of investment was, in 1930, 7.1 per cent., which is 0.6 per cent. lower than in 1907-8.

The fall in the yield of industrial investments is not sufficiently

*Income from British Long-term Overseas Investments, 1907-8,
1930, and 1934*

	<i>Return on Nominal Capital, per cent.^a</i>		
	<i>1907-8^b</i>	<i>1930^c</i>	<i>1934^d</i>
Dominion and colonial governments	3.6	4.3	4.2
Foreign governments	4.8	4.9	3.7
Dominion and colonial municipalities }	4.5	4.6	4.7
Foreign municipalities		5.5	3.1
Governments, &c.	4.0	4.5	4.1
Indian railways	3.9	5.5	5.1
Railways in other British countries	4.0	5.3	3.3
United States railways	4.5	6.0	2.3
Railways in other foreign countries	4.7	4.5 ^e	1.8 ^e
Railways	4.4	4.9	2.6
Electric light and power	4.2	6.2	5.2
Gas	7.3	10.0 ^e	7.9 ^e
Waterworks	6.9	6.0 ^e	3.5 ^e
Tramways and omnibus	5.1	4.2	2.3
Telegraphs and telephones	6.5	7.0	5.0
Public utilities, &c.	5.9	6.0	4.4
Shipping	1	5.5	4.6
Canals and docks	19.6	20.8	35.6
Shipping, &c. . . . .	..	8.9	12.3
Commercial and industrial	6.3	7.5	5.0
Iron, coal, and steel	3.9 ^e	5.3	3.2
Breweries	4.2	5.8	6.0
Commerce and industry	5.7	7.0	4.9
Mines	11.1 ^h	8.6	10.5
Nitrates	15.0	5.2	0.6
Oil	4.5	12.4	9.0
Rubber	8.2	5.3	2.4
Tea and coffee	8.4	7.1	6.2
Raw materials	10.6	9.0	7.7
Banks and discount companies	13.6	9.4	4.9
Financial, land, and investment	3.3	4.8	2.4
Banks and finance	5.6	6.2	3.2
Other investments ¹ . . . . .	..	5.7	4.3
Total	5.2	5.6	4.3

^a No computation is made regarding capital appreciation or depreciation, and returns in the form of sinking funds, &c., are likewise disregarded. ^b Sir George Palaiah's estimates, *Economic Journal*, March, 1929. ^c Derived from estimates by Sir Robert Kindersley, *Economic Journal*, June 1933. ^d Derived from estimates by Sir Robert Kindersley, *Economic Journal*, Dec. 1936. ^e Excluding shares in companies registered outside the U.K. ^f No estimate available. ^g Iron and coal mines. ^h Excluding iron and coal mines. ¹ Includes all types of long-term investments which are not mentioned above, especially the bearer shares of foreign and colonial railway, gas, and waterworks companies, and securities not quoted on United Kingdom stock exchanges.

large to call for comment; but it is rather surprising that the yield on overseas government and municipal and railway securities¹ was so low as 4·5 and 4·9 per cent. respectively in 1930. In 1907-8 the yields on these two classes of securities were 4·0 and 4·4 per cent., i.e. 1·0 and 1·4 per cent. respectively above the yield on Consols; but in 1930 the average yield on Consols was 4·48 per cent.—almost exactly the same as the yield on overseas government and municipal securities and actually higher than the yield on Dominion and colonial government securities. At the same time, the yield on overseas railway securities was only 0·5 per cent. higher than the yield on Consols. This paradoxical result arises from the use of nominal values of securities by Sir Robert Kindersley in making his estimates of British overseas investments. It is not his fault that his estimates are thereby rendered somewhat misleading, because it would be almost impossible to compile estimates of the total capital outstanding on the basis of market prices. Unfortunately, estimates of percentage yield on the basis of nominal values are of very doubtful validity. A rough survey² of the market prices of certain securities in London in

¹ It must be remembered that a large number of these are government guaranteed, especially in Canada and India.

² The following table (from the *Economist*, 3 Jan. 1931) shows the yield at the beginning and end of 1930 on the basis of market prices of a representative selection of overseas government and railway securities.

Yield, per cent.

	<i>Beginning 1930</i>		<i>End 1930</i>	
	<i>£</i>	<i>s. d.</i>	<i>£</i>	<i>s. d.</i>
2½ per cent. Consols	4	12 8 ^a	4	6 9 ^b
4½ per cent. India (1950-5)	6	0 0	5	9 3
Australia 5 per cent. (1935-45)	5	18 0	7	1 0
South Africa 5 per cent. (1933-43)	5	2 0	4	12 9
Canada 4 per cent. (1940-60)	4	18 0	4	7 3
New Zealand 4½ per cent. (1947)	5	1 9	4	15 4
New South Wales 5½ per cent. (1947-57)	5	14 6	7	3 0
Brazil 5 per cent. funding 1914	7	1 9	7	14 6
San Paulo Coffee 7½ per cent.	9	1 0	11	5 6
German 7 per cent. (1924)	6	13 0	7	0 0
Japan 6 per cent. (1924)	6	4 6	5	16 9
China 4½ per cent. Gold (1898)	7	12 0	5	19 7
Argentine 5 per cent. Internal (1909)	5	19 3	5	18 6
Greek 6 per cent. Stabilization	6	19 6	6	15 0
East Indian Railway 3½ per cent. deb.	5	13 6	5	9 6
Canadian Pacific 4 per cent. pref.	5	3 6	5	0 0
" " Ordinary	5	2 3	6	7 6
Bengal N. Western Ordinary	6	18 6	6	18 6
Buenos Aires Pacific Ordinary	8	4 9	14	2 10
Leopoldina Ordinary	10	0 0	24	8 10
Buenos Aires Great Southern Ordinary	8	3 0	8	19 3
United of Havana		Nil.		Nil.

^a Average for January.

^b Average for December.

1930 shows that, in fact, the yield on Dominion and colonial government securities ranged between 6 and 4½ per cent., that on foreign governments between 11 and 5½ per cent., and on overseas railways between 24 per cent. and zero. There were, indeed, few individual issues which showed yields as low as those suggested by the figures given in the foregoing table. Thus, although that table is useful in so far as it affords a comparison between the yields on different classes of securities at the same date, it is not nearly so suitable as a guide to the changes which have taken place through time. Only when the difference between the yields at different times on the same category of investment are very great can any useful deductions be drawn.

During the years of depression the income from British overseas investments probably declined less than might have been supposed. Sir Robert Kindersley's figures for the percentage yield on certain classes of capital are set out below:

Percentage Return on British Overseas Investments

	1929	1930	1931	1932	1933	1934*
Government and municipal loans	4.6	4.5	4.6	4.3	4.1	4.1
British companies operating abroad:						
Interest on loan capital	4.7	4.5	3.9	3.5	3.2	3.4
Dividends on share capital	8.4	7.1	4.1	3.6	3.6	3.9
Foreign and colonial companies:						
Interest on loan capital	4.9	4.9	4.7	4.6	4.2	4.1
Dividends on share capital	9.6	8.1	6.0	6.4	5.9	7.4
Average yield on all classes	6.2	5.6	4.6	4.3	4.1	4.3

* Provisional.

The total income from British overseas investments is estimated to have amounted in 1932, the worst year, to 60 per cent. of the income from this source in 1929, and by 1935 this proportion had risen to nearly 75 per cent. With regard to the fortunes of the various classes of investment during the depression, two points emerge, one relating to the relative movements in the returns on bonds and equities, and the other to the comparative positions of British companies operating abroad and of foreign companies. To take the latter point first, the table shows that receipts from British companies operating abroad suffered a heavier decline than those of foreign and colonial companies. In the category of British companies operating abroad the large volume of foreign railway investment was an important factor, the average dividends on foreign railway shares falling from 5.4 per cent. in 1929 to 0.7 per cent. in 1933. In other

important classes, dividends on oil shares fell from 14·7 per cent. in 1929 to 1·4 per cent. in 1932, but rose to 10·2 per cent. in 1933; in mining from 9·35 per cent. in 1929 to 3·7 per cent. in 1933 (3·2 per cent. in 1932); in 'commercial and industrial' from 5·9 per cent. in 1930 to 3·4 per cent. in 1933; and rubber shares paid almost no dividend in 1933 compared with 8·0 per cent. in 1929. The dividends of foreign and colonial companies fell by much smaller amounts: railways in British possessions paid dividends of 9·9 per cent. in 1929 as against 2·6 per cent. in 1932 and 2 per cent. in 1933;¹ mines 16·3 per cent. in 1929 compared with 12·7 per cent. in 1933; and 'commercial and industrial' 10·4 and 7·3 per cent. Dividends on shares in oil companies were 0·7 per cent. in 1932 compared with 2·7 per cent. in 1929 but rose to 3·7 per cent. in 1933. A very large part of the losses in British companies was in railway securities, which constitute nearly one-third of the total investment in this category, the exchange restrictions in South America being the most important single factor in stopping dividend payments. Maintenance of payments on certain classes of securities, especially mining shares, was helped by the depreciation of sterling; gold mines, especially in South Africa, receiving the greatest benefits.

A feature of the fall in the returns on British investments overseas between 1929 and 1933 was that it was not, as might have been supposed, confined entirely, or even very largely, to the returns on equity holdings. Fixed-interest-bearing securities are usually looked upon as being a safer investment than those whose yield is variable; but this is not always the case and, indeed, the safety of an investment depends only to a minor degree on the form of the contract between lender and borrower. This was well illustrated by the experiences of British investors after 1931, for they found that in many cases bonds yielded a much smaller return than that which was originally stipulated in the loan contract.² Some bonds have, indeed, been in complete default. It may, perhaps, be concluded, therefore, that the average British investor has under-estimated the risks involved in lending by means of bonds in many cases, and that there may, in future, be some tendency for him to alter his relative valuations of bonds and shares in favour of the latter.

Conclusion.

The post-war history of Great Britain as a lending country may be summed up by saying that the volume of her exports of long-term

¹ This was caused largely by the complete cessation of dividend payments by the Canadian Pacific Railway.

² On the difficulties of drafting loan contracts see below, Appendix II, pp. 347f.

capital was determined by two opposing sets of forces. There were on the one hand, a group of factors which tended to restrict such exports and to cause overseas lending to be conducted on a much smaller scale than before the war. On the other were forces which operated in the opposite direction, which enabled a large volume of capital to be exported and which tended to remove any doubts as to the wisdom of lending abroad to such an extent.

Among the considerations which had the effect of restricting the volume of exports of long-term capital should be mentioned the demand for capital to finance the reorganization of home industry on a sound peace-time basis, which was especially important in the earlier post-war years. By 1922 this demand had collapsed, but capital exports did not expand immediately because of political and economic instability in most potential borrowing countries. Secondly many borrowers found that they could obtain capital more easily in New York, a new international capital market. Canada and several South American countries conducted most of their post-war borrowing there (although British investors often purchased some of the securities which were issued on behalf of these countries in New York). The most important single cause of the reduced volume of capital exports by Great Britain after the war was, however, the over-valuation of sterling in 1925. The chief concern of the British financial authorities between 1925 and 1931 was to prevent a drain of gold from the Bank of England. To this end interest rates were kept at a relatively high level and certain qualitative restrictions on capital exports were also imposed from time to time. Thus even borrowers in a sound economic position often found it impossible to obtain capital in London at rates which they were willing to pay.

Had strict deflation been imposed in accordance with the canons of orthodox economics, there would, of course, have been no capital exports at all. But such rigid restriction was, it was thought, rendered unnecessary by a second set of factors which tended to conceal the symptoms of disorder in the British economic structure. Foremost among these was the inflow of French capital in search of a safe, though temporary, resting-place. These short-term funds gave a perilous equilibrium to the British balance of payments and enabled the authorities to allow money rates to fall, a process which was assisted in 1927 by the action of the Federal Reserve Board in the United States. Moreover, the discernment of investors was blunted by the deep-rooted belief of the pre-1931 decade that all the economic difficulties caused by the war would be overcome when the currencies of the world were once more convertible into defined quantities of

precious metal. In this belief, the issues of many European and other borrowers were readily purchased even when, to less biased judgments, they must have appeared manifestly unsound. Finally, active measures to encourage borrowers in Empire countries were taken by those in control of the new issue market, and the privileges enjoyed by Dominion and colonial governments were renewed and enlarged by the Trustee Act of 1925. In such circumstances, investment in these countries increased with great rapidity and formed by 1930 more than one-quarter of the total of British long-term capital overseas.

There has been no post-war 'South Sea Bubble', but the overseas investment activities of Great Britain must be criticized on three grounds: the volume of lending was too large in view of the balance of payments position; certain European and other borrowers were permitted to overborrow, because of mistaken estimates of their 'capacity to pay'; and borrowers in Empire countries were unduly favoured, largely as the result of extra-economic considerations. On the whole, the post-war investments of Great Britain have not had such unfortunate results as those of the United States or France. But serious mistakes were made, nevertheless, and British experience offers no grounds for complacency on the part either of monetary authorities or private investors.

CHAPTER XI

THE CREDITORS—THE UNITED STATES

In 1913 the foreign investments of United States citizens amounted to about \$2,600 millions, while investments by foreigners in the United States were between \$4,000 and \$5,000 millions. In 1930 United States investments abroad were estimated at \$15,675 millions (excluding government war debts), and investments by foreigners in the United States at \$6,800 millions. It is this change from the position of a net debtor on long-term to the extent of about \$1,900 millions, to that of a net creditor by about \$8,900 millions which must be analysed. The principal changes in the position of the United States as regards long-term investment are shown below:

Long-term Debts and Credits of the United States
(\$ millions)

	1913 ^a	1930 ^b	1935 ^b
<i>Owed to the United States</i>			
by Canada	750	3,942	3,764
Mexico	1,050	695	897
Central America	50	276	
South America	100	3,042	2,937
Europe	350	4,929	3,543
West Indies	100	1,233	1,107
Africa		118	132
Asia	205	1,023	820
Oceania		419	405
	+2,605	+15,675	+13,605
<i>Add for bank capital</i>		+ 125	+ 125
<i>Deduct for securities repurchased</i>		- 1,100	- 1,100
Net total.	+2,605	+15,170 ^c	+12,630 ^c
<i>Owed by the United States</i>	-4,500 ^d	- 6,800	- 5,035 ^e
Net long-term position	-1,895	+ 8,370	+ 7,595

^a Dunn, *American Foreign Investments*, p. 3.

^b Estimates of U.S. Dept. of Commerce.

^c Excluding war debts of about \$10,000 millions.

^d The chief creditors of the United States in 1913 were Great Britain and Germany.

^e A table showing the nationality of this capital is given in Chapter XIV, p. 310.

Estimates of the 1913 position are necessarily rather crude, and too much faith should not be placed in the figures, but the broad out-

lines of the change in America's position are clearly shown by the table. A change of such magnitude necessarily imposed severe strains on the economies of all the nations of the world, and it could not have taken place in such a short time except as the result of the dislocations caused by the war. This chapter attempts to describe the recent trend of American foreign investment and to analyse the strains and stresses which it set up in the international capital and money markets.

The American Capital Market.

The foreign investments of Great Britain, France, and Germany before the war were influenced very greatly by the character and structure of their money markets. Similar influences were equally important in the United States in the post-war period. Transition 'from the world's chief debtor to its largest creditor' entailed such an increase in the importance of American methods and practices that the character of international investment was influenced almost more by New York than by the older and more conservative traditions of the City of London. The difference between America and Great Britain as international creditors has been related both to more or less fundamental dissimilarities in their financial systems, and to the different ways in which each has conducted the business of making foreign loans.

To an English observer one of the most striking characteristics of the American short-term money market is its lack of any well-developed business in bills of exchange. Discounting either of commercial or government bills is of minor significance in comparison with the importance which it assumes in London. Though this may not appear vital in any respect, it has, however, a considerable relevance to the working of the Federal Reserve System and to investment banking. For the value of the bill of exchange—apart from its function of facilitating commodity transactions—lies in the fact that it forms a second line reserve for the banking system, which requires quickly maturing assets to replace cash reserves when they become depleted. This would seem to be of special importance in a country where there were many thousand comparatively small banks instead of a few large ones. But the bill has never been popular as a means of effecting payments in America and no amount of effort has yet succeeded in making it so. Banks then, in the absence of liquid securities of this type, placed a certain proportion of their funds on deposit at low rates of interest in other banks, usually larger ones, and these in turn kept accounts at the biggest

institutions—the ‘down-town’ banks of New York. Thus the quickly realizable assets of the whole American banking system were almost entirely ‘pyramided’ on New York. Once there, they were lent to the stock exchange, which in normal times exerts a considerable demand for funds of this nature. For the New York stock exchange does not work on the basis of settlements every fortnight, as does London, but all obligations have to be met on the day following that on which they are incurred. The demand for short-term loans on the part of operators is, therefore, enormously larger than in centres where settlements are less frequent; the whole system centres on the stock exchange, and the New York call loan rate assumes immense importance.

Thus, whereas British short-term money rates are extremely sensitive to international conditions, those in New York are influenced almost entirely by domestic considerations. The call-money rates in New York are a function of the volume of business being done on the stock exchange, and since dealings on the exchange are very often carried out in the hope of capital appreciation rather than in expectation of changes in rates of interest, call-money rates are influenced very slightly, if at all, by similar rates in London and elsewhere or by the state of the foreign exchanges. During a period of rapid capital appreciation in stocks and shares, therefore, call-money rates rise to fantastic levels¹ and large quantities of foreign funds are thereby attracted to New York.² Such an influx can exert a strong deflationary effect in other money markets and become an extremely important influence, as in 1928 and 1929, on the trend of American foreign investment.

The dissimilarities between British and American practice with regard to the flotation of foreign long-term securities are also important. In New York, between 1925 and 1930, this business was undertaken by specialized issue houses. These issue houses, or syndicates of issue houses and banks, first made short-term advances to foreign borrowers, which, when market conditions were favourable, were usually funded into long-term loans. The profits of the issue houses consisted of the margins between the purchase prices of the securities issued (i.e. what the ultimate borrower received) and their selling prices (i.e. what the ultimate purchasers of the loan paid). From these margins, the expenses of the flotation had to be deducted, but

¹ Call-money rates rose, for example, to 20 per cent. at the end of March 1929; at this time the discount rate of the Federal Reserve Bank of New York was 5 per cent.

² In 1929 some \$3,000 millions of foreign money was estimated to have been invested in New York on short-term.

despite this, profits were often substantial. An issue might pass through the hands of several firms or syndicates before being offered to the public. Each of these would retain a part of the total; but would always try to make a profit on the part which was passed on to other buyers. As an example of the way in which this system worked, the flotation of a loan of \$35 millions for the Polish Government in 1925 may be considered. The issue house in this instance was Dillon, Read & Co. The Polish Government received 86½ per cent. of the face value of the loan. The small syndicate who took up the loan sold it to a larger syndicate for 88, this syndicate sold it for 91 and the eventual retail price was 95. There was, therefore, a margin between the first buying price and the ultimate selling price of 8½ per cent. of the face value of the bonds.¹ This margin covered the expenses of the various syndicates concerned as well as their net profits. Such margins were sometimes as high as 14 per cent. and devices were frequently employed which concealed their true magnitude.

The size of this spread was partly determined by the heavy expenses incurred in flotation. These arose chiefly from the methods which had to be pursued in order to ensure that the whole of an issue was sold to the public at a remunerative price, for, especially in the early post-war years, the unfamiliarity of foreign securities made them difficult to sell to the American investor. Thus the employment of 'bond salesmen', whose services had been very valuable to the issue houses in the flotation of domestic securities before the war, became an essential feature of the sale of both domestic and foreign securities. Issue houses also established branches throughout the United States and Canada in order to make these issues more readily available to small investors who had formerly held only government securities or savings deposits. In addition, a number of the metropolitan banks in the larger cities created special companies, called 'security affiliates', which also sold new issues all over the country. The best known of these companies were the National City Company (associated with the National City Bank of New York) and the Guaranty Bank (associated with the Guaranty Trust Company of New York). These new organizations were not bound by the laws that prevented branch banking and were able, therefore, to open offices in all the important cities and towns in the United States as well as in foreign countries. Incidentally, a large number of the bonds sold in this manner found their way into the portfolios of

¹ Cf. *United States Senate Inquiry into the Sale of Foreign Bonds* (Washington, Government Printing Office, 1932), p. 476.

small banks all over the country, which appear to have purchased them in many cases in order to maximize income rather than to spread risks or preserve liquidity.

Despite the expenses involved, profits from the sale of foreign bonds were large, and many foreign countries and corporations which might not have done so on their own initiative were induced to become borrowers in New York in order that such gains might be realized.¹ As time went on new concerns were attracted into this business and gross margins gradually diminished. Thus, for example, the average margin between the first buying price and the ultimate selling price of 110 German loans floated between 1924 and 1930 was 4.86 per cent. of the face value of the bonds; but between 1924 and 1926 the average was 5.88 per cent., and from 1927 to 1930 only 3.62 per cent.² The same was true of loans to other borrowers; competition forced issuing houses to reduce their margins and profits fell.

United States, 1920-29: Yields on Domestic and New Foreign Bonds^a

	<i>Weighted average yield on new foreign bonds^b</i>	<i>Yield on 60 high-grade domestic bonds^c</i>	<i>Excess of yield on new foreign bonds over domestic bonds</i>	<i>Average yield on new foreign bonds relatively to domestic bonds</i>
	<i>Per cent.</i>	<i>Per cent.</i>	<i>Points</i>	<i>Per cent.</i>
1920	7.69	5.88	1.81	131
1921	7.54	5.79	1.75	130
1922	6.63	4.94	1.69	134
1923	6.42	4.98	1.44	129
1924	6.56	4.85	1.71	135
1925	6.51	4.72	1.79	138
1926	6.51	4.60	1.91	141
1927	6.14	4.47	1.67	137
1928	6.09	4.49	1.60	136
1929	5.81	4.69	1.12	124
Average 1920-29	6.59	4.94	1.65	133

^a United States Department of Commerce, *Handbook on American Underwriting of Foreign Securities* (Government Printing Office, Washington, 1930), p. 44.

^b This is an index of *all* new foreign bonds whose yields at their price of issue are known.

^c Standard Statistics Co. Index: 15 industrial bonds, 15 railroad bonds, 15 public utility bonds, and 15 municipal bonds.

¹ See the *Senate Inquiry into the Sale of Foreign Bonds*, *passim*.

² See Kuczynski, *Bankers' Profits from German Loans* (Washington, The Brookings Institution, 1932), p. 135. It is indicated that these margins are, if anything, under-estimated.

This decline in the difference between the cost to the borrower and the selling price to the ultimate lender enabled the former to obtain foreign capital more cheaply without reducing the yield received by American investors.

Rates of interest declined from the heights recorded at the end of the war, but once the peculiar conditions associated with that period were passed, they developed a remarkable stability. Even more interesting is the unvarying nature of the margin between the yields on home and foreign bonds (see preceding table). The weighted average yield on new foreign bonds at their issue price was, over the period, some 30 per cent. higher than that on high grade domestic bonds. The fact that this margin did not tend to diminish—the exceptional year of 1929 apart—bears witness to the similarity of investors' anticipations throughout the ten years.

The conclusion emerges that the fall in profits from foreign bond flotation enabled overseas borrowers to obtain loans more cheaply, while, at the same time, investors were willing to subscribe to those loans at prices which yielded a fairly constant margin over and above the return obtainable from domestic investments. And America was investing increasing sums abroad. The figures given below, which are

*Total Foreign Capital Issues offered in the U.S.A., 1919-34**

Year	Nominal capital		Refunding		Estimated net nominal capital
	No. of issues	Amount	No. of issues	Estimated amount	
		(\$ millions)		(\$ millions)	(\$ millions)
1919 . . .	65	771	12	379	392
1920 . . .	104	603	4	106	497
1921 . . .	116	692	12	69	623
1922 . . .	152	863	16	99	764
1923 . . .	76	498	8	77	421
1924 . . .	120	1,217	17	248	969
1925 . . .	164	1,316	23	240	1,076
1926 . . .	230	1,288	28	163	1,125
1927 . . .	265	1,577	22	241	1,337
1928 . . .	221	1,489	26	238	1,251
1929 . . .	148	706	11	35	671
1930 . . .	122	1,088	20	182	905
1931 . . .	41	285	..	56	229
1932 . . .	7	88	4	59	29
1933 . . .	8	72	2	60	11
1934 . . .	4	65	4	65	..
1935 . . .	2	62	2	17	45

* From Moody's *Manual of Investments*, 1936. Issues for borrowers within the United States customs area are excluded.

published annually by the United States Department of Commerce, include only publicly offered long-term issues and make allowances for such proportions of these flotations as may have been subscribed from abroad; they show clearly the remarkable growth in America's foreign investments.

The amount of new capital subscribed increased in every year from 1919 to 1927, with the exception of 1923, in which year the occupation of the Ruhr and other political disturbances had violent economic repercussions. Refunding was most important in 1919, when many war issues became due; but after 1920 an increasing number of new foreign issues were offered, the majority of which called for new capital. The post-war boom in foreign securities began in 1924, actually with the successful flotation of the Dawes Loan, and, despite a decline in the last year, it continued until 1928. The tendency was reversed by the boom on Wall Street which gathered momentum in 1928 and was at its height in 1929, a boom whose characteristic feature was that it was confined to domestic securities. When it collapsed, there was a moderate revival of foreign issues during 1930, but during the depression the figures fell to a small fraction of their previous size.

This growth of foreign investment did not, moreover, represent merely a facet of the general desire of investors to benefit from the increasing profitability of industry, for new capital issues on foreign account increased not only absolutely but also relatively to new domestic investment:

*New Foreign Issues in the United States as a Percentage of Total
New Capital Offerings*

	<i>Per cent.</i>		<i>Per cent.</i>
1920	11	1926	18
1921	15	1927	20
1922	15	1928	17
1923	7	1929	7
1924	17	1930	14
1925	17	1931	8

Thus, 1923 apart, a larger proportion of the American capital invested through new issues was seeking employment abroad every year from the end of the war until 1927.

During the years prior to 1928 it is thus possible to discern three separate but interrelated trends in the American foreign issues market. In the first place, there was an increase both in the absolute volume of foreign investment and in the proportion of total new capital issues which were floated on foreign account; secondly, the

margin between the yields obtainable on foreign as opposed to domestic investment remained unchanged; and thirdly, competition between issue houses tended to lower the cost of borrowing, without diminishing the apparent return to investors. This affords ample evidence of the increasing faith in the safety of foreign investment during these years. Despite the larger proportion of resources which was directed abroad, the rates charged on domestic and foreign borrowing did not show a tendency to converge. The capital exported to Europe, above all for assisting the stabilization of currencies and for facilitating economic restoration, was regarded as wisely invested, advantageous to lender and to borrower alike. Meanwhile the efforts of issue houses in appealing to an ever-widening circle of investors were accompanied by a large measure of success.

Much criticism has been levelled against American issue houses. They have been accused of soliciting subscriptions to wholly unworthy issues, of being concerned only for their own profits and of disregarding the most elementary precautions to ensure that adequate protection was afforded to the loans which passed through their hands. There is, undoubtedly, a certain amount of truth in many of these allegations and a number of the criticisms put forward before the Senate Inquiry were substantiated; but it would be totally wrong to regard every important house as involved to an equal extent in questionable or unwise transactions. Some American issue houses employed experts of the highest standing to investigate financial and economic conditions in particular countries in order to ensure as far as possible that new loans would be successful. The employment of bond salesmen is a practice which is open to abuses, but the over-optimistic judgements which were made, particularly in respect of European loans, were not encouraged solely by those responsible for negotiating the issues.

Stabilization loans did, indeed, play a very important part in post-war recovery, and the difficulties with which debtors have been confronted in meeting service payments have been caused chiefly by the enormous volume of borrowing which was contracted, e.g. by Germany, *after the gold standard had been restored*. The mistake lay in the belief that the whole of the economic disorganization resulting from the war had been overcome once currency stabilization had been achieved. A mass of indebtedness was contracted which it was impossible to repay and the economic systems of debtor countries became, in many cases, adjusted to an inflow of capital which it was optimistically expected would continue indefinitely. The fundamental reasons why the service charges on this indebtedness could

not be met lay for a large part in the economic structure of the United States itself. One factor has already been mentioned, viz. the high rates of interest obtainable in New York for short-term funds which caused an inflow of foreign funds during the boom period, thereby creating a demand for dollars which tended to raise their price and to increase the costs to foreigners of making service payments to American creditors. Of far greater importance was the whole nature of the American balance of payments, and in particular the markedly favourable balance of trade.

The Balance of Payments

United States: Balance of International Payments

(\$ millions)

	<i>Balance on Current Accounts^a</i>	<i>Movements of long-term Capital</i>	<i>Other capital movements^b</i>	<i>Gold and Currency Movements^c</i>
1920-4 . . .	+4,945	-2,820	-645	-1,480
1925-9 . . .	+2,220	-2,610	+265	+ 125
1930-4 . . .	+1,510	+ 420	-585	-1,345

^a This is the balance on account of merchandise trade, silver movements, all service items, and interest payments including war-debt receipts.

^b Includes government capital transactions, short-term capital movements, and 'errors and omissions'.

^c Excluding silver movements.

In the foregoing table the trend of the balance of international payments of the United States is clearly shown. In each five-year period large but rapidly diminishing balances on current account had to be paid by foreigners to United States citizens. In the first period this balance amounted to nearly \$5,000 millions, of which over 55 per cent. was lent to foreigners and the remainder paid by imports of gold and exports of short-term capital. In the second period the balance on current account was less than half as large as in the first. Exports of long-term capital were also smaller, but by a very small amount, and their total exceeded the balance of income transactions by \$400 millions, so that, in this period, the United States was an importer of short-term capital and an exporter of gold. Finally, in the third period, when the balance on current account was less than a third as large as in 1920-4, the United States was an *importer* of long-term capital. In these circumstances the balance was completed by imports of gold and exports of short-term capital. The 'over-lending' in the middle period was very slight, so that during the fifteen years covered by the table the net amounts lent to

The Balance of International Payments of the United States, 1919-35*

(In millions of dollars)

	1919	1920	1921	1922	1923	1924	1925	1926	1927	1928	1929	1930	1931	1932	1933	1934	1935
Current Accounts																	
1. Merchandise	+4,018	+2,380	+1,976	+719	+375	+981	+683	+378	+681	+1,037	+841	+782	+334	+269	+225	+478	+236
2. Shipping and freight	+72	+92	+33	7	8	8	8	61	66	80	66	96	72	45	16	35	36
3. Tourist expenditure	50	180	200	200	400	500	580	498	528	552	638	602	456	275	221	245	292
4. Immigrant remittances, charity, &c.	600	700	800	400	350	356	350	284	258	276	288	215	202	163	132	131	115
5. Interest and dividends	+50	+50	+80	+225	+250	+305	+358	+487	+519	+534	+568	+616	+536	+392	+384	+367	+375
6. War debt receipts	+242	+52	+87	+157	+258	+182	+187	+128	+206	+207	+207	+241	+112	+99	+20	1	..
7. Government transactions	+227	+118	+51	16	19	5	5	43	29	57	22	81	100	70	52	27	55
8. Miscellaneous items ^b	+170	+26	11	58	71	96	+94	18	31	82	105	16	7	2	8	63	95
9. Balance on Current Account	+8,066	+2,204	+1,414	+480	+187	+712	+286	+156	+507	+725	+447	+629	+160	+121	+215	+461	+208
Capital Accounts																	
10. New issues for foreign borrowings	-357	-451	-547	-685	-280	-322	-248	-929	-1,201	-1,111	-631	-822	-212	-27	-10	..	44
11. Direct investments	-200	-200	-200	(4)	(4)	(4)	(4)	-167	-178	-258	-261	-182	-182	-32	-24	22	51
12. Foreign securities purchased from foreigners	-29	+481	227	-228	54	114	90	-115	-154	-559	-225	-200	-347	-228	-686	-405	475
13. U.S. securities repurchased from foreigners	-198	-258	..	..	..	..	..	-509	-650	-1,125	-1,054	-916	-498	-208	-580	-480	970
14. Foreign securities resold to foreigners	(0)	(0)	..	..	..	..	..	+228	+225	+449	+474	+206	+659	+228	+565	+510	425
15. U.S. securities sold to foreigners	(0)	(0)	..	..	..	..	..	+625	+221	+1,681	+1,489	+1,025	+589	+500	+760	+480	1,505
16. Redemption and sinking fund payments and receipts	+815	+371	+255	+78	+23	+45	+140	+257	+224	+291	+199	+173	+207	+122	+73	+89	170
17. Net movements of long-term capital	-276	-229	-671	-717	+1	-602	-487	-602	-723	-662	-127	-267	+219	+217	+492	+2022	+462
18. Government capital account	-1,781	-240	88	..	..	..	..	..	..	..	..	..	..	..	..	..	..
19. Net movements of short-term capital	..	..	..	+275	+3	+218	-61	+250	+200	-188	80	-485	-709	-409	-555	+184	+1,075
20. Balance of 'known' capital items	-2,157	-1,069	-787	-242	+4	-386	-548	-252	+177	-850	-217	-752	-490	-122	-326	+886	+1,537
21. Net movements of gold and currency	+250	+50	786	-225	-245	-266	+42	-112	+99	+222	-125	-258	+166	-91	+82	-1,229 ^c	-2,076 ^d
22. Errors and omissions	-1,158	-1,185	+129	+127	+74	-60	+120	+208	-723	-107	95	+81	+164	+152	+88	+482	+321
23. Balance on Capital Account	-2,065	-2,204	-1,414	-480	-167	-712	-286	-156	-507	-725	-447	-629	-160	-121	-215	-461	-208

* Compiled from Estimates of the U.S. Dept. of Commerce, of *The Balance of International Payments of the United States in 1935* (Washington, Government Printing Office, 1936), pp. 25-6. The annual figures for certain items, notably currency movements, long-term and short-term capital movements, silver movements, and interest and dividends are not fully comparable owing to revisions in estimates, changes in methods of collecting data, and (in the case of silver) the shift of the item from one category to another.

^b Includes such items as: silver movements (prior to 1934), parcel post, motion-picture royalties, bunker-fuel sales, sales of vessels, ship chandlery, insurance transactions, imports of electric power from Canada, trade in newspapers and periodicals, patent and copyright fees, advertising, telegraph and telephone services, stock-transfer fees, fiscal agents' commissions, brokerage fees, &c.

^c Excludes underwriters' commissions, discounts, and refunding.

^d Not estimated.

^e Included in figures for purchases of American and foreign securities, which are net figures.

^f Includes net estimated transfer of funds in arbitrage operations.

^g A small unestimated part of this figure represents movements of long-term capital.

^h Includes net imports of silver valued at \$26 millions in 1934 and \$236 millions in 1935.

foreigners by the United States were considerably less than the export surplus on current account. Thus, despite exports of short-term capital to the extent of \$965 millions, the gap was only filled by imports of gold to the amount of \$2,700 millions. Half these gold imports arrived in the single year, 1934, and this trend was continued in 1935, when imports of gold and currency (excluding silver) were valued at \$1,740 millions. One may say that the United States lent too much to individual borrowers, but it must nevertheless be remembered that her export surplus was so large in the early post-war years that the United States was 'underlending' to the extent of \$400 millions a year up to 1924. A similar tendency is clearly seen since 1930 as the result of rather different causes.

*War Debt Payments (Principal and Interest) to the U.S.A.**

<i>Fiscal years</i>	<i>\$ millions</i>
1918	106
1919	327
1920	93
1921	112
1922	58
1923	229
1924	214
1925	183
1926	195
1927	206
1928	208
1929	199
1930	240
1931	236
1932	99
1933	20
1934	1
1935	0.5

* Moulton and Pasvolsky, *War Debts and World Prosperity* (Washington, The Brookings Institution, 1932), pp. 482-5.

The above table gives the amounts received by the United States Government on account of war debts between 1918 and 1934. It is obvious that the difficulties experienced by foreigners in obtaining dollar exchange were considerably increased by the necessity of making these payments. It should, however, be noted that the strain on the foreign exchanges would have been even greater if war debts to the United States had been paid in full, for, even in the years when actual payments were large, additional dollar exchange to the value of at least \$250 millions would have had to have been found to meet the full payments. If, as is indeed probable, Americans would have been unwilling to lend even larger amounts abroad either on long- or

on short-term, these payments would have been made in gold, and it is extremely doubtful that increased gold imports would have forced the United States to assume a less unstable position in regard to her foreign balance of payments.

A word should, perhaps, be said about American imports of gold during the last three years. These are the consequence partly of direct action by the United States Government, partly of the repatriation by American citizens of their foreign balances, and partly of the flight of capital from certain European countries to the United States. Largely as a result of these imports the American banking system now possesses cash reserves far in excess of the legal minimum. The Federal Reserve Commission has, however, made use of its power to compel Federal Reserve Banks and Member Banks to carry higher reserve ratios, thus lessening the danger of inflation from this source. Secondly, the Treasury has taken direct action to 'sterilize' all purchases of newly mined or imported gold after 21st December 1936. Finally, the American government has practically promised, in the 'Gentlemen's Agreement' of the 25th September 1936, that it will not further devalue the United States dollar in terms of gold. Taken together, these official actions have considerably reduced the possibility of the enormous inflation in the United States which might have been the result of such large gold imports.

The basic situation with regard to the indebtedness to America is sufficiently well known by this time to require only the briefest comment. Debtors can, in the end, only meet the service payments on their borrowings by selling goods or services to their creditors. But the United States has continuously pursued a policy which would render such payment exceedingly difficult, and it is not, therefore, surprising that such a large proportion of the loans made by American investors are now in default, or that many equity holdings are earning practically nothing in dollars; indeed, it is remarkable that this did not occur at an earlier date. New borrowing, especially, by European countries, postponed readjustments in the balances of debtors and creditors alike and disguised the essentially unstable character of the whole situation. The continued increase in the volume of foreign lending by the United States may be said to have been caused by four factors, each of which it lay within the power of that country to control to a certain extent, viz. the high tariff which effectively excluded European manufactures, the insistence on the payment of war debts which increased the size of the transfers to be made, the proclivity of the American capital market to attract short-term balances, and,

finally, the 'share-pushing' of issue houses which was the result of the large profits to be obtained from the flotation of foreign issues. Throughout the post-war period, the long-term lending of the United States to foreign countries was made on such a scale that, in the conditions then existing, default became sooner or later inevitable. The United States was lending goods and demanding repayment in gold or dollars, and as the prices of these latter in terms of goods were forced up by the demands of debtors, the burden of interest and sinking-fund charges became more and more onerous.

By the height of her tariffs and the principles which have governed their alteration from time to time the United States has repeatedly shown its failure to recognize the part that commodity movements must play in maintaining international equilibrium. Under the so-called 'flexible' provisions of the Tariff Act of 1922 the President was empowered to move rates of duty within certain limits in order to make the costs of imported goods equal to the price at which they could be manufactured at home. Such a principle, if it could be put into practice and universally applied, would, of course, annihilate all international trade. These powers have not been utilized except to a minor extent, but considerations of a similar kind led to the Hawley-Smoot Tariff of 1930, which aroused general resentment abroad and hastened retaliatory restrictions by other countries.¹ No small part of the defaults of recent years have been caused, more or less directly, by this measure alone.

Enough has already been said of the part that war debts and movements of short-term capital have played in bringing about what Mr. Secretary Wallace has called 'the mutual insanity of the different nations of the world with respect to international trade'. It should, nevertheless, be emphasized that certain of the most important hindrances to foreign debt payment are being reduced at present. Tariff amendments during 1934 repealed the cost-of-production-equalizing provisions of previous Tariff Acts and envisaged a reciprocal lowering of barriers to trade. War-debt payments have practically ceased. Short-term balances have almost all been repatriated, and whether they will be built up again remains problematical. As a consequence of the default of interest payments by foreign countries, the receipts and payments of the United States on foreign account are now equalized by capital transfers which are smaller by about \$200 millions per annum than in 1930-32.

¹ See *International Economic Relations*, Report of the Commission of Inquiry into National Policy in International Economic Relations (University of Minnesota, 1934), pp. 36-8.

The outlook is, in fact, considerably improved, although, in the face of heavy gold imports during 1934 and 1935, it may be doubted whether sufficient has yet been accomplished to permit the receipt of interest and amortization payments without grave dislocation. The devaluation of the dollar has made things easier, except in so far as loans obtained in America bore contractual agreements to meet service payments in foreign currencies, and except to those countries whose currencies have depreciated even more than dollars.

The Geographical Spread of Investment.

The direction of American foreign investment has not been restricted to certain zones by political affiliations as in the case of France, nor diverted to any considerable extent into specific channels by the ties of Empire as was the case with a large part of the British exports of capital. But other important factors, not always of a strictly economic character, have tended to favour investment in certain regions and to discourage it in others.

Before the war, of the \$2,600 millions odd of foreign securities held in the United States, some \$1,200 millions represented loans to Cuba, Mexico, and various Central American republics; \$750 millions were invested in Canada; of the rest, Europe had absorbed only \$350 millions.¹ Proximity had influenced the direction of capital exports, and a large part of the investment had taken place within the American continent, both because of the specialized knowledge which was available with respect to this region, and also as a result of definite governmental pressure. Central America and the Caribbean Islands were treated as a sphere of special interest to the United States. Investment there was encouraged for a variety of reasons by the State Department, and the political factor was especially in evidence during the first decade of this century, when the era of financial imperialism, known as 'dollar diplomacy' and linked with the name of Secretary Knox, was at its height. To quote Professor Angell:²

'In the general Caribbean area—here understood broadly, taken as running from Mexico to the northern countries of South America—the motive frequently stated by officials for the exercise of dollar diplomacy was a desire to free the countries concerned from their financial dependence on Europe, which incidentally threatened the Monroe Doctrine. Actually, not only there but also in other parts of the world, the chief motive in those years was the desire to expand the financial influence of the United

¹ See above, p. 128.

² J. W. Angell, *Financial Foreign Policy of the United States* (New York, The Council on Foreign Relations, 1933), p. 77.

States, both for the sake of its political consequences in the regions directly affected and elsewhere, and for the sake of business profits as such.'

Domination over these regions was accompanied in the pre-war period by many chauvinistic acts which left little doubt as to the connexion between economic and political penetration. The proclamation of the right of the United States to interfere in Cuban affairs in order to 'maintain a government which can protect life, property and individual liberty'; the landing of troops on Mexican territory; and the general championship of *Civis Americanus in partibus peregrinis* were designed to free these territories from dependence upon European countries, to ensure the furtherance of political ambitions, and to protect profits. Nevertheless, such actions have served to reveal and check the tendency towards imperialism rather than to foster it. The war was not the signal for the amicable settling of all these disputes—the intervention in Nicaragua and the occupation of Haiti (accompanied by martial law from 1916 until 1931) might indeed be taken as evidence to the contrary—but the amount of attention paid to the disturbances has sometimes masked the fact that there has been a very definite movement towards recognition of the 'right of national self-determination'. Undoubtedly such policies belong primarily to the past and, although statements such as that of President Coolidge that 'the person and property of a citizen are part of the general domain of the nation, even when abroad' may have served to attract certain quantities of capital into Central America, this represents but a small proportion of the total volume of foreign investment which has been undertaken by the United States during the past fifteen years; investments in Mexico, in particular, have been regarded with well-merited distrust by American investors.

It is in Europe that the largest and most important body of American investment has been made, and therein lies, perhaps, the fundamental paradox of post-war international finance. The United States has remained aloof from European politics, but has increased very considerably her financial interest in European conditions. This peculiar, and one might almost say, impossible dichotomy of opinion has been at the root of many misunderstandings, of which the controversy with regard to war-debt payments has not been the least important.

Recognition of the fact that economic and political interests can never be completely separated was contained in a public announcement made by the Department of State on the 3rd March 1922, part of which read:

'The flotations of foreign bond issues in the American market are assum-

ing an increasing importance, and on account of the bearing of such operations upon the proper conduct of foreign affairs, it is hoped that American concerns which contemplate making foreign loans will inform the State Department in due time of the essential facts and subsequent developments of importance. . . . Responsible bankers will be competent to determine what information they should furnish and when it should be supplied. . . . The Department of State cannot of course require American bankers to consult it. . . . The Department believes that in view of the possible national interests involved, it should have the opportunity of saying to the underwriters concerned, should it appear advisable to do so, that there is or is not objection to any particular issue.'

Although nominally a request, bankers were bound in their own interests to accept this as a command, and, with a few negligible exceptions, every foreign loan floated since that date has had the approval of the United States Government at least to the extent that they have 'seen no objection' to it. The principal use of the power of veto in early years was to ensure that war-debt payments were made or funding agreements reached. Within six months of the announcement a projected loan of \$175 millions to Roumania was proscribed until such time as an agreement should have been reached with respect to war debts. Further loans to France were forbidden at the beginning of 1925 until the French Ambassador at Washington had signed a plan negotiated with the American World War Debt Funding Commission. Debt-funding commissions were immediately dispatched by Belgium and Italy upon the threat of similar action. In this way, the power to control new lending put private American investors in a worse rather than a better position, because it gave preferential treatment to the claims of their Government upon foreign debtors.

But exports of capital from the United States have gone not only to Europe but to every country in the world. Details of the distribution of the most important item in these exports, new foreign issues, are given on the next page.

The principal recipients, Europe, Canada, and Latin America, have none of them benefited from a steady inflow of capital from the United States, and there have been major changes in the direction of investment on several occasions. European borrowing was largest in the immediate post-war years and then again from 1924 until 1928, the steadiest stream of capital into Latin America occurred from 1926 onwards, and Canada proved most attractive as a field for investment in 1929.

Europe had, of course, been borrowing heavily in the United States

during the war and this was continued in the early post-war years by the granting of credits for relief and rehabilitation purposes. But such investment fell off to a marked extent between 1921 and 1923 during the period of the most violent currency fluctuations. Between the beginning of 1921 and the end of 1924 some 62 per cent. of the capital exports to Europe were on account of countries which were themselves creditors of some standing.¹ In the following period, from 1925 to 1928, however, despite the fact that new issues on European account had more than doubled, the volume of issues made on behalf of these countries was less than half as great as in the preceding three years, and the percentage taken by them of the total issues of European borrowers fell from 62 to 11. After the successful flotation of the Dawes Loan in 1924, American activity and resources were concentrated on attempts to restore economic equilibrium in the countries which had suffered most severely from the war.

*Percentage Distribution by Geographical Areas of net Nominal Capital obtained through Issues publicly offered in the U.S.A.**

	<i>Europe</i>	<i>Canada</i>	<i>Latin America</i>	<i>Rest of the World</i>
1920 . . .	49.7	37.0	9.9	3.4
1921 . . .	25.1	31.0	36.8	7.1
1922 . . .	27.7	22.0	29.3	21.0
1923 . . .	25.7	28.5	27.2	18.6
1924 . . .	54.3	15.7	19.3	10.7
1925 . . .	58.5	12.7	14.7	14.1
1926 . . .	43.0	20.1	32.7	4.2
1927 . . .	43.2	17.7	25.4	13.7
1928 . . .	47.8	14.8	26.4	11.0
1929 . . .	21.1	43.1	26.1	9.7
1930 . . .	40.1	30.8	22.0	7.1
1931 . . .	34.0	54.8	1.4	10.1
1932 . . .	..	100.0	..	..
1933 . . .	32.3	50.4	17.3	..
1934 . . .		No new capital issued		
1935 . . .	..	94.2	0.4	5.4

* Figures for 1920-9 derived from United States Department of Commerce, *Handbook on American Underwriting of Foreign Securities*, pp. 21-2; for 1930-4 from League of Nations, *Balances of Payments, 1931 and 1932*, and 1934; and for 1935, from the United States Department of Commerce Bulletin, *The Balance of International Payments of the United States in 1935*, p. 54.

That so much United States capital was invested in Europe was the result of a general consensus of opinion that it would prove tremendously beneficial, not merely to the borrowers concerned, but to the whole world. The Dawes Loan itself was preceded not only by

¹ *Viz.* Great Britain, France, Belgium, Sweden, Holland, and Switzerland.

solicitation from the German Government to the American banking houses, but also by communications from the heads of the various allied governments. In the formulation of the accompanying plan the United States took an important part. The State Department did everything in its power to ensure the success of the League Loans, especially those to Austria and Greece, and the Secretary of the Treasury released various liens on public assets in order that they might be pledged as security for the new issues. A series of credits was arranged by the Federal Reserve Bank to facilitate the restoration of the gold standard in European countries, and Poland, Czechoslovakia, Italy, and France took advantage of these offers. The response of American investors was immediate. By the end of 1930 private investments in Europe totalled nearly \$5,000 millions. Germany was, of course, the largest single debtor—to the amount of some \$1,421 millions on long-term—her borrowing being partly dictated by the payments she had to make for reparations. Once the mark had been stabilized American capital poured into the country. This continued for several years, but by 1927 some doubts of Germany's capacity to pay began to be expressed. Although, therefore, a large part of the loans to Europe were made in order to provide the foreign exchange with which bank reserves could be increased and currency fluctuations stopped, the stability so obtained unfortunately attracted more and more capital in the belief that no further difficulties could impair the ability of debtors to meet interest and amortization payments.

The loans made under the auspices of the League of Nations between 1923 and 1928 were well received in the United States. The fact that there was international supervision and control over the uses to which the loans were put, and the general consensus of opinion that without such loans stable economic conditions in Europe would be impossible, rendered them particularly attractive to American investors. As the table on page 184 shows, United States investors subscribed a part of all the League Loans except those to Danzig, which were issued in very special circumstances. Unfortunately, most of these loans are now in default, and have therefore been severely criticized by American holders. For this the League is not wholly to blame. Despite the most careful investigation before the loans were granted and, in most cases, continued supervision ever since, the League officials could not prevent new and more difficult situations from arising. It is sufficiently obvious that the countries receiving these loans could not have carried on without them; but it is not nearly so certain that the subsequent loans floated abroad,

*League Loans 1923-8**

<i>Name of loan</i>	<i>Subscribed in U.S.A.</i>	
	<i>Amount (\$ millions)</i>	<i>Per cent. of total</i>
Austrian, 1923	25.0	15.1
Hungarian, 1924	9.0	13.3
Greek (Refugee), 1924	11.0	16.0
Danzig (Mortgage), 1925 . . . . .	..	..
Bulgarian (Refugee), 1926	4.5	29.1
Danzig (Tobacco), 1927 . . . . .	..	..
Estonian, 1927	4.0	53.0
Greek (Stabilization), 1928	15.0	40.0
Bulgarian (Stabilization), 1928	9.0	33.3
Total	77.5	19.1

* *Third Annual Report of the League Loans Committee (London), 1935.*

after comparative prosperity had been established with the help of a League Loan, were either as necessary or as useful as their promoters maintained. In fact, they were definitely harmful, in that they gave these countries supplies of capital to which their economic systems only became adjusted after several years, and which ceased almost as soon as that adjustment had taken place. Each loan made by Americans to Europe after the war could probably be justified by itself; it was the cumulative effect of these loans which was harmful, and which made ultimate default unavoidable.

The financing of Latin America has undergone several important changes since before the war. Most of the capital imported was formerly of European origin, but between 1914 and 1920 the Latin American countries could look to New York alone for fresh funds, and over a large part of the post-war period it has been cheaper for most of them to borrow there rather than in Great Britain.¹ The flow of United States capital into South America has been erratic, but apart from the year 1921, during which investment in other parts of the world, and especially in Europe, was limited, the steadiest increase in United States holdings occurred from 1926 onwards. Private investments by the United States in South America doubled between 1925 and 1930.

The largest single debtor of the United States is Canada, where American investments amounted to nearly \$4,000 millions in 1930. The causes of the post-war increase in this indebtedness require little explanation: proximity has undoubtedly been an important factor, and the technical facilities for the establishment of new firms,

¹ See above, pp. 135-8.

together with the Canadian tariff policy, and, latterly, the preferences given to Canadian goods in Empire markets, have all furthered such movements of capital. Even so, the volume of investment in Canada has been of surprising magnitude, and the extent to which the United States has displaced Great Britain as a source of capital for Canada can be gauged from the fact that, whereas before the war between 80 and 90 per cent. of all imported capital came from London, since the war only some 4 per cent. has been of British origin, although borrowings in London have tended to increase slightly since 1932. The character of that investment is discussed below; the important point is that Canadian borrowing was at its maximum in 1929 during the New York boom, when new capital issues in the United States on overseas account were about half as large as in 1928. In contrast to other parts of the world where boom conditions in the United States tended to exert a deflationary effect, the spread of the boom across the border had results similar in Canada to those which were experienced in the United States. This was because the exports of capital largely took the form of direct investments by American enterprises.

Further consideration of the geographical distribution of American investment cannot conveniently be made apart from the nature of the enterprises in which capital has been placed and the general character of that investment. It does not suffice to consider the spread of American resources between different countries alone, for in many cases this would give a false impression of that investment, which has frequently been restricted to a narrow range of enterprises.

The Character of the Investment.

American holdings of foreign securities are frequently classified as 'direct' or 'portfolio' investments. 'Direct' investments are the foreign security holdings of United States industrial and commercial corporations which, in so far as they possess a majority interest, thereby exert control over foreign subsidiaries; 'portfolio' investments are the foreign security holdings of private individuals, insurance companies, investment trusts, and the like. Foreign government loans are not included as direct investments, which therefore consist of American-owned properties, public utilities, purchasing agencies, and raw material developments in other countries.¹ Thus, broadly speaking, the direct investments of industry and commerce represent

¹ See the United States Department of Commerce, Trade Information Bulletins, Nos. 731 and 767: *American Direct Investments in Foreign Countries*, 1930, and *A New Estimate of American Investments Abroad*, 1931.

United States: Private long-term investments abroad, December, 1930^a
(\$ millions)

Country	Direct investments	Portfolio investments						TOTAL	Per cent. of world total	Notes
		Government and government guaranteed				Private	Total			
		National	Provincial	Municipal	Other					
<i>Europe</i>										
Austria	17	45	15	25	8	5	98	115	0.7	
Belgium	65	179	..	10	..	..	189	254	1.5	
Bulgaria	1	13	..	..	..	..	13	14	0.1	
Czechoslovakia	6	21	..	8	..	1	80	85	0.2	
Denmark	16	100	..	47	17	4	168	184	1.2	
Finland	1	47	..	14	10	7	78	79	0.5	
Other Baltic States	10	4	..	3	..	..	7	17	0.1	b
France	162	138	24	51	87	10	310	472	3.1	
Germany	244	179	95	112	415	376	1,177	1,421	9.1	
Greece	10	43	..	..	..	..	43	53	0.3	
Hungary	10	7	..	24	18	60	109	119	0.7	
Irish Free State	3	3	..	..	..	..	3	6	..	
Italy	121	91	..	52	28	109	280	401	2.6	
Luxembourg	1	..	..	..	..	7	7	8	..	
Netherlands	44	47	..	6	..	69	122	166	1.1	
Norway	23	123	8	22	16	22	191	214	1.4	
Portugal	18	..	..	..	..	..	..	18	0.1	
Poland	53	87	9	8	20	..	124	177	1.1	
Roumania	16	9	..	..	..	..	9	25	0.2	
Saar Territory . . . . .	..	..	..	6	2	..	8	8	..	
Spain	92	3	..	..	..	..	3	95	0.6	
Sweden	19	30	..	..	..	224	254	273	1.7	
Switzerland	18	44	..	..	..	..	44	62	0.4	
Turkey	14	..	..	..	..	..	..	14	0.1	
United Kingdom	497	144	..	..	..	..	144	641	3.9	
Yugoslavia	8	39	..	..	11	..	50	58	0.4	
Total Europe	1,468	1,396	151	388	632	894	3,461	4,929	31.4	
<i>Africa</i>										
Algeria	3	..	..	..	..	..	..	3	..	
British Africa	90	..	..	..	..	..	..	90	0.5	
Egypt	7	..	..	..	..	..	..	7	..	
French Africa	1	..	..	..	..	..	..	1	..	
Liberia }	14	3	..	..	..	..	3	17	0.1	
Other } . . . . .	..	..	..	..	..	..	..	..	..
Total Africa	115	3	..	..	..	..	3	118	0.7	
<i>Asia</i>										
British Malaya, Siam, and Fr. Indo-China	27	..	..	..	..	..	..	27	0.2	
China	130	..	..	..	..	..	135	130	0.8	
Dutch E. Indies	66	135	..	..	..	..	..	201	1.3	
India	39	..	..	..	..	..	..	39	0.2	
Iraq	6	..	..	..	..	..	..	6	..	
Japan	62	162	..	43	36	142	383	445	2.8	
Palestine, Syria, Cyprus	7	..	..	..	..	..	..	7	..	
Persia	1	..	..	..	..	..	..	1	..	
Philippines	62	65	..	4	2	14	85	167	1.1	
Total Asia	420	362	..	47	38	156	603	1,023	6.5	
<i>Oceania</i>										
Australia and New Zealand	155	162	65	35	..	2	264	419	2.7	
Total Oceania	155	162	65	35	..	2	264	419	2.7	
<i>North America</i>										
Canada }	2,049	298	388	109	451	623	1,869	3,942	25.2	
Newfoundland } . . . . .	..	24	..	..	..	..	24			
Total North America	2,049	322	388	109	451	623	1,893	3,942	25.2	

^a League of Nations, *Balances of Payments, 1930*, p. 179.

^b Danzig, Estonia, Latvia, Lithuania.

^c Portfolio investments estimated at \$2.5 millions by Professor Remer.

*United States: Private long-term investments abroad,
December, 1930 (Cont'd.)*

(\$ millions)

Country	Direct investments	Portfolio investments						TOTAL	Per cent. of world total	Notes
		Government and government guaranteed				Private	Total			
		National	Provincial	Municipal	Other					
<i>Latin America</i>										
<i>(a) Mexico and Central America:</i>										
Costa Rica	22	0	..	..	2	..	11	33	0.2	
Guatemala	71	2	..	..	2	..	4	75	0.5	
Honduras (incl. British).	72	..	..	..	..	..	..	72	0.5	
Mexico	694	..	..	..	..	..	..	694	4.4	a
Nicaragua	13	..	..	..	..	..	..	13	0.1	b
Panama	29	15	..	..	3	..	18	47	0.3	
Salvador	30	5	..	..	..	..	5	35	0.2	
Total	991	31	..	..	7	..	33	969	6.2	
<i>(b) West Indies:</i>										
Cuba	936	123	..	4	..	4	131	1,067	6.6	
Dominican Republic	70	17	..	..	..	..	17	87	0.6	
Haiti	15	13	..	..	..	..	13	28	0.2	
Jamaica	22	..	..	..	..	..	..	22	0.1	
Other	29	..	..	..	..	..	..	29	0.2	
Total	1,072	153	..	4	..	4	161	1,233	7.9	
<i>(c) South America:</i>										
Argentina	359	322	37	40	..	..	449	808	5.2	
Bolivia	61	55	..	..	..	..	55	116	0.7	
Brazil	210	140	142	32	..	3	347	557	3.6	
Chile	441	155	..	20	35	..	260	701	4.5	
Colombia	130	44	63	23	14	23	172	302	1.9	
Ecuador	12	..	..	..	..	..	..	12	0.1	
Guianas	6	..	..	..	..	..	..	6	..	
Paraguay	12	..	..	..	..	..	..	12	0.1	
Peru	125	71	1	3	..	..	75	200	1.3	
Uruguay	28	43	..	10	..	..	53	81	0.5	
Venezuela	247	..	..	..	..	..	..	247	1.6	
Total	1,631	630	293	158	99	31	1,411	3,042	19.4	
Total Latin America	2,634	1,014	293	162	106	35	1,810	5,244	33.5	
TOTAL WORLD	7,841	3,259	397	730	1,183	1,710	7,334	15,676	100.0	
Deduct for international securities movement . . . . .	..	..	..	..	..	..	630	630	..	
Add for insurance companies' and banks' capital	7,841	..	..	..	..	..	7,304	15,045	..	
Adjusted total . . . . .	..	..	..	..	..	..	..	15,170	..	

a Portfolio investments estimated at \$116 millions by Edgar Thurington; but market value not more than \$15 millions.

b Some small portfolio holdings, amount unknown.

c Some small holdings of government and railroad bonds, amount unknown, but not very large.

the ownership of foreign branch-factories and subsidiary organizations, which are not merely financed with American capital, but also controlled and managed from within the United States. Such holdings largely consist of those equities which carry voting rights.

The distribution of United States investments abroad at their maximum in 1930 is shown in the tables on pp. 186-7. At the end of 1930 almost exactly half of the foreign investments of the United States were direct and half portfolio—\$7,841 millions in the former category and \$7,834 millions in the latter. It will generally be found that in the more highly developed and industrialized areas of the world portfolio investments have tended to predominate, and that in agricultural and primary-producing countries the reverse has been true, though there are important exceptions to this generalization. Investment in European countries, with the important exception of Great Britain, has been very largely portfolio, whereas in Latin America and in Canada direct holdings have formed the greater part of the total. Thus nearly three-quarters of the enterprises abroad which are controlled from within the United States are to be found in the Americas.

The growth of direct investment in other countries reflects the desire of United States undertakings to obtain control of similar organizations abroad. About 1,500 branch factories in foreign lands are owned in the United States, and it is interesting to note that over 70 per cent. of the total direct investment in foreign manufacturing industries is in concerns in which the American equity holding exceeds half the total issued capital. On the other hand, there are very few foreign concerns whose capital is completely held within the United States, largely because of legal difficulties which frequently confront organizations of this type. Equity interests have been readily acquired if control could be obtained thereby, but the American investor has shown a marked reluctance to acquire industrial securities without voting rights. Many devices have been adopted in order to secure control, especially the acquisition of patent rights, and the purchase of blocks of securities previously issued on foreign stock exchanges. The penetration of American ownership has been particularly marked in certain industries such as transport, petroleum, and mining.

The table opposite contains an estimate of the distribution of American foreign investments as between different types of holdings in 1930. It should be remembered that the values of direct and portfolio investments were approximately equal at that time, as has been shown above. Of the portfolio investments, about 63 per cent.

are represented by holdings of foreign government securities, issues of public utility undertakings account for 8 per cent. of the total, railroads for 6 per cent., and banking and credit companies for 5 per cent. A comparison of the first and second columns of the table shows that investment in manufacturing industries and in the petroleum and mining industries is mainly direct; investment in banking and credit companies is chiefly portfolio, and that the pulp and paper industry seems to have attracted both kinds of investment in almost equal proportions.

United States: Distribution of Private Long-term Investments Abroad, 1930

Kind of investment	Percentage invested		
	Direct	Portfolio	Total
Government securities:			
National . . . . .	..	42	21
Provincial . . . . .	..	11	6
Municipal . . . . .	..	10	5
Commerce and transport	22	15 ^a	18
Manufacturing industries	20	4 ^b	12
Petroleum "	15	1	8
Mining "	15	2	8
Agriculture	12	4 ^c	8
Distributing agents	5	..	3
Pulp and paper industries	4	3	3
Banking and credit companies	1	5	3
Miscellaneous	6	3	5
	100	100	100

^a Public utilities 8, railroads 6, steamships 1.
^b Iron and steel 1, match industry 1, chemical industries 0.5, electrical industries 0.5.
^c Sugar 3.

The spread of United States ownership across the border into Canada has taken place on a tremendous scale. The paper and pulp industry has virtually migrated from the one country to the other; more than half of the newsprint used in the United States is produced in Canada, and a large proportion of this Canadian industry is controlled by United States capital. Direct investments in other manufactures amount to more than \$500 millions, and this is concentrated especially in industries producing agricultural and industrial machinery, motor cars, and electrical goods. Much of this investment has been stimulated by the Canadian tariff, and United States manufacturers have also established plants in that country in order to take advantage of the preferences granted to Canadian exports by Empire

countries. Public utilities have received nearly \$1,000 millions of United States capital. There is, in fact, almost no activity in Canada and Newfoundland which has not obtained some capital from the United States, and throughout almost the whole of the post-war period it has been cheaper for Canadian public authorities to borrow in New York rather than in London.

Statistics of United States investments in Canada are given below.

*United States Investments in Canada, January, 1931**

	\$ millions
Government securities (Dominion, provincial, and municipal)	825
Railways	806
Other public utilities	557
Pulp, paper, and lumber	478
Mining	234
Metal industries	501
All other industries	288
Trading establishments	170
Finance and Insurance	151
Land and Mortgage	98
Total	<u>4,108</u>

* Estimates of the Canadian Bureau of Statistics.

In Europe, on the other hand, only in Great Britain have American direct investments exceeded portfolio holdings, over one-third of the enterprises controlled by the United States in the whole continent being in the United Kingdom. The borrowings of public authorities since the war have been the chief factor in the preponderance of the portfolio class of capital exports. In Germany, for instance, portfolio holdings amounted in 1930 to \$1,177 millions, of which \$801 millions represented securities of the National Government, States, municipalities, and corporations which were governmentally guaranteed, and only \$376 millions the borrowing of private corporations. In France \$300 millions was invested in public and semi-public bodies and only \$10 millions of the portfolio holdings were in private corporations; in Norway \$169 millions were public as against \$22 millions private; and in Sweden a large part of the borrowing by private corporations represented issues raised by the Swedish Match Company, which was in turn a lender to European governments. In Italy public utilities absorbed a large part of the American capital invested there. About \$700 millions of the direct investment in Europe was in manufacturing concerns and \$230 millions in petroleum, especially in distributing agencies. The manufacturing industries chiefly favoured were those producing motor-cars and electrical, telephone, and wireless apparatus. The most striking feature of the

whole export of United States capital to Europe was the high proportion absorbed by public authorities. Securities which bore a fixed rate of interest were preferred, largely in the belief that such investment was safer than equity holdings—a belief which was somewhat (but not altogether) illusory, as later developments have shown.

United States investments in Central America before the war were almost entirely direct, and investment of all types has been on a much smaller scale in recent years. Cuba has absorbed a very large part of this capital. It is estimated that about 53 per cent. of this investment is in the sugar industry, 10 per cent. in real estate, 8 per cent. in railroads, 7 per cent. in public utility undertakings, and 12 per cent. in government securities. The remainder is spread over all the other industries of the country. In Mexico, petroleum wells and refineries have absorbed 27 per cent. of the total American capital invested. Other important fields of investment in Mexico have been mines (23 per cent.), railways (18 per cent.), and real estate (14 per cent.). The destruction of property and the proclamation of decrees nationalizing various assets have rendered the future of that investment very problematical. Investments by private individuals and corporations in other Central American countries have been of relatively small amount. In Panama and the Canal Zone very large sums have been invested by the United States Government in the Canal itself, in railways, hospitals, and various public utility enterprises. In Guatemala, Costa Rica, and several other countries large direct investments have been made in recent years by the United Fruit Company.

Investments in South America have been principally in government and public utility securities; but direct investments in raw material producing industries have also been important. More than one-half of the American investment in Argentina is represented by the borrowings of the federal, provincial, and municipal governments. Of the remainder, 40 per cent. is in public utilities and 20 per cent. in manufacturing industries. About 40 per cent. of the \$700 millions invested in Chile is in government and municipal bonds, and a further 40 per cent. is directly invested in copper and nitrate production. In Brazil, most of the portfolio investment is in government obligations, and recent direct investment has been largely concentrated in public utility undertakings. The larger part of the direct holdings in Colombia are in petroleum, but mining and banana production have also absorbed considerable amounts; 84 per cent. of the portfolio holdings are government and municipal bonds. In

Venezuela, 97 per cent. of the direct investments are in petroleum, of which commodity that country is now one of the world's principal producers, and there has also been some investment in railways. In Peru, American investors have been interested chiefly in minerals and petroleum, and in Bolivia, in mining. In Uruguay, about two-thirds of the United States investment is in government and municipal securities; direct investments have been made in meat packing and public utilities. Over 40 per cent. of the investment in South America is, then, in government and municipal obligations; of the remainder, large amounts have been absorbed in public utilities, petroleum production, and mining. This distribution is typical of American investment in most parts of the world.

In other countries, United States capital has been employed principally in the production of raw materials or in subsidiary manufacturing plants where high tariffs or other barriers to trade make it difficult to supply commodities by the ordinary channels. Mining in South Africa, rubber in the Netherlands East Indies, and agricultural production in China have utilized considerable sums as have manufacturing in Japan and Australasia and public utilities in the more highly developed parts of Asia. But the investment of the United States in areas other than Europe or the New World has been small compared to that of Great Britain. The British Empire (Canada and Australia apart) has remained the preserve of British capital. Such American investment as has taken place within its boundaries has been very largely in the form of direct investments by United States enterprises which wished to establish subsidiary concerns to supply the Empire market with products that it would be uneconomical to import from America.

As will have appeared from the above, there are two factors which have profoundly influenced the character of the foreign investment of the United States. Where the risks attached to lending seemed to be high, as was the case with investments in Europe, there has been a marked preference for fixed-interest-bearing securities, and loans to public authorities have been by far the most important type of investment. Capital exports to most other parts of the world (and, to a lesser extent, to Europe) have been dictated by the desire of American companies to obtain control of concerns which would otherwise be their competitors in other countries, and by the impossibility of continuing business in many countries unless goods could be manufactured locally and sold as domestic produce. Direct investments have been largely concentrated in a few particular lines of activity, and in many countries these have formed the larger part

of the American capital employed. Examples of this tendency are afforded by the investments of the International Telephone and Telegraph Company, which has subsidiaries in nearly every country of the world, of the General Electric Company, of the Standard Oil Company of New Jersey, which is indirectly responsible for a large part of the \$1,115 millions invested abroad in petroleum, of the firms which control the Canadian pulp and paper industry, of General Motors and Ford, and of American public utility concerns which control similar enterprises in all parts of the world.

The private American investor, as distinct from the big international concern, has shown a marked preference for fixed-interest-bearing securities rather than for those whose yield is variable. He has, that is to say, been a lender rather than an investor, using the words in their narrower sense. It is improbable that the private citizens of any large international creditor country have ever shown such a decided unwillingness to subscribe to foreign equity issues. Between 1921 and 1924 the volume of public offerings of preference and ordinary shares on overseas account amounted to less than half of one per cent. of the issues of bonds and notes, and, of the fixed-interest-bearing obligations, those for governments and municipalities were about three times as large as those for industry. From 1925 to 1929 this aversion was less marked; equity flotations rose to 21 per cent. of new foreign issues in 1929—which was, however, a year of decreased capital exports—and at the same time industrial bond issues increased relatively to those for governments and municipalities, exceeding them in 1928 and 1929. Even in this respect 1929 was an exceptional year. The Wall Street boom was almost entirely in equities, and this affected foreign issues to a certain extent, particularly those of Canadian borrowers. In 1930 the movement was again reversed, equities falling to 4 per cent. of new foreign issues and official bodies obtaining larger loans than industry.

This preponderance of bonds and debentures among the new issues floated on the American capital market may appear to be irreconcilable with the picture which has been drawn of that country's shareholding in a vast number of commercial and industrial undertakings abroad. In the first place, however, a very large proportion of the direct investments of the United States were acquired through the purchase of concerns which had already been established in other countries. Corporations have not usually sought to obtain the capital with which to establish subsidiary enterprises by appealing directly to the general public by means of an overseas issue; they have tended instead to purchase flourishing undertakings or to

lease patent rights in order to obtain majority interests. Such purchases of foreign enterprises have usually been financed by the issue of additional obligations by the American holding company. In the second place, American companies which wished to operate in countries where there were no established concerns in their particular line of business have frequently found it less expensive and more convenient to finance overseas expansion in a similar roundabout manner. This was particularly the case during the boom years, when appeals to the public were most fruitful if equities in American undertakings were offered. A considerable part of the direct investment abroad has thus taken place without the flotation of foreign issues. Thirdly, certain of the most important corporations have been able to finance a considerable part of their foreign development without having any recourse to the capital market. The petroleum combines in particular have been practically independent of new issues, since the funds for both domestic and external expansion could be taken from large accumulated reserves. Lastly, during the post-war years portfolio have been increasing more rapidly than direct investments, principally on account of the heavy borrowing of European public authorities. A considerable part of the direct investments abroad were made before the war, and probably not less than \$3,000 millions was exported for this purpose between 1914 and 1922.

The character of United States investment has thus resulted in a narrower diversification of resources than might be expected. Loans to European governments and municipalities have been by far the most typical form of capital exports since the war. Secondly, investment in subsidiary industrial and commercial undertakings in Canada, Latin America, and elsewhere has taken place on a considerable scale without the flotation of foreign issues. Thirdly, public utilities have proved attractive since they appeared to promise a dependable rate of return. The distribution of American foreign investments was narrow in an industrial rather than a geographical sense, although the latter is also very important. It was the result of two desires which have conditioned almost the whole of the post-war capital exports of the United States—to assist Europe to recover from the aftermath of the war and to obtain monopolistic control of certain essential goods and services through the expansion of American corporations. In the one case, little attention was paid to the ability of Europe to meet the interest on her borrowings in the form of goods and services; in the other, the restricted number of commodities involved rendered that investment more vulnerable in the face of a fall in prices.

Recent Legislation.

Public sentiment in the United States has been roused by the default on interest payments by a very large number of foreign debtors,¹ and steps have been taken by recent Acts of Congress to prevent such a situation from arising in future. This legislation takes the form of attempts to regulate both the activities of issue houses and speculation on the stock exchanges, and its most important features are contained in four Acts passed in 1933 and 1934.

The Banking Act of 1933 forced all banks who wished to insure their deposits with the Federal Deposit Insurance Corporation to discontinue their investment banking activities and to sever their connexions with any 'security affiliates'.² Among the more important New York firms which have abandoned their securities business are the National City Bank, the Guaranty Trust Company, J. P. Morgan & Co., Drexel & Co., Brown Brothers, and Harriman & Co. Others who abandoned their banking business and became issue houses include Kuhn, Loeb & Co., Speyer & Co., and Dillon, Read & Co.³

This Act also gave certain additional powers to the Federal Reserve Board which may be summarized as follows:

1. (a) The Federal Reserve Board is given supervisory control over all relations between Federal Reserve Banks and foreign banks or bankers.
- (b) Any negotiations between Federal Reserve Banks and foreign banks must receive the prior permission of the Federal Reserve Board.
- (c) The Federal Reserve Board may be represented at such negotiations, and, in any case, must receive special reports of the progress of the negotiations.
2. The Federal Reserve Board is given power to make regulations governing the relations between Member Banks and foreign nationals who wish to make loans on the Stock Exchange.

The Securities Act of 1933 was framed when the passion for reform was at its height.

'The purposes of the Securities Act of 1933 are to make available to him [the investor] complete and truthful information from which he may

¹ The size and distribution of these defaults are discussed below, Chapter XIV, in some detail.

² All Federal Reserve Member Banks and all banks which are re-established with the aid of the F.D.I.C. are compelled to insure their deposits; other banks may do so by conforming to certain regulations, especially that they shall allow the F.D.I.C. to inspect their books.

³ Madden and Nadler, *The International Money Markets* (London, Pitman, 1935), p. 166.

intelligently appraise the value of a security, and to safeguard against the negligent and fraudulent practices perpetrated upon him in the past by incompetent and unscrupulous bankers, underwriters, dealers, and issuers.¹

The Johnson Act of 1934 is aimed specifically at foreign borrowers and may have important repercussions in future. It is printed in full below.²

The Securities Exchange Act of 1934 regulates the margins which must be required on brokers' loans. The actual margins required are determined by the Federal Reserve Board, but certain kinds of collateral are exempted from the regulations.

The Act also laid down strict rules governing the issue of full prospectuses for all new issues in order that investors might be given whatever protection there may be in a complete disclosure of the facts of any given situation.

Legislation of this sort can assist only *future* investors; it can do nothing to obtain for American investors the sums due on their past loans to foreign borrowers. All attempts to prevent highly speculative activity in the new issue market must be worthless if the balance of payments of the lending country is of such a nature that it is impossible in many cases for even the most deserving borrowers to meet their obligations in full. Of the American legislation the further criticism may be made that it consists mainly of 'locking the door after the horse has been stolen', for it is extremely doubtful if

¹ Report of Senate Committee on Banking and Currency, 1934.

² An Act—To prohibit financial transactions with any foreign government in default on its obligations to the United States. (Public No. 151-73D Congress.) (S. 682.)

Sec. 1. 'Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That hereafter it shall be unlawful within the United States or any place subject to the jurisdiction of the United States for any person to purchase or sell the bonds, securities, or other obligations of any foreign government or political subdivision thereof or any organization or association acting for or on behalf of a foreign government or political subdivision thereof issued after the passage of this Act, or to make any loan to such foreign government, political subdivision, organization, or association, except a renewal or adjustment of existing indebtedness while such government, political subdivision, organization, or association is in default in the payment of its obligations, or any part thereof, to the Government of the United States. Any person violating the provisions of this Act shall upon conviction thereof be fined not more than \$10,000 or imprisoned for not more than five years, or both.

Sec. 2. 'As used in this Act the term "person" includes individual, partnership, corporation, or association other than a public corporation created by or pursuant to special authorization of Congress, or a corporation in which the Government of the United States has or exercises a controlling interest through stock ownership or otherwise.'

Approved, 13 April 1934.

American investors will ever again be attracted by the doubtful securities which they purchased so readily in the 'twenties.

Conclusion.

In terms of the balance of payments, the ultimate nature of the security which debtors can offer bears little relation to the specific enterprise in which American capital is invested. It is clear that the ability of most countries with a heavy indebtedness to the United States (except Germany) to meet the service on their borrowings can only be restored by a recovery in agricultural prices. Whether the investments are in petroleum, public utilities, communications, raw materials, or telephones, they can yield once more an adequate return to their American owners only if the exports of the debtor countries expand relatively to their imports. If further defaults and losses are to be avoided, it is imperative that the United States should make without delay the adjustments necessary to enable its debtors to pay in goods and services.

But there are few indications that any attempts to make these adjustments are contemplated at Washington. The fundamental nature of the problem is not even yet apparent to some American statesmen. This cannot be more clearly illustrated than by the following quotation from a speech made by Mr. Cordell Hull, the Secretary of State, to the United States Chamber of Commerce on the 30th April 1936. He said:

'The foreign trade programme of this Government is based fundamentally upon what to us is an indisputable assumption—namely, that our domestic recovery can be neither complete nor durable unless our surplus-creating branches of production succeed in regaining at least a substantial portion of their lost foreign markets. Our production of cotton, lard, tobacco, fruits, copper, petroleum, automobiles, machinery, electrical and office appliances, and a host of other specialities is geared to a scale of operation the output of which exceeds domestic consumption by 10 to 50 per cent.'¹

Unless and until it is clearly recognized that America's imports are more important to the world as a whole than her exports, there can be no real revival of international trade and international lending. The vast majority of American public men are obsessed with the idea that their export industries must regain 'their lost foreign markets'. They fail utterly to realize that the development of these industries was

¹ *The Times*, 1 May 1936.

only possible when America was lending abroad on a large scale and that these industries cannot maintain, still less increase, their exports unless either foreign lending is resumed again on a large scale or its place is taken by a corresponding increase in imports. 'America must choose.'

CHAPTER XII

THE CREDITORS—FRANCE

IN addition to Great Britain and the United States, several other states have at one time and another lent larger or smaller amounts abroad. Among them may be mentioned France, the Netherlands, Sweden, Germany, Belgium, Italy, and Japan, but most of these are borrowers more frequently than they are lenders. France alone has been consistently a net creditor on an appreciable scale.

Statistics of French economic and industrial activity are few and it is therefore almost impossible to ascertain the exact position of that country on long-term capital account. The present chapter contains, for this reason, only approximate estimates of French investments in other countries. The figures given should always be treated with the greatest reserve; they do show, however, that although France is an important lender, her total foreign investments are small compared with those of the two countries already discussed.

The Balance of Payments.

No official computation is made of France's balance of international payments, but there have been several private estimates, of which the most generally accepted are those of M. Pierre Meynial.¹ It is important to notice that they refer not to France alone but to France and her overseas territories with the exception of Indo-China. The reason for this is that most French colonies use the same currency as France itself, and thus form an homogeneous unit from the point of view of foreign exchange requirements. Merchandise movements between the colonies and the home country are therefore excluded from the foreign trade figures, and of the invisible items one of the most important omissions is that of capital exports to the colonies. Also, owing to the failure to draw a fine distinction between interest and amortization payments on overseas loans, the balance does not always represent very accurately the sum available for new foreign investment.

The violent changes from year to year in the French balance of

¹ See *La Balance des comptes de quelques grands pays industriels* (Paris, 1926). Also annual articles in *La Revue d'économie politique: la France économique*. For 1927 and later years the estimates of the League of Nations have been used. These are based on those in *La Revue d'économie politique*, but differ somewhat from the latter as certain revisions have been made.

France: Balance of Payments—1913, and 1920-6.
(*Francs millions*)

	1913	1920	1921	1922	1923	1924	1925	1926
<i>Current Account:</i>								
Merchandise	-1,671	-20,380	- 224	-2,366	-3,092	- 500	- 1,300	- 2,483
Shipping	+ 330	+ 3,200	+1,200	+1,120	+1,500	+ 1,500	+ 2,200	+ 3,750
Insurance and transit	+ 60	+ 170	+ 142	+ 155	+ 169		+ 400	+ 500
Foreign workers . . . . .	..	- 330	- 336	- 388	- 720	- 1,000	- 2,000	- 3,300
Tourists	+ 600	+ 2,200	+2,800	+3,000	+4,000	+ 4,800	+ 9,000	+13,000
Interest payments	+2,300	+ 1,600	+1,900	+1,960	+2,000	+ 2,300	+ 1,800	+ 2,800
War debts and reparations . . . . .	..	- 448	- 376	- 74	- 807	+ 2,500	+ 150	+ 936
Balance on current account	+1,619	-13,988	+5,106	+3,407	+3,059	+ 9,600	+10,250	+15,205
<i>Capital Account:</i>								
New foreign issues floated in France	-1,155	- 202	- 215	- 256	-1,122	..	..	- 200
French securities floated abroad . . . . .	..	+ 1,974	+1,600	+1,487	+ 150	+ 1,650	..	+ 1,720
Other known capital movements . . . . .	..	- 1,292	-2,837	- 575	-2,302	- 908	..	- 580
Balance	-1,155	+ 480	-1,452	+ 656	+3,274	+ 744	..	+ 940
Gold movements	- 537	+ 473	+ 212	- 48	+ 18	..	..	- 65
Balance of gold and known capital items	-1,692	+ 953	-1,240	+ 608	-3,256	+ 744	..	+ 875
Errors and omissions	+ 73	+13,035	-3,866	-4,015	+ 206	-10,344	..	-16,080
Balance on capital account	-1,619	+13,988	-5,106	-3,407	+3,050	- 9,600	..	-15,205

France: Balance of Payments, 1927-35
(France millions)

	1927	1928	1929	1930	1931 .	1932	1933	1934	1935 ^a
<i>Current Account:</i>									
Merchandise balance	+ 108	- 3,299	-11,107	-12,913	-13,250	-10,088	-8,998	-6,750	- 6,000
Shipping income	+ 3,350	+ 3,150	+ 3,100	+ 2,700	+ 2,400	+ 2,000	+1,600	+1,300	+ 1,300
Insurance and transit	+ 450	+ 500	+ 500	+ 400	+ 300	+ 200	+ 500	+ 300	+ 300
Foreign workers	- 2,500	- 2,200	- 2,500	- 2,500	- 1,800	- 1,200	- 800	-1,000	- 750
Tourist expenditure	+ 6,000	+ 7,500	+ 8,500	+ 8,500	+ 6,000	+ 3,000	+3,000	+2,500	+ 750
Net interest movements	+ 2,240	+ 3,230	+ 5,000	+ 4,674	+ 3,350	+ 1,163	+1,850	+2,500	+ 4,000
Net war debts and reparations payments	+ 2,682	3,624	+ 4,593	+ 4,300	+ 1,320	..	..	..	..
Balance	+12,330	+12,505	+ 8,086	+ 5,161	- 1,680	- 4,925	-2,848	-1,150	- 400
<i>Capital Account:</i>									
New foreign issues floated in France	- 500	- 579	- 1,100	- 1,400	- 3,725	- 1,645	- 400	..	- 225
French securities floated abroad	+ 1,182	+ 167	+ 200	..	..	..	..	+ 300	+2,000
Repayments and other known long-term capital movements	- 4,892	- 354	- 130	- 3,107	- 9,619	+ 4,738	- 700	- 200	?
Changes in the floating assets of the Bank of France and the Government	+ 2,232	- 7,140	+ 6,576	+ 4,140	+ 6,350	+17,844	+3,632	+ 184	?
Balance	- 1,978	- 7,906	+ 5,546	- 367	- 6,994	+20,937	+2,532	+ 284	+ 1,775
Gold movements	+ 525	- 6,473	- 8,589	-11,729	-18,504	-18,489	+2,070	-1,500	+15,000
Balance of gold and known capital items	- 1,453	-14,379	- 3,043	-12,096	-25,498	+ 2,448	+4,602	-1,216	+16,775
Errors and omissions	-10,877	+ 1,874	+ 5,043	+ 6,935	+27,178	+ 2,477	-1,754	+2,366	-16,375
Balance on capital account	-12,330	-12,505	- 8,086	- 5,161	+ 1,680	+ 4,925	+2,848	+1,150	+ 400

^a Provisional figures.

payments were so important as to overshadow almost completely the long run position which was that of a creditor country receiving considerable sums annually as interest on its past investments abroad, and making considerable new investments at various times. Very important were movements of short-term capital; but these are almost entirely 'unknown', though their magnitude may be guessed from the 'errors and omissions' item. Because of their size and because they had very serious repercussions in Great Britain and the United States, and through these countries, in most of the debtor states of the world, movements of French short-term capital must be considered in some detail.

During the war the franc had been supported in the face of a huge import surplus of merchandise by means of credits from Great Britain and the United States. In the spring of 1919 both these countries discontinued their advances and removed the burden of maintaining the rate of exchange on to the shoulders of France herself. Faced with a deficit in the balance of trade of the magnitude of 20,000 million francs, France sought private credits from abroad which were, in fact, forthcoming, for speculation at the time was on a rise rather than a fall of the franc. At the beginning of 1920 the short-term credits granted to France amounted to about 3,000 million francs, and during that year they increased by over 12,000 millions, considerable sums being deposited in French banks and with French merchants or used for the purchase of short-dated securities. But such a method of bridging the gap created by the withdrawal of official foreign support for the franc was one which could in the end only have led to disaster and default. It is, in fact, a striking instance of the ease with which the balance of trade can adjust itself to the volume of foreign investment that when, in the course of 1921, those foreign credits began to be withdrawn, the adverse balance was reduced to a small fraction of its size in the previous year.¹ By the end of 1921 the short-term liability of France was about 11,000 million francs and a reduction in the next year to some 7,000 millions was accomplished without any great disturbance; the passive balance remained at a normal figure and the franc-dollar exchange rate rose from an average of 16·90 in November 1920 to 10·82 in April 1922.

Matters did not rest for long in this comparatively satisfactory state. It should be emphasized that the events leading up to the final

¹ See Iversen, *International Capital Movements* (London, Humphrey Milford, 1935), p. 67, and Jacques Rueff as against J. M. Keynes, *Economic Journal*, 1929, pp. 391-8.

collapse of the franc cannot be traced to an inherently unsound composition of the balance of payments; the budgetary situation was a much graver source of anxiety. Successive French governments hoped to obtain from Germany such sums in reparations as would pay, not merely for the restoration of the devastated areas, but also for part of the ordinary services normally financed out of the budget. The government debt, which arose from a succession of unbalanced budgets, was allowed to accumulate because that indebtedness was regarded as a temporary phenomenon to be paid off out of receipts from Germany. When such payments were not forthcoming, this debt was the principal source of inflation, and the attempt to enforce payment by the occupation of German territory only served to augment the volume of government borrowing. This belief in Germany's ability to pay reparations and the consequent series of unbalanced budgets, rather than over-borrowing from abroad or the existence of a price and income structure greatly out of equilibrium with those of other countries, was the cause of the flight from the franc in 1925.

The flight of capital brought about successive readjustments in the other items of the balance of payments. Some observers, working on the basis of different figures, are of the opinion that the balance of trade became active between 1924 and 1926; certainly, the increased income from the invisible items of the account, and notably from the expenditure of foreign tourists, rendered the balance of goods and services successively more favourable from 1923 to 1926. That the crisis was due to lack of confidence rather than to any insufficiency of reserves of foreign exchange was shown by the recovery of the franc-dollar exchange between March and April 1924 from 27·05 to 14·82, following the announcement of the Morgan Loan, which was not sufficiently large in itself to cause such a marked recovery. With the assumption of power by the *Cartel des Gauches* another fall set in, and the franc declined to about 18, where it remained for nearly twelve months. As far as can be ascertained, the bulk of the foreign short-term credits granted to Paris had been withdrawn before the end of 1924; when the final collapse began in the spring of 1925 it was occasioned, not by the withdrawal of foreign capital, but by a flight from the franc on the part of the French themselves. By the 20th July, 1926, the dollar stood at 50; three days later Poincaré formed his ministry and in December the period of *de facto* stabilization began with the franc-dollar rate at 25·50.

Reviewing the period between the end of the war and the beginning of 1927, capital movements fall into three periods: first, the

inflow of funds which took place while the exchange was pegged between 1918 and 1920, and which consisted of short-term money owned both by official bodies and private persons; secondly, the four years from the beginning of 1921 until the end of 1924 during which these foreign balances were realized and the funds repatriated; lastly, the period of the flight from the franc during which French capital was exported for safety.

There was, of course, an embargo on the export of capital throughout. Under the law of the 1st May, 1916, the French market was practically closed to foreign securities; after the 1st August, 1917, all transactions in foreign securities and exchange were centralized through the Treasury; and, finally, all forms of capital export were forbidden on the 3rd April, 1918. These laws remained in force until the stabilization, but it did not prove very difficult to evade them. The easiest way to increase balances abroad was to re-invest in other countries the proceeds from exported merchandise. Even the introduction of foreign securities on the French stock exchanges went on unhindered for some time.¹ Various foreign issues were permitted by the government which itself made certain direct advances to foreign governments. As far as can be ascertained, only a small proportion of the funds which escaped the control were used to purchase long-term securities or to subscribe to new issues. The bulk of the resources was placed in foreign banks, left in merchant and credit institutions abroad, or hoarded in foreign currencies, Great Britain, Holland, Switzerland, and the United States being the chief recipients.

At the beginning of the period of *de facto* stabilization in December 1926, the balance did not undergo any pronounced change. Exports of capital, predominantly on short-term, continued, and it was soon found that the new franc-sterling rate was too low rather than too high and two courses thus lay open to France. Either the balances abroad could be realized and gold imported on the basis of which a monetary expansion could take place (which would in the course of time bring French costs into line with those in other countries) or capital could be exported in order to prevent the franc from rising. Despite the French investor's reluctance to place his money in foreign long-term securities because of his recent losses on pre-war investments, and although the French Government did not believe that

¹ See the *Economist*, 1 March 1924, p. 474. Some 'hundreds of millions of francs' were used to buy shares in Royal Dutch, Shell, and Mexican Eagle in spite of the law of 1918. The Treasury Department responsible for affixing the stamps which gave these securities legal currency in France received no instructions to refrain from doing so, and from 1918 until 1924 continued to sanction the import of stocks and shares.

political considerations warranted the encouragement of such transactions, the policy of lending the foreign balances was the one chosen. This was the result partly of internal and partly of external considerations. In order to balance the budget the government had had to impose very heavy taxation, part of which could be avoided by French citizens if they purchased foreign securities in London, New York, or Berlin. The export of capital caused by this attempt to avoid taxation permitted the undervaluation of the franc to continue. It was, however, chiefly because any extensive conversion of French balances into gold or their withdrawal from Great Britain would have embarrassed the Bank of England that the former policy was not adopted. M. Poincaré pointed out in the Chamber of Deputies on the eve of stabilization that 'The Bank of France . . . has bought gold in New York and London. But on the latter market the monetary stocks were soon reduced to a point at which the bank of issue was disturbed. Therefore, in order to allay the anxiety of the Bank of England . . . the Bank of France has voluntarily stopped buying gold on the London market.'

That this situation could continue for any length of time was impossible; French short-term balances abroad could not continue to increase indefinitely, because a point must eventually be reached when a sudden scare and scramble for liquidity would bring disaster to the Bank of England. The *de jure* stabilization of the franc by the law of the 25th June 1928 took place at the moment when the incipient boom in New York was just beginning to attract capital to that centre and a transfer of some part of the French short-term funds from Great Britain to the United States could not be avoided. The drain of capital from London began with the stabilization, and short-term capital exports from France had ceased by about the end of 1928.

The magnitude of the French balances abroad cannot be precisely determined. Those of the Bank of France amounted to about 27,000 million francs in the middle of 1928 and by the end of the year stood at nearer 33,000 millions; the Treasury held about 10,000 millions and credit institutions and private individuals at least 15,000 millions in foreign countries. In the last-named category there had probably been a fairly heavy reduction during 1927 as confidence was restored in the franc, but this was more than offset by an increase in official holdings of foreign assets. Of this 58,000 million francs, equivalent to about £450 millions, it is probable that at least £300 millions was held in Great Britain. In the long run, if the French investor could not be persuaded to invest abroad on long-term it was

inevitable that a large part of these funds should be repatriated since, apart from fears as to their safety, resources would not be attracted to any great extent by short-term rates in London or, after the autumn of 1929, by those in New York.

The truth of the accusation that the gold imports which followed upon the realization of the French balances were 'sterilized' largely depends upon whether they could have been stopped before they endangered other European currencies. In the first place the Bank of France must be acquitted of the charge, for it ceased to import gold on its own behalf in 1929 and further reductions in its foreign balance were not used to obtain precious metal from Great Britain. As has been pointed out by Dr. Balogh,¹ the demand for gold arose from the need of the joint stock banks to replenish their cash reserves because of the rise in the note circulation and, after the Oustric crash in 1930, to meet the requirements of their depositors for hoarding. Contingent factors were the operations of the Treasury and the Caisse Autonome d'Amortissement in converting and funding the national debt at a lower rate of interest, and the peculiar structure of the French banking system with its inability to economize in the use of gold.

Even under these circumstances a large measure of expansion did in fact take place. It is argued that although the increase in the ratio of gold holdings to sight liabilities in the Bank of France from 40·4 per cent. in June 1928 to 57·02 per cent. in September 1931 may not imply that there was a deliberate attempt to prevent internal expansion, nevertheless it does show that the French system was not capable of meeting such an abnormal situation. That the French monetary authorities must be acquitted of sins of commission does not make them guiltless of sins of omission, and they may well be accused of failing to take abnormal measures to meet an abnormal situation.² But from the evidence afforded by the balance of payments it appears that readjustments to the gold inflow took place on an extensive scale. The balance of trade which was active in 1927 to the extent of 108 million francs became successively more passive until in 1931 there was an import surplus of over 13,000 million francs. The balance of goods and services (excluding gold) underwent a similar decline in each year from 1928 until 1932. Such changes, accompanied by a heavy import of gold, showed that that gold was not being wholly sterilized, either deliberately or unintentionally.

¹ *Economic Journal*, Sept. 1930.

² In this respect the inability of the Bank of France to make use of open market policy is important. See Royal Institute of International Affairs, *The International Gold Problem* (Oxford, 1931), *passim*.

The French balance of trade during the years before the collapse of the gold standard exhibited the same power of readjustment to movements of capital on an extensive scale as it had done in the early post-war period. This readjustment may not have taken place with sufficient rapidity, but within the existing legal framework it was not possible to avoid the repercussions on other currency systems except, perhaps, by exchanging short- for long-term assets. The initial cause of the withdrawal of gold was the under-valuation of the franc at the time of stabilization. But had it proved possible to invest large sums abroad in long-term securities further disasters might well have been avoided. Indeed, from 1926 until 1931 there was an increase every year in the volume of new issues floated on foreign account in France; but it was totally inadequate to meet the existing situation. Neither were the prospects for large-scale foreign investment favourable, nor were the French financial institutions equal to the suddenness with which the increase had to take place.

The failure of France to adapt itself to changed circumstances after the return to the gold standard was not a failure which it would have been easy to avoid. The inflation had increased the propensity of the French to hoard; it had reduced foreign investment to a minimum, and it is not, therefore, surprising that France has played a much smaller part in international investment in recent years than in the period before 1914. Not in two or three years could the memory of losses in pre-war Russian and European bonds, nor even in *Rentes*, be obliterated.

French Holdings of Colonial and Foreign Securities.

To estimate the volume of foreign and colonial securities held in France in recent years, it is necessary, in the first place, to ascertain the effect of war losses and the ensuing devaluation of the franc on the portfolio as it existed in 1914. Secondly, from data on new issues and other sources, the amount of new investment which took place between the end of the war and the beginning of the period of *de jure* stabilization may be obtained. Thirdly, the amount of capital used to purchase long-term securities abroad during the same period must be calculated. Lastly, account must be taken of the new investment since 1928, and of the reduction in the portfolio through sales of foreign assets between 1930 and 1933.

There is a substantial measure of agreement that in 1914 France held colonial and foreign securities to the value of about 45,000 million francs.¹ Upwards of half were rendered worthless by the war,

¹ See above, Chapter IX. Moulton and Lewis, C. K. Hobson, Colson, Rist, and Caillaux are in agreement with this figure.

and in 1920 there probably remained in the French portfolio about 19,000 million francs, including both those holdings which were actually paying interest and those which might be expected to do so with some measure of economic and financial restoration. Between 1919 and 1924 there were further reductions through the sale of a considerable number of foreign securities which had been pledged as collateral for loans in Spain, Holland, Switzerland, and Scandinavia. In addition, sinking fund receipts and amortization payments would probably have reduced the total to approximately 18,000 million francs by 1928.¹

A number of estimates have been made of the effect of the French inflation on the portfolio, and there has been an undoubted tendency to exaggerate the extent to which it enhanced the value of bonds and shares issued on account of countries in which the franc was not the currency unit. It has usually been assumed that the depreciation had the effect of multiplying the monetary value of the portfolio by the average extent to which foreign currencies appreciated in terms of the franc.² But, even when account is taken of the fact that the franc was not the only currency which became severely depreciated after the war, it will be clear that the only securities whose market value was likely to be greatly increased were those whose service was payable in foreign currencies or in gold. During the period between the end of the war and 1928 there was an *a priori* assumption that all foreign bonds whose contractual agreements bore promises to pay in francs would be paid in paper francs and not in *francs de germinal*, i.e. of a gold content fixed by the law of 1803 (the 17th Germinal year XI (5)).

The law of the 25th June 1928, which stabilized the franc at approximately one-fifth of its pre-war gold value,³ contained, however, a clause which read 'the present definition is not applicable to

¹ Cf. Moulton and Lewis, *The French Debt Problem*, p. 27, in which the figure of 18,500 millions is given for 1919. It is pointed out that interest payments were suspended during the war on about 3,000 millions of securities in South America. A large number of these, however, were soon restored to the income-paying class.

² e.g. by Meynial who, having pointed out that about 19,000 million francs remained of the pre-war holdings, continues: 'but the depreciation of the franc at the end of 1919 and above all in 1920 doubled or tripled their 1913 value (Egypt and Suez, U.S.A. and Canada, England and the Netherlands, Switzerland, Spain and Portugal, Argentina and Brazil). Thus, the portfolio ought to be evaluated at a figure, varying with the course of the franc, between 40 and 50 thousand million francs as a minimum.' Similarly Moulton and Lewis (*op. cit.*, pp. 27, 32, and 35) use conversion ratios, different for French commercial and political debts, which vary with the course of the exchange on 'seventeen important countries'.

³ 1 fr. (1928) equalled 65.5 milligrams gold nine-tenths fine as against 322.585 milligrams gold nine-tenths fine by the law of 1805.

international payments which, before the promulgation of the present law, could validly be stipulated in gold francs'.¹ This was an attempt to ensure that the holders of foreign investments in France should not suffer any loss, measured in real terms, from the devaluation, and that, in monetary terms, they should thus receive service payments which would increase the market value of their securities fivefold, measured in devalued francs. In this object the clause has been unsuccessful despite the attempts of the French Government to enforce payment on these terms by bringing proceedings before the Permanent Court of International Justice at the Hague. In fact, only in the case of four pre-war loans were the gold clauses interpreted strictly in accordance with the French contention, viz. issues to Denmark, Stockholm, the port of Rosario in Argentina, and the Credit-Foncier Franco-Canadien, which in all represent a quite insignificant sum.²

Very few loans issued in France before the war carried gold clauses. The service payments on the vast majority of those which have not gone into default have been made either in foreign currencies which have themselves depreciated or in devalued francs. The suggestion has been made that the law should be modified in order to ensure that loans which did not bear gold clauses should still be payable in *francs de germinal*, but it is admittedly somewhat late in the day to institute judicial proceedings with this end in view. Apart from the doubtful logic and ethics of the French claim that a country whose foreign debt payments have been reduced by four-fifths should have the right itself to be paid in full, there is the incontrovertible fact that this interpretation of the obligations of debtors has been generally recognized nowhere save in France.

In order to arrive at a valid estimate of the present value of French pre-war foreign investments it would be necessary to discover what part of the whole bore contractual agreements to meet service payments in francs and what part in other currencies. As far as can be ascertained no data on this point exist, and at any rate such contractual agreements bear little relation to the currency in which payments have in fact been effected. It may, however, be assumed that holdings of shares in companies abroad whose earnings would not be directly affected by the French inflation, have, in general, been enhanced in price relatively to fixed-interest-bearing obligations. Neymarck estimated in 1911 that of the foreign investments held in France only one-quarter were equities.³ In default of further informa-

¹ Article 2.

² *Journal officiel*, 7 Oct. 1934. *Rapport annuel de la Commission des emprunts-er.*

³ A. Neymarck, *Finances contemporaines* (Paris, 1911), vol. vii, p. 172.

tion, it can only be assumed that such a ratio was applicable equally to all countries in which investments had been made; but in view of the physical destruction of property during the war it would probably be an exaggeration to suggest that, measured in francs, such holdings were more than tripled in value as a result of the devaluation.¹ With regard to bond indebtedness it may be assumed that only such part of the foreign portfolio as was acquired through the purchase of securities previously issued in other markets, and therefore likely to be denominated in foreign currencies, has increased in price. This was the case with certain of the holdings in the United States, the British Empire, and South America. Since, however, these securities were of the type most readily saleable during the war years, and as they constituted only about one-tenth of the portfolio even in 1914, the proportion surviving until 1928 can certainly not have been in excess of 10 per cent. of the bonded obligations held. Hence the effect of the French devaluation on the foreign portfolio cannot have been to increase the nominal total of 18 milliard francs to a market value in excess of 35 milliards.²

In order to arrive at a total figure for the French portfolio at the time of stabilization it is necessary to take account of the foreign investment of a long-term or permanent character which took place between the end of the war and 1928. Various estimates have been compiled of the annual volume of capital subscribed in France to new issues for other countries. Although these are useful in giving a general impression of the quantity of foreign investment by this method in each year, they are all open to certain objections either of incompleteness or of lack of detail.³ Nevertheless, they constitute the

¹ The index of the average annual prices on the Paris Stock Exchange of fifty-four securities bearing a fixed rate of interest fell from 69 in 1920 to 53 in 1926, whilst 190 representative equities increased in price from 151 in 1919 to 299 in 1926. Such increases would be larger in the case of foreign shares.

² Total, 18 milliards in pre-war currency, of which one-quarter represented share holdings tripled in value to 13.5 milliards. Of the remaining 13.5 milliards of fixed-interest obligations, one-tenth increased fivefold in value to approximately 6.7 milliards, whilst the other 12 milliards expressible in francs were not augmented in value, making a grand total of 32.4 milliard francs.

³ Issues of French companies operating abroad and in the colonies are published from 1920 onwards in the *Statistique générale de la France*, but there is no distinction between that part of the capital raised which is spent in France or abroad. In the *Bulletin des annonces légales officielles* certain issues are given, but there is a similar gap in the information and capital issues not open for public subscription are not included. With regard to the borrowings of foreign governments, notes giving certain details are published from time to time by the Minister of Finance (see e.g. *Le Temps*, 2 Mar. 1932) but public

only sources of material which are available and their very variety affords a useful means of checking the results obtained, one against another. The nominal volume of capital exported through issues subscribed both publicly and privately on behalf of borrowers in the colonies and foreign countries may be placed at roughly 5 milliard francs between the end of the war and 1928. No great accuracy is claimed for this figure, but it may be taken as representing the order of magnitude of the sums involved.

Attempts to estimate the volume of purchases of long-term securities in other countries or of the introduction of foreign securities into France meet with even greater difficulties. Even in countries with the most reliable statistical information, estimates of these items are the least certain of the terms entering into the balance of payments, and in France only indirect information proves of any use. Much of the capital exported during the inflation might well have been used in purchasing foreign securities, especially British and American. As has been shown above, the introduction of foreign securities on to the French Bourse amounted to some 'hundreds of millions of francs'. Moreover, in view of the popularity of bearer securities on the Continent, large sums could pass from country to country by this means with very little hindrance. Nevertheless, it has been generally assumed that the bulk of the French capital which sought safety abroad during the inflation was left in short-term deposits or hoarded, for the French investor still believed in the ultimate stability of his own country, and regarded the balances which

issues, government advances, Treasury bills, and short-term credits are mingled indiscriminately and no distinction is made between new issues and refunding operations. M. Meynial, in his annual computation of the balance of payments, shows the most important issues of the previous year, but his figures specifically exclude colonial borrowings and in any case do not appear to be complete; in particular, holdings retained by the government, e.g. the whole French *tranche* of the Dawes Loan), are excluded. *L'Observation économique* (e.g. Dec. 1934) lists the issues from 1926 onwards, but the figures are open to the same objection as those of the *Statistique générale*, and in addition conversion loans also appear to be included. *La Commission des emprunts-or* includes in its list a number of government securities floated since the war, but these do not appear to be complete as checked from other sources. Malpas (*Les Mouvements internationaux de capitaux*, pp. 204-6) has estimated the issues in certain years from some of the above sources, but no totals are essayed and completeness is not claimed for the presentation. Nor are the calculations of the balance of payments of use as an indirect guide to the volume of long-term capital exported, since, apart from the exclusion of the colonies, the figures for the general balance as mentioned above do not accurately represent the sums available for new lending, since a close distinction between interest and amortization payments is not always made, and, in addition, a large part of the capital exports were made on short-term and have since been repatriated.

he held abroad as of use in tiding over the period of temporary disorganization rather than as an accumulated fund from which it would be possible to expand his long-term loans to foreign countries.

The volume of the French balances abroad has been estimated above. Of the 36,000 million francs in the possession of the Bank of France in June 1928, 10,500 millions represented 'negotiable securities', a sum which increased to 18,400 millions by the end of 1930. Such holdings had fallen almost to zero by 1933, and this appears to have been the case also with the balances of the Treasury and of private individuals. It is clear that very little of the total of 58,000 millions can have been placed in long-term securities or, if such was the case, the securities have since been sold. It is known, however, that the French held certain quantities of Consols and Local Loan Stock in Great Britain,¹ in Belgium they were purchasers of *Rentes*, in Switzerland, Holland, and the United States it is possible to trace their participation. Most of these securities were acquired before the stabilization. The magnitude of the sums involved was probably not more than twice the volume of capital exported through subscription to foreign issues floated in France, and it is accordingly estimated to be roughly 10,000 million francs for the period between the end of the war and 1928. Between 1928 and 1933, however, a good deal of this capital was repatriated.

With the advent of comparative calm in the currency sphere, it appeared that France might once more regain her position as an international financial centre of importance. The volume of long-term foreign investment increased as stability was restored, and the hope that had been entertained in the early post-war years of a return to conditions comparable to those which had ruled before 1914 proved not to be altogether without justification. By the time that the franc was established on a firm basis, most of the other European currencies had also recovered from their post-war vagaries, and the confidence of the French investor had been partly restored. From 1928 until 1931, there was a steady increase in the volume of foreign investment. (Even at the beginning of the depression, the decline was not as great as in the case of Great Britain or the United States.) It was only in these years that long-term capital exports occupied a place in the French economy of importance equivalent to that which they had possessed before 1914.

¹ Not, however, to the extent of £369 millions as recorded by the *Commission des emprunts-or*. This figure represents the total volume of the securities outstanding in which French holdings have been traced, and not the volume of the French holdings themselves.

Despite the increased statistical information about this period, it proves no less contradictory than that which is available for earlier years. The calculations appearing in *L'Observation économique* are reproduced on p. 214 and may be accepted only with the provisos mentioned above, that apparently a number of refunding issues have been included and that the data relating to the capital raised by private companies operating in the colonies and foreign countries does not closely represent the volume of capital actually exported on this account.

When these figures are compared with those obtained from other sources¹ it appears that they tend to exaggerate the sums involved. Nevertheless, they are valuable in showing the general tendencies from year to year and the relative quantities of capital attracted into various lines of investment.

For the period 1928 to 1933, the volume of French capital subscribed through new issues on foreign account, according to M. Meynial, was nearly 9,000 million francs. Although some movements may have escaped attention, this is less probable than that a number of short-term advances which were renewed from time to time have been included more than once by *L'Observation économique*. On the other hand, there is evidence of fairly considerable purchases of American and other foreign securities during 1928 and 1929 which would not appear in the statistics of new issues. Similar consideration points to the conclusion that new colonial investment probably did not exceed half the sums recorded in *L'Observation économique*. The increase in the French portfolio of foreign securities between 1928 and 1933 may thus be tentatively estimated at about 15,000 million francs, and the increase in holdings of colonial securities at approximately 7,000 million francs.

As against these increases there were heavy reductions in the total portfolio through the sale of foreign securities held in France between 1930 and 1933. The most readily marketable form of foreign long-term assets—those expressed in foreign currencies and originally bought on other markets—were successively liquidated, especially as the widespread currency depreciation rendered them less attractive to French investors. Sales of American holdings began in 1930 and the withdrawal of short-term balances went hand in hand with a repatriation of funds previously invested on long-term. During 1931 this movement reached its maximum, and the import of capital through sales of foreign securities and purchases of French

¹ e.g. *La Revue d'économie politique: La France économique*, annual articles on capital issues and on the balance of payments; Malpas, loc. cit., &c.

New Issues for Foreign Borrowers in France^a

Francs millions

	French companies operating in the colonies			Colonial government loans	Total for the colonies	French companies operating in foreign countries			Issues for foreign		Grand total	
	Share capital	Loan capital	Total			Share capital	Loan capital	Total	Governments	Companies	France	Sterling ^b (£ millions)
927 . . .	733.1	240	973.1	105	1,078	253.7	42.1	295.8	46	..	1,420	13.52
928 . . .	886.2	350.2	1,236.4	70	1,306	666.1	185	851.1	128	..	2,285	21.76
929 . . .	1,164	328.7	1,492.6	414	1,906	277.7	463	740.7	517	301	3,465	33.00
930 . . .	640.3	724	1,364.2	1,343	2,707	408.7	519.5	928.2	2,630	1,543	7,808	74.36
931 . . .	336.3	359.6	696	2,493	3,189	105.4	470	620.4	4,192	500	8,501	80.96
932 . . .	91	324	415	2,251	2,666	40.2	0.2	40.4	1,358	2,400	6,464	61.56
933 . . .	129	210	339	2,689	3,028	55	6	61.5	1,410	350	4,849	46.18
934 . . .	80.8	125.4	206.2	1,533	1,739	20.7	65.1	85.8	0	..	1,825	17.38

^a *L'Observation économique*, Dec. 1935, p. 452.

^b Converted at the rate of 105 francs to the £.

investments by foreigners has been placed at 12,000 million francs. In 1932 the process continued on a smaller scale after the heavy repatriation of securities in the previous year, and 1,000 million francs are estimated to have been involved. Such movements went a long way towards offsetting the increase in foreign investment which resulted from the confidence which stabilization engendered. The confidence was in fact short-lived and barely had expansion set in than it was offset, first by the American collapse in 1929, and then by Great Britain's departure from the gold standard. The search for safety which had led French investors in the earlier post-war period to seek assets expressible in foreign currencies now led them to revert once more to the franc. The reduction in the French portfolio through such sales of foreign securities probably amounted to about 12,000 million francs.

We are now in a position to gain an impression of the French portfolio as a whole at the end of 1933.

French Portfolio of Colonial and Foreign Long-term Investments, 1933

	<i>Francs milliards</i>
Pre-war holdings revalued in 1928 francs	35
Capital subscribed to new colonial and foreign issues, 1919-28	5
Capital involved in purchase of long-term foreign securities, 1919-28	10
Purchases of foreign securities and new issues for colonies and abroad, 1928-33	22
	<u>72</u>
Less sales of foreign securities, 1930-33	12
Total in 1933	<u>60</u>

French holdings of foreign and colonial securities thus amounted to about 60,000 million francs (£750 millions at 105 francs per £). The margin or error involved in such calculations is large and the true figure may be greater or smaller by 10 to 15 per cent.¹ It should be emphasized that this is a *gross* figure, i.e. no account is taken of

¹ Other estimates of the portfolio are as follows:

1924 Moulton and Lewis	43,100 million francs
<i>L'Information</i>	75,500 " "
1925-6 M. Olphe-Gaillard	80,000 " "
1926-7 " "	60,000 " "
1927-8 " "	80,000 " "
1928-9 " "	118,000 " "

It is believed that these calculations err on the side of exaggeration, both because of the rate at which pre-war holdings have been revalued in post-war francs and because of too ready an acceptance of the data with regard to new issues. The estimates of Moulton and Lewis, already criticized above, approximate most nearly to those given here, and there is reason for thinking that for the period covered they were the most accurate available.

investments by foreigners in France or foreign holdings of French securities.

A certain check on these calculations, at least up to 1928, can be obtained from the figures of France's income from foreign investments. Between the end of the war and 1928 the market value of overseas holdings has been written up from 19,000 million francs to 50,000 million francs, including both pre-war and post-war exports of capital. Between 1920 and 1928, the gross income from foreign investments (i.e. neglecting sums paid out on account of investments by foreigners in France) increased from 2,000 million to 4,700 million francs, but of this latter figure approximately 1,000 millions represented the interest on short-term balances abroad. Some measure of depreciation would have enhanced the value of certain foreign securities even by 1920. After that date, the increased income from foreign investments does not suggest an increase in the total volume of overseas holdings in excess of the above estimate. From 1928 onwards, M. Meynial has not given separate figures for the gross income from foreign investments, but the data are more reliable for these years.

Colonial and foreign investments are not so important to the French economy as they were before the war. The depreciation of the franc brought heavy losses to the holders of foreign securities just as it affected adversely those whose savings had been placed in domestic bonds, and the losses were increased by the preference of the French investor for fixed-interest-bearing obligations. The net receipts in the form of interest and dividend payments only amounted at their highest point in 1929 to 5,000 million francs (including short-term holdings) as compared with 2,300 million old gold francs or 11,500 million post-war francs in 1913. It is clear that currency disorganization is as disadvantageous to creditor countries as to debtors, and that, in the event of devaluation, there is little hope that lenders will be able to obtain service payments comparable in real terms to those which they formerly received.

Government Influence and the Direction of Investment.

There has been a close association between finance and government in France since the earliest days of large-scale capital exports. At no time has there been the same readiness to accept the principle of *laissez-faire* in investment matters as in Great Britain. Although restrictions upon the granting of foreign loans do not, under normal circumstances, amount to a rigid control, certain well-defined rules must be observed in connexion with all transactions involving finan-

cial relations with other countries. In particular, the opinion of the Quai d'Orsay has to be obtained. If the Ministry does not approve it, the flotation cannot be attempted, and there is a high degree of co-operation in this matter, not only between the Quai d'Orsay, the Treasury, and the Bank of France, but also between these institutions and the Press.

It would be difficult to over-estimate the effect of his losses on pre-war loans on the attitude of the French *rentier* with regard to foreign investment since the war. Although the countries which defaulted for the greatest amounts, Russia and Austria-Hungary, were no longer in a position to raise capital in Paris, the feeling of distrust spread to other borrowers. It was largely because of his bitter experience with regard to political loans before the war that the French investor preferred to hold his balances abroad in the form of short-term deposits during and after the post-war inflation. The government has found it correspondingly difficult to direct capital towards those countries whose friendship it wished to consolidate. It is not surprising, therefore, that a comparatively large part of the French foreign investment during the last fifteen years has taken place not by means of public issues, but through private loans from French industry and commerce in the form of *valeurs non abonnés*.

One of the main lines of development of French foreign policy in the early post-war period was the strengthening of Poland as a useful ally to dominate Germany's eastern frontier in the place of Russia. Impoverished and in need, not merely of capital, but also of the friendship of a Power sufficiently strong to guarantee her independence, Poland looked to France for assistance, and any understanding offered mutual advantages. Since, however, such friendship would be useless to France if unaccompanied by sufficient resources to enable its concomitant obligations to be implemented, it was essential that Poland should not remain weak and undefended. Thus, considerable quantities of armaments were sold to Poland on credit, but not all the French capital invested in Poland has, needless to say, been directly connected with armaments.

The countries of the Little Entente also received considerable amounts of French capital. Investment in these countries was favoured by the French Government for political reasons, and a considerable part of the capital which was sent to Czechoslovakia, Roumania, and Yugoslavia was used for purposes which could not be justified on strictly economic grounds. Some of the money was raised by new issues in Paris on behalf of governments and private

companies in these countries; but a part of it took the form of direct advances by the French Government—a method which was not common before the war.

French exports of long-term capital reached their post-war maximum in 1931. This is of particular importance since the capital exports of Great Britain and the United States had diminished considerably by that date, and most European countries were badly in need of foreign capital. France was the only country from which such assistance could be procured, and the quasi-monopoly which French capitalists thus obtained was used by their government for political purposes to a degree which had been impossible while the London and New York markets were still freely open to foreign borrowers. The French opposition to the proposed Austro-German Customs Union was a case in point. Austrian finances showed pronounced weakness early in 1931, and in May a loan of 150 million schillings was projected, but French participation was refused except on the condition that the idea of a Zollverein was abandoned. The Bank of England lent £5 millions to stave off the crisis, but this was exhausted by September, and as further credits could not be obtained from this source, Austria was left with the only alternative of accepting the French conditions. At the same time, financial aid to Germany was refused except on condition that the proposed Zollverein be abandoned by the German Government and that work be stopped on a new cruiser which was then being built. These conditions, however, were not accepted because Dr. Brüning believed that they would seriously antagonize public opinion in his country. This is a particularly clear example of the French policy of combining finance and politics; but all post-war exports of capital were not, of course, made in such circumstances.

Nevertheless, in general, there was a considerable similarity between French investment since and before the war, not in its immediate geographical direction, for with the political map of Europe changed almost beyond recognition this would be meaningless, but in the policies and motives which guided those movements of capital. According to the figures of *L'Observation économique*, of the capital invested in French companies operating abroad between 1927 and 1933, over 60 per cent. was used in Europe, and of the loans to governments, which are far more important, almost the whole were made within the Continent. Russia had, of course, ceased to be a borrower in Paris; the pre-war financial alliance with Italy and France had no post-war counterpart; instead, Poland and the countries of the Little Entente were the principal recipients of funds, though when

the moment was propitious Austria, Hungary, Bulgaria, and Turkey were also accepted as borrowers. The very nearness in point of time of these post-war loans closes many avenues of information which are open to the chroniclers of the financial history of an earlier epoch, but general impressions, impalpable and unsatisfactory as they are, can only lead to the conclusion that there has been no radical change in the type of foreign investment most favoured in France.

There was, however, one feature of French post-war capital exports which deserves special mention. Not all of the investment for political purposes was done by private investors; a very considerable part consisted of direct advances by the French Government. In so far as this was the case the stigma which attached to pre-war loans to Russia—that the *rentier* was left to bear the burden of default—does not apply, because this burden was spread over the whole tax-paying public. In an earlier chapter it was argued that political loans of this nature have both moral and economic advantages over loans of the pre-war type, and that it is better for all concerned that capital exports which have a political rather than an economic justification should be made directly by governments. In this respect, therefore, post-war French governments cannot be so severely criticized as those which promoted the pre-war loans to Russia without taking any responsibility for their failure.

Most of the French colonial investment was made before the war¹ and the majority of the post-war issues have been for refunding purposes. Colonial securities enjoyed a certain popularity before 1927, but since that date attention has been diverted to the continent of Europe. They are unattractive both because of their low yields, for which the possibilities of capital appreciation are insufficient to compensate, and because their prices are extremely erratic on the French stock exchanges. Thus, of seventy Indo-Chinese holdings, thirty-nine, representing capital invested to the total of about 1,500 million francs, have paid no dividends, while the remaining thirty-one, capitalized at 8,500 million francs, have paid on an average 1.87 per cent. It has been estimated that French investments in her colonies amounted in 1929 to 16,000 million francs.² Of this amount about 3,200 million francs represents the public issues of French colonial governments, and about 540 million francs are invested in bonds of the *Crédit Foncier de France*, the remainder being in securities issued by banks and private

¹ Cf. *L'Europe nouvelle*, 11 Jan. 1930, pp. 76-8.

² Cf. Southworth, *The French Colonial Venture* (London, P. S. King, 1931), pp. 94 ff. Other estimates are much lower.

companies in the colonies. The most important forms of private enterprise in which French capital has been invested are railroads; banks; mines; phosphates, fertilizers, and chemical products; trading companies; and ports, docks, and warehouses, in that order. In addition to French capital, British, Syrian, and Chinese investments have been made in some colonies on a considerable scale. Colonial investment has not, however, been very important at any time, and several attempts have been made to increase the popularity of colonial issues; these have, however, met with little response.

Indeed, foreign investment as a whole has never been regarded with such favour in France as in England or America. Before the war several resolutions were passed in the Chamber of Deputies deprecating the export of capital. Since the war the lack of confidence resulting from losses in Russia, and political agitation in Europe, have effectively reduced the volume of long-term loans. Even at the peak period between 1927 and 1933 only about 17 per cent. of the new issues floated on the French capital market were on account of the colonies and foreign countries. It was for this reason, probably as much as any other, that the French Government made direct advances to its political allies. There appears to be a growing body of opinion in France which desires to restrict capital exports to investments in the colonies and to refrain altogether from loans to European countries. It does not seem probable, however, that political considerations would permit of such a conservative policy and one may expect to see no great change in the direction of French capital exports in the near future.

CHAPTER XIII

THE DEBTORS¹

THE creditor countries of the world are few. In 1929 they were: Great Britain, the United States, France, Netherlands, Switzerland, Belgium, the Irish Free State, and Sweden.² Certain of these were only creditors for small amounts, though some had considerable foreign investments; but in general, the countries which have exported capital on any large scale, in addition to the three principal creditors whose holdings have already been discussed, can be numbered on the fingers of one hand. All the rest are debtors, some for very large and others for very small amounts.

The Volume of International Indebtedness.

Estimates of the total volume of international indebtedness can only be compiled with considerable difficulty and are, at the best, little more than approximations. Moreover, any violent exchange movements tend to make them misleading within a short space of time. One of the most recent calculations of this type has been made by Professor Julius Hirsch³ and relates to the middle of the year 1932. He estimates that the total international indebtedness of the world (excluding reparations) was at this time Rm. 307,208 millions (£15,000 millions),⁴ of which Rm. 252,628 millions consisted of private indebtedness and Rm. 54,580 millions of 'political indebtedness' (*politische Verschuldung*). The total of Rm. 307 milliards includes both short-term indebtedness and inter-governmental debts; if deductions are made on account of these, the total is reduced to slightly less than Rm. 250 milliards (say £12,000 millions).⁴ A certain corroboration of this figure is given by the League of Nations estimate that total international interest payments in 1930 amounted to £750-800 millions, which represented an average rate of about 6 per cent. on the capital sum.⁵ On an earlier page we estimated that the rest of the world owed rather more than £7,000 millions on long-term in 1930 to the three principal creditor countries, Great Britain, the United States, and France. A comparable figure from

¹ N.B. Whenever in this chapter foreign currencies have been converted into sterling the rate of exchange used was, unless otherwise stated, the mean of the buying and selling rates for spot exchange quoted in London on 15 Oct. 1936.

² Cf. League of Nations, *Balances of Payments, 1933*, p. 39.

³ *Weltwirtschaftliches Archiv*, April 1933, pp. 324-8.

⁴ Converted at Rm. 20.43 per £.

⁵ *Balances of Payments, 1930*.

Hirsch's estimates would be Rm. 208 milliards (£10,000 millions);¹ but this total would appear to include (a) some inter-governmental debts, (b) some short-term debts, (c) the long-term private indebtedness of France to Great Britain and the United States, and of Great Britain to the United States. It is not possible to estimate by how much Hirsch's figure should be reduced, but it is clear that some fairly considerable deduction is necessary, and that that would reduce the total to a figure not greatly different from our own estimate of £7,000 million.

This estimate of £12,000 millions for the total long-term indebtedness of the world in 1932 has little meaning unless it is compared with similar estimates for other dates, but such estimates are, unfortunately, not very reliable. Two are, however, available: from the data given above in Chapter IX, it is seen that the total long-term investments abroad of Great Britain, France, Germany, and the United States amounted to £7,000–£7,500 millions in 1913; and the total international indebtedness in 1924 was said to be about £9,500 millions.² Such figures are sufficiently comparable to show that there was a very considerable increase in long-term international lending in the decade following the war.

International investments were at a maximum about 1930; since that date they have been considerably reduced. In order, therefore, to gain an impression of the weight of debtors' liabilities at the onset of the depression, one should attempt to estimate the amount of foreign capital in each country at that date. The following table has been compiled from a number of different sources which vary widely in accuracy, methods of compilation, and results. It must be regarded as merely tentative, and includes as far as possible industrial and direct investments as well as public and private debts. Most of the investment was of a long-term character, but where a considerable proportion of the liabilities were on short-term this has been indicated. The gross amount of foreign capital employed includes all outstanding obligations, and the net figures show the deductions which must be made on account of the foreign investment which some debtors have themselves undertaken.

Germany was the largest debtor, but about half her obligations were on short-term. She also possessed foreign assets to the amount of about £400 millions, some £250 millions of which were long-term. Canada and Australia appear next in order among the borrowing

¹ Converted at Rm. 20.43 per £.

² *Wochenbericht des Institutes für Konjunkturforschung*, Berlin, iv (1931–2), p. 164.

*Foreign Capital Employed in Certain Countries, 1930**

Country	Foreign capital employed		Interest and Dividend payments		Foreign capital employed per head
	Gross	Net ^b	Gross	Net ^b	
	(£ millions)				£
Germany	1,350 ^c	925	68	49	20
Canada	1,330	955	58	38	127
Australia	817 ^d	753	36	34	122
China	660	580	20	20	1½
Argentina	640	635	32	32	55
India	575	565	26	25	2
Brazil	520	520	16 ^e	16 ^e	13
Dutch East Indies	320	320	22	22	5
Cuba	295	295	(1)	(1)	74
South Africa	260	260	15	15	34
Japan	260	50	12	2	4
Chile	250	250	11 ^f	11 ^f	64
Poland	234 ^g	205	11	10	7
Roumania	200	200	8	8	11
New Zealand	197 ^h	189	9	9	128
Hungary	143 ⁱ	143	7	7	11
Norway	128 ^j	94	5	4	45
Austria	120	80	5	3	18
Peru	115	115	(1)	(1)	17
Greece	115	115	6	6	18
Denmark	94 ^k	53	5	3	27
Czechoslovakia	88	46	7	3	6
Colombia	85	85	(1)	(1)	9
Venezuela	80	80	(1)	(1)	25
Uruguay	60	60	4	4	3
Yugoslavia	60	60	5	5	5

* Major Sources: League of Nations, *Balances of Payments*; Corporation of Foreign Bondholders, *Reports*; *Statistical Yearbooks* of Canada, Australia, New Zealand, India, and South Africa; *Statistical Yearbooks* of League of Nations; Staley, *War and the Private Investor*, App. I; *South American Journal*; Moody's *Manual of Investments*; Kimber's *Record of Government Debts*.

^b i.e. after deductions on account of each country's investments abroad.

^c Of which about £575 millions consisted of short-term capital.

^d Of which short-term capital, £34 millions.

^e These figures refer to 1932.

^f These figures refer to only six months of 1930.

^g Of which short-term capital, £71 millions.

^h " " " £25 "

ⁱ " " " £49 "

^j " " " £40 "

^k " " " £23 "

^l No accurate estimate can be made because a large part of the foreign capital consists of 'direct' investments.

nations, and China, Argentina, India, and Brazil were all net debtors to the extent of more than £500 millions. The three countries with by far the largest external indebtedness per head of population were all British Dominions: New Zealand, Canada, and Australia; they are followed by Cuba, Chile, and Argentina. During the post-war period the indebtedness of Germany has increased much the most rapidly. Other investment was directed mainly towards South America, Canada, Australasia, and the other countries of central Europe. The capital invested in South America and Canada was principally American, that in Australasia, British, and in Germany and the rest of Europe, British and American.

The interest and dividend figures indicate the size of the favourable balances on current account which would have been necessary to meet service payments in full after the flow of new capital had ceased. Those debtors who were accustomed to maintain a favourable balance of trade, like New Zealand and Canada, found themselves after 1929 in a much better position than others, like Germany and Argentina, who had relied for some time on fresh borrowing in order to pay the service on their old debts.

THE CHARACTER OF THE INVESTMENT

A rough estimate of the character of British, American, and French holdings of the securities issued by foreign and colonial borrowers shows that about 37 per cent. of the external investments of these three countries are represented by securities of national, State, provincial, and municipal governments in all parts of the world; between 25 and 30 per cent. has been employed in industrial and commercial enterprises of various kinds, and a further 20 per cent. in the development of means of communication and transport—especially in railways. These figures are only very approximate; but it is evident that governments, industrial and commercial enterprises (including direct investments), and communications have attracted capital in that order, and that, together, they have accounted for rather more than four-fifths of the total external investment of the three principal creditor countries.

Government Debt.

The importance of government borrowing has been emphasized in the preceding chapters. The total amount of the public debts of the most heavily indebted countries are given below. So far as is possible, public indebtedness has been understood to include the obligations of national, State, provincial, and municipal govern-

ments; but for a number of countries about which less information is available, only the debts of central governments have been included. Reparations are excluded, but war and relief debts are included. These figures must be regarded as little more than approximations, like those already put forward in this chapter.

External Public Indebtedness of Certain Countries, 1930

	<i>External public indebtedness (£ millions)</i>	<i>External public indebtedness as percentage of total foreign capital employed</i>	<i>External public indebtedness as percentage of total public debt</i>
Germany	260	20	..
Canada	270	20	25
Australia	599	73	52
China	86	13	75
Argentina	240	38	36
India	390	68	44
Brazil	166	32	61
Dutch East Indies	99	31	..
Cuba	30	11	64
South Africa	161	62	63
Japan	192	74	24
Chile	80	32	85
Poland	90	38	90
Roumania	157	78	91
New Zealand	159	81	57
Hungary	55	38	86
Norway	42	33	50
Austria	60	50	90
Peru	22	19	70
Denmark	32	34	55
Czechoslovakia	51	35	19
Colombia	30	35	68
Venezuela	nil	nil	nil
Uruguay	30	50	..

Sources: See note to table on p. 223.

Despite the nature of much of the material on which it is based, the table serves to emphasize the magnitude of the sums lent to debtor governments. In certain cases such as Australia, India, Japan, and New Zealand, over two-thirds of the imported capital has been for the use of public authorities. Only in a few cases has a large part of the investment not been in government bonds; Cuba, China, and Venezuela may be particularly mentioned. Those countries which have not financed the major part of their government debts by foreign borrowing are those in which there has been enough

industrial development to permit local accumulation of capital sufficient for such purposes and, occasionally, even for investments in other countries as well. Such countries include, for example, Germany, Canada, Czechoslovakia, and Japan. On the other hand, relatively undeveloped countries with little experience in the accumulation and handling of capital have tended to borrow abroad for government purposes. It is not surprising that some of these countries, whose governments are often unstable and whose banking and financial systems are almost entirely undeveloped, should be among the least credit-worthy of debtor nations.

The scope of government activity differs tremendously from country to country, and borrowing for certain purposes such as railway building has sometimes been undertaken by public authorities and sometimes by private companies. In many countries the government have undertaken to exploit large areas of land, to build railways and to develop other public utility enterprises with the prospect of a return on capital which would not be sufficient to induce a private entrepreneur to shoulder the risk of such an investment. In these cases the foreign holdings of government securities are relatively large. They may be large, too, when governments have borrowed for less easily justifiable purposes, e.g. in order to finance deficits which would have been met out of current income if stricter control were kept over government expenditure.

Government borrowing is sometimes classified as 'productive' or 'unproductive' according to the way in which the proceeds of a loan are spent. If the loan is used to purchase capital assets which can reasonably be expected to yield an annual return to their owners, the investment is said to be productive; investment in goods which yield no monetary return is said to be unproductive. Such a definition is, however, necessarily vague, although the statement that one form of investment is more productive than another does have a certain meaning, viz. that, other things being equal, the borrowers in the first case will probably have less difficulty in meeting service payments on their loans than those whose borrowing yields little or no annual return.¹ In this sense, it may be said that borrowing by the British Dominions and colonies has, on the whole, been more productive than that of many other countries, particularly the majority of the South American republics.²

¹ It should, however, be noted that by borrowing for strictly productive purposes a borrower may release other funds which he can use for unproductive purposes.

² It may, of course, be argued that if investment in income-producing assets

In the field of foreign investment a further classification is sometimes made, namely between 'self-liquidating' and 'non-self-liquidating' loans. If a loan is used to extend harbour facilities, for instance, and if the dues paid by ships using the harbour are in the form of drafts on foreign countries, then the return on that investment is in foreign currencies and the problems of meeting service payments on the loan are greatly reduced; such a loan is therefore called 'self-liquidating'. Here again, it is clear that this distinction is one of degree rather than of kind, and it is more accurate to speak of loans as more or less self-liquidating rather than as self-liquidating or non-self-liquidating in any absolute sense.

Investments in Railways.

A detailed analysis of the types of private undertakings in which foreign capital has been invested cannot be made here; but because there appears to be some misapprehension on the subject, a few words about investment in railways may not be inappropriate. Before the war, countries in all parts of the world borrowed very large sums in London, Paris, and Berlin for railway building, and this investment was regarded as highly desirable by all concerned. The volume of capital exported from these three centres for this purpose was never known with any great accuracy, since the borrowing was frequently undertaken by public authorities and a very large part of the capital subscribed to government bonds represented, in fact, investments in railways. About 40 per cent. of British overseas holdings in 1913 were in railway securities, and Sir George Paish has estimated that as much as two-thirds of the capital raised by overseas governments was also employed in this way. Thus about 60 per cent. of the entire volume of British overseas investment appears to have been devoted to railway construction. As far as Great Britain is concerned, however, investments in overseas railways have become much less important since the war, as is clearly shown in the table on the next page.

There have been three main reasons for the decline of roughly £700 millions in the total of British overseas railway investments since 1913: (1) the sale of nearly £600 millions of American

is 'productive', then investment designed to prevent depreciation of those assets is also productive; expenditure on armaments, therefore, may even be regarded as productive, if viewed as an amortisation payment or insurance premium which counteracts or prevents some possible forms of depreciation of a country's assets. Such an argument is, perhaps, rather far-fetched, and in this book only measurable money returns are considered when discussing the productivity of an investment.

British Holdings of Securities of Railway Companies Operating Abroad

(Nominal values—£ millions)

	In British countries			In foreign countries			Total
	India	Other	Total	United States	Other	Total	
1880 ^a	90	†	90	†	240	240	330
1907-8 ^b	123.3	189.0	312.3	600.0	286.7	886.7	1,199.0
1913 ^c	140.8	306.4	447.2	616.6	467.2	1,083.8	1,531.0
1926 ^d	116.4	276.2	392.6	..	484.0 ^e	484.0	876.6
1927 ^d	114.6	275.4	390.0	..	489.6 ^e	489.6	879.6
1928 ^f . . . . .	..	306.2	306.2	29.5	529.3	558.8	865.0
1929 ^d	97.5	240.6	338.1	29.8	454.4 ^g	484.2	822.3
1930 ^d	89.7	245.8	335.5	28.2	460.2 ^g	488.4	823.9
1931 ^d	89.7	249.7	339.4	29.1	460.1 ^g	489.2	828.6
1932 ^d	88.4	251.0	339.4	29.5	454.9 ^g	484.4	823.8
1933 ^d	88.4	250.4	338.8	28.1	444.3 ^g ^h	472.4	811.2
1934 ^d	88.2	250.8	339.0	34.8	438.9 ^g	473.7	812.7

^a Estimates by Nash; cf. Jenks, *Migration of Capital*, p. 413.

^b Estimates by Sir George Paish; cf. Sir Robert Kindersley in the *Economic Journal*, March 1929, p. 20.

^c Estimates by Dr. Feis; cf. his *Europe, the World's Banker*, p. 27.

^d Estimates by Sir Robert Kindersley; cf. *Economic Journal*, March 1929, June 1930, Sept. 1931, June 1932, June 1933, Sept. 1934, Sept. 1935, and Dec. 1936. The author has very kindly allowed us to use an advance copy of the last-mentioned number which contains the figures quoted above for 1934.

^e Includes the United States.

^f Estimates by the *Economist*, cf. issues of 1 to 22 March and 18 Oct. 1930. The figure for 'Other British countries' appears to include India, and that for 'Other foreign countries' includes bonds and debentures of foreign companies valued at £152.8 millions instead of £118.5 millions in accordance with the correction suggested by the *Economist*.

^g The preponderance of bearer securities makes it impossible to estimate the amount of the British-owned share capital of foreign companies, and this has accordingly been neglected in preparing these estimates.

^h The smallness of this figure is accounted for by the reduction in British loan capital outstanding in 'Foreign Rails' from £80.6 millions in 1932 to £47.9 millions in 1933. This can only partly be explained by the substantial repayments during the year; the chief reason was the exchange of sterling debentures of a foreign railway company for shares of a mining company. (See the *Economic Journal*, Sept. 1935, pp. 446 and 450.)

railway securities during the war; (2) the increased tendency of the governments of many countries—particularly British Dominions—to undertake the operation of railways themselves rather than to leave them in the hands of private enterprise, and (3) a decline in new railway construction. The first point requires no comment. Regarding the second, it is clear that the fact that most new railways are government owned and that old lines are being purchased by govern-

ments has tended to mask the amount of new investment in railways. Some measure of the extent of the change from private to government ownership is found in the fact that 46 per cent. of the railway mileage in operation in the British Empire (excluding India) was privately owned in 1913, whereas the corresponding figure for 1931 was only 24 per cent. Finally, the following table shows that even if new investments in private overseas railways have declined, they have not ceased:

*New Issues in London by Railway Companies Operating Overseas**

(£ millions)

	<i>In British countries</i>	<i>In foreign countries</i>	<i>Total</i>
1923	3.0	6.0	9.0
1924	0.6	3.3	3.9
1925	1.7	4.2	5.9
1926 . . . . .	..	7.6	7.6
1927	5.0	6.3	11.3
1928	9.5	4.2	13.7
1929	4.5	7.8	12.3
1930	5.5	9.8	15.3
1931	0.8	3.1	3.9
1932	1.3	..	1.3
10-year total	31.9	52.3	84.2

* Excluding conversions; from the League of Nations *Balances of Payments, 1927-9*, vol. ii, p. 178, and 1934, p. 181.

During the ten years 1923 to 1932, private overseas railway companies appear to have raised new capital in London at the rate of £8.4 millions a year, of which £3.2 millions were taken by Empire and £5.2 millions by foreign borrowers. The amount of railway borrowing, then, represented 8.1 per cent. of the total of new issues in London during this period.

Railway building in the British Empire has by no means ceased since 1913. The table on p. 230 shows, for the four largest Empire countries, the length of line open for railway traffic and its cost of construction and equipment in 1913 and 1920 as a percentage of 1931.¹ Between one-sixth and one-third of the present railway mileage of each of these four countries has been put into operation since 1913; in South Africa one-quarter and in India and Australia one-seventh of the lines have been opened since 1920. Moreover, as networks are expanded, there is an increase in the cost of construction and consequently in the demand for capital per mile of line built. Thus in

¹ *Statistical Abstract for the British Empire, 1934.*

Australia, half the expense of railway building has been incurred since 1913, and in South Africa and India more than two-fifths of the capital employed in railways has been invested during the last twenty odd years.

		1913	1920	1931
South Africa	miles . . .	63	73	100
	cost . . .	56	68	100
India	miles . . .	83	86	100
	cost . . .	57	72	100
Australia	miles . . .	66	86	100
	cost . . .	50	69	100
Canada	miles . . .	70	94	100

The larger Dominions and colonies have, of course, accumulated considerable quantities of capital of their own since the war, and their railway building has been financed to an increasing extent out of domestic resources. But in Canada an estimate for 1931 showed that \$1,738 millions of British and foreign capital had been invested in railway securities, i.e. about 27 per cent. of the total external capital employed. In Australia, State loan expenditure on railways until 1933 had amounted to £358 millions or about 45 per cent. of the total productive loan capital employed. In South Africa some 37 per cent. of the public debt is represented by expenditure on railways and harbours, and in New Zealand about 22 per cent. of the government's borrowing has been for railway purposes. These figures are not conclusive, but they do indicate that, although the borrowing of Empire countries in Great Britain for railways has been smaller since the war than it was before, a considerable amount of construction has still been proceeding, and that railway indebtedness still constitutes one of the most important items in Dominion and colonial public debts.

There has been little investment in railways in other parts of the world, either by the United States or by Great Britain, since before the war. British investment in Argentine railways has shown no tendency to expand at its former rate, and this is also true of similar investment in other parts of South America. The United States has never made a great number of railway investments abroad, except in Canada,¹ and it does not appear that other creditor countries have been greatly attracted to this form of capital export during the period in question.²

¹ It may be noted in passing that the Canadian railway companies have made substantial direct investments in railways in the United States.

² Although Dutch investors hold a considerable amount of United States railway securities.

Economic nationalism, as manifested in many agricultural countries which are attempting to attain comparative self-sufficiency, has been responsible for some new investment in railways in more recent years. The Export Credits Guarantee Department of the Board of Trade has found that countries such as Iran, Poland, and Brazil are making great efforts to improve their transport facilities, and tenders are constantly being invited for railway construction and electrification. It should be remembered, however, that such investment is very different from investment by means of new issues of long-term capital.

Thus, although they cannot be expected ever to regain the position which they held before the war, Britain's investments in overseas railways must continue for some time to be an important factor in her economic life. Even in the depth of depression, these investments enabled Great Britain to obtain over £20 millions worth of imports per year without any immediate *quid pro quo*, which is a not inconsiderable benefit.

INDIVIDUAL DEBTORS

EUROPE.

The principal European borrower since the war has been Germany; but almost all the other countries have borrowed larger or smaller sums for various purposes. The period is especially notable for the number of government-aided or guaranteed loans made to various European states by France, Great Britain, and the United States, and in this connexion it is necessary to make some reference to a series of loans made under the auspices of the League of Nations.

*The League Loans.*¹

The tables on the next page show the amounts of the League Loans and the proportions subscribed by various countries.

There are several reasons for giving special consideration to the League Loans. In the first place, their importance, in view of what was achieved with their aid, was such as to make the sums involved an exceedingly misleading guide to the part which they played in the universal effort to restore European stability after the war. This is the result of the particular circumstances which preceded their flotation, for almost all the countries which received League Loans would have found it impossible to borrow abroad by any other method.

¹ Cf. *Annual Reports of the League Loans Committee* (London).

THE DEBTORS

*League Loans**

<i>Date</i>	<i>Name</i>	<i>Amount (£ millions)</i>
1923	Austrian Government Guaranteed Loan	33.6
1924	State Loan of the Kingdom of Hungary	14.2
1924	Greek Government 7 per cent. Refugee Loan	12.2
1925	Municipality of Danzig 7 per cent. Mortgage Loan	1.5
1926	Kingdom of Bulgaria 7 per cent. Settlement Loan	3.4
1927	Free City of Danzig 6½ per cent. (Tobacco Monopoly) State Loan	1.9
1927	Republic of Estonia 7 per cent. (Banking and Currency Reform) Loan	1.5
1928	Greek Government 6 per cent. Stabilization and Refugee Loan	7.5
1928	Kingdom of Bulgaria 7½ per cent. Stabilization Loan	5.4
	Total	81.2

*Creditors for League Loans**

	<i>Per cent. of total loans</i>
Austria	3.2
Belgium	1.2
Czechoslovakia	4.8
France	3.0
Great Britain	49.1
Greece	3.3
Holland	1.8
Hungary	0.4
Italy	5.9
Spain	2.6
Sweden	1.6
Switzerland	4.0
United States	19.1
	<u>100.0</u>

* League Loans Committee (London), *Third Annual Report*, June 1935, pp. 60 and 61.

Secondly, they enabled the newly created states of Europe to attain that modicum of economic independence without which their political independence would have been an empty sham, and it enabled them to do this quickly, without any loss of prestige, and in a manner compatible with the strongly nationalistic sentiments of their inhabitants.

Thirdly, the League Loans involved several novel features which, in the years before the depression, promised well for the furtherance of financial co-operation between nations. These features, some of which were not entirely unknown before the war, were concomitants of the existence of any such extra-national body as the League

itself. The general supervision which the League exercised, to a greater or lesser extent, at different stages and places, represented a departure from traditional practice in that contact between borrower and lender was not direct, but through an intermediary. In each case the whole question of the situation in the prospective borrowing country was the subject of a special inquiry conducted by the League before any loan was raised.¹ As a result of this inquiry recommendations were made to the Council of the League by the Financial Committee which, on endorsement, were put into effect by that Committee. Nor did the League's supervision stop with the successful flotation of a loan. Except in the cases of the Danzig and Estonian issues, the League maintained an International Financial Commission, or appointed a Commissioner-General resident in the borrowing country, to supervise the collection of the loan service and to see how the proceeds were spent. These officials were given adequate powers to interview persons and examine documents so that proper supervision could be exercised.

The loans also exhibited certain new features whereby additional security, other than the pledge of the borrowing country, was given to investors which, although it was not a serious embarrassment to the borrowers, did much to ensure the success of the issues. In all cases, the service of the loans was secured, over and above that protection afforded by League supervision, by a first charge on various revenues or real assets. The interest and principal of the Austrian Loan were, moreover, guaranteed by various governments, in many cases to an extent considerably in excess of the subscription of their respective nationals to the loan. This, the first of the League Loans, was the only one which was directly guaranteed as to principal and interest by foreign governments, and it is possible that an extension of this practice to the other League Loans would have been of considerable subsequent benefit to those who invested in them.

Finally, the League Loans represent an enormous increase in 'anonymous' inter-governmental lending. By this is meant the flotation of a single issue in several financial centres which made it impossible for any single creditor to put pressure on the borrower.

It must be emphasized that the creditor governments were not so intimately connected with League Loans as has often been supposed, except in so far as they had a moral obligation to their own peoples whom they urged to subscribe to the issues. Similarly, the

¹ This does not apply to the two small loans to Danzig which were made in very special circumstances.

attitude and responsibilities of the League itself should be noted and not exaggerated. Though the moral obligation of the Council cannot and would not be disputed, it is as well to remember that it was actually under no obligation beyond that of ensuring the successful flotation of a loan and of making such provisions for the collection of the service as was indicated in each specific case. To quote the Report of the Rapporteur on the work of the Financial Committee at the League Assembly of 20th September 1927:

'All these loans were issued without the least difficulty. The investing public has confidence in the loans issued under the auspices of the League of Nations because it knows that they are based on plans carefully studied by the impartial and highly qualified experts who form the Financial Committee. Furthermore, it is well known that this Committee follows systematically and assiduously financial conditions in the countries with which it is concerned.'¹

In general, it is impossible to deny that everything which could reasonably be done was done in order to ensure that the League Loans should be successful in the broadest sense of that word, and with the utmost good faith on the part of the League, the borrowers, and the lenders alike. No justifiable appeal for assistance was refused to any impoverished country, and the criterion of what was justifiable was determined by persons whose ability and disinterestedness were beyond question. The genuine desire on the part of the debtors to fulfil their obligations is shown by the manner in which, without exception, they have given absolute priority to the League Loans before any other external obligations. League Loans are the 'First Debentures' of international investment; if their dividends have remained unpaid it is certain that many creditors for other securities are in a far worse plight.

*Germany.*²

Ethical and economic considerations alike were favourable to the export of foreign capital to Germany at the end of the war. Apart from the gigantic industrial reorganization necessitated by the sudden change from war to peace, and the need to ameliorate the actual physical distress of many of her inhabitants, Germany was also forced to pay large amounts as reparations to the victors and

in l. 1 Quoted in the *First Annual Report of the League Loans Committee* (London, 1927), p. 23.

which for a detailed analysis of German borrowing see C. R. S. Harris, *German Foreign Indebtedness* (Oxford University Press, for the Royal Institute of International Affairs, 1935).

to attempt to re-establish the former standards of life of her people in a geographical area which had been shorn of some of its richest parts. Only by a long and difficult struggle could she hope to do this with the aid of her own capital accumulation, and she was forced to rely on foreign lenders in order to obtain the funds necessary for the work of reconstruction. These lenders, especially the United States, were more than willing to assist, and vast sums of money began to pour into Germany. In such circumstances, it is hardly to be wondered that Germany borrowed a larger volume of foreign capital in a shorter space of time than any other country has ever done.

The period of large-scale German foreign borrowing began in 1924 with the stabilization of the mark and the issue of the Dawes Loan. Rates of interest within Germany were relatively high and lenders all over the world, and particularly in the United States, Great Britain, Holland, Switzerland, and Sweden, were willing and anxious to make loans to German governments, municipalities, banks, and industries. The problem of how Germany was to obtain an export surplus sufficient to meet the service payments on these loans as well as the sums due on reparations account appears to have been overlooked. Even before the war Germany had had an unfavourable balance of trade; in 1924, her productive capacity had been greatly diminished by the territorial changes and consequent industrial dislocation imposed by the Peace Treaties, and her creditors were protecting their own industries with tariffs to a far greater extent than ten years before. In such circumstances the creation of an export surplus was almost an impossibility.

A secondary, though nevertheless important, consideration concerns the purposes for which the loans were used. Much of the foreign investment in Germany between 1924 and 1930 was of an unproductive nature, and an even larger proportion was of a kind which added nothing to the available supplies of foreign exchange. That much of the borrowing of municipalities was of this type was pointed out by Dr. Schacht, President of the Reichsbank, in November 1927. 'The expenditure', he said, 'upon the construction of stadia, swimming baths, pleasure gardens and ornamented buildings, upon land and estates, amusement halls, banqueting halls, hotels, offices, planetaria, aerodromes, theatres and museums, upon credit concessions to, and participation in, private business, amounts to a total sum not much below the total of foreign loans raised by cities.'¹ Such investments do, of course, provide an economic return, but

¹ *Frankfurter Zeitung*, 19 Nov. 1927, quoted by Harris, *op. cit.*, p. 5, n.

since this cannot be measured in money terms, and since it does not accrue directly to the borrower in an accounting sense, these investments must be classified as unproductive.

Of a slightly different nature are the problems raised by the technical methods employed in using foreign short-term funds. Loans to German banks and other borrowers on short-term were used to purchase assets of a kind which were liquid only in the long period. Technically, it is not true to say that German banks borrowed short and lent long, since their loans to industry were nominally for short periods; but if they were used to purchase fixed plant—as was often the case—they became, in fact, long-term loans since they could only be repaid over a long period of time. The existence of these loans materially intensified the difficulties of German banks during the international scramble for liquidity in the summer of 1931.

Germany's foreign indebtedness reached its highest point during the summer of 1930. At that time, short-term loans and credits amounted to about Rm. 15 to 16 milliards, and long-term loans to Rm. 11 milliards.¹ Of the short-term loans, probably about 70 per cent. was due to foreign (mostly American) banks, chiefly by German banks—who had re-lent it to industry—but also by German industries and municipalities. The remainder of the short-term loans were due mainly to foreign firms who had made loans to German industry or who had deposits in German banks. It is difficult to give any distribution of the long-term loans to Germany as between classes of borrowers. As a whole, however, States, municipalities, and other public and semi-public bodies were by far the largest group of borrowers. In this connexion it is interesting to note that long-term investment in Germany also took the form of purchases of German domestic securities, real property, mortgages, &c., by foreigners. If these are included, the total of foreign long-term investment at its peak in 1930 would be raised from Rm. 11 milliards to, perhaps, Rm. 18 milliards.

Some idea of the relative amounts of capital invested in Germany by different countries can be gained from the following tables. The figures given by the *Economist* for the position of the short-term debt at the end of July 1931, when some Rm. 3 milliards had been withdrawn, are shown at the top of page 238.

The United States heads the list, with Holland second and Great Britain third. The relatively high proportions taken by Holland and Switzerland are indications of the continued importance of these countries as international banking centres, and much of the money

¹ Cf. Harris, *op. cit.*, p. 8.

Long-term Foreign Loans to Germany, 1924 to 30th June 1931^a

(Nominal value in millions of Reichsmarks)

	<i>U.S.A.</i>	<i>Great Britain</i>	<i>Holland</i>	<i>Switzerland</i>	<i>Sweden</i>	<i>France</i>	<i>Belgium</i>	<i>Italy</i>	<i>Other countries</i>	<i>Total</i>	<i>Percentage</i>
<i>Dawes and Young Loans</i>	875	490	174	136	152	475	51	46	..	2,399	25.2
<i>States, municipalities, &c.</i>	860	210	256	53	530	..	..	..	10	1,919	20.1
<i>Public utilities</i>	1,073	48	115	114	3	..	..	..	32	1,385	14.5
<i>Municipal banks, &c.</i>	188	6	30	8	4	..	..	..	14	250	2.6
<i>Private borrowers</i>	2,269	346	599	201	108	..	..	..	69	3,592	37.6
<i>Total</i>	5,265	1,100	1,174	512	797	475	51	46	125	9,545	100
<i>(£ millions)^b</i>	(258)	(54)	(57)	(25)	(39)	(23)	• (2)	(2)	(8)	(465)	
<i>Percentage distribution</i>	55.2	11.5	12.3	5.4	8.3	5.0	0.5	0.5	1.3	100	

Note: This table shows where the loans in question were issued, but does not indicate their present domicile.

^a *The Economist*, 23 Jan. 1932, Reparations and War Debts Supplement, quoted by Harris, op. cit., p. 95.

^b Converted at the rate, Rm. 20.43 = £1.

which came from them must have originated in other European countries such as France, Czechoslovakia, and Sweden.

*Short-term Foreign Loans to Germany, July 1931**

(Rm. millions)

<i>Due to</i>	<i>Acceptance credits</i>	<i>Other short-term loans</i>	<i>Total</i>	<i>Percentage</i>
U.S.A.	1,405	1,738	3,143	26.3
Great Britain	886	1,167	2,053	17.2
Holland	263	1,806	2,069	17.3
Switzerland	236	1,642	1,878	15.7
Other countries	188	2,638	2,826	23.5
Total	2,978	8,991	11,969^b	100.0

* *The Economist*, Reparations and War Debts Supplement, 23 Jan. 1932, p. 11, quoted by Harris, *op. cit.*, p. 9.

^b Approximately £585 millions (Rm. 20.43 = £1).

As the table on p. 237 shows, the United States was also Germany's largest creditor on long-term, with Holland and Great Britain second and third. Over half of all the foreign long-term loans to Germany during the period 1924 to 30th June 1931 were floated in the United States.

How these vast imports of capital affected the balance of Germany's foreign payments is shown in the following consolidated balance of payments for the years 1924-30 inclusive:

*The German Balance of Payments 1924-30**

<i>Current account:</i>	<i>Rm. millions</i>
Merchandise	- 6,224
Shipping and other services	+ 2,928
Armies of occupation, &c.	+ 907
Interest payments	- 2,728
Reparations payments	- 10,146
Balance on current account	- 15,263 ^b
<i>Capital account:</i>	
Long-term loans and bonds repurchased	+ 7,174
Movements of securities	+ 1,008
Other German investments abroad (net)	+ 698 ^c
Short-term capital movements	+ 4,756
Indefinable capital movements	+ 3,734 ^d
Balance of capital movements	+ 17,370
Gold and foreign exchange	- 2,107
Balance on capital account	+ 15,263

* Calculated from estimates given in the *Sonderheft zu Wirtschaft und Statistik*, No. 14, 1934.

^b £745 millions (Rm. 20.43 = £1).

^c This is accounted for by the repatriation of pre-war investments in the U.S.A.

^d Includes Rm. 1,200 millions of United States bank-notes exported in 1924 and 1925.

It is seen from the foregoing table that imports of capital exceeded Germany's payments to foreigners on account of interest and reparations by a considerable sum, which was balanced by large net imports of merchandise, gold, and foreign exchange. How Germany was to continue to meet her obligations abroad when this capital import ceased does not appear to have been considered by her creditors, whose concern for their own future was completely overshadowed by their desire to have as large an income as possible in the present.

The most important features of German borrowing were, then, that foreign loans continued to be made long after the need for stabilization and relief loans had vanished; and that debts—most of which could be called at short notice—were accumulated in foreign currencies to an extent which, in view of the industrial development of the country and the high tariffs imposed by its creditors, could never be justified by reference to her actual or potential export balance of goods and services; and, finally, that many of the short-term credits were used in such ways that any crisis would render them illiquid even in terms of German currency.

The inevitable crisis came after the failure of the Kreditanstalt in 1931. It was followed by moratoria, exchange restrictions, default, and radical political changes.

Austria.

The circumstances in which Austria was left at the end of the war are sufficiently well known to require only the briefest recapitulation. Formerly the centre of the vast Austro-Hungarian Empire, it was economically and geographically truncated by the war, which enabled many parts of it to gain their independence and left Vienna with a population of nearly two millions isolated in a country whose total inhabitants were less than three times that number. Surrounded on all sides by tariff walls, burdened with heavy reparations, threatened with profound social disorders and forbidden to unite with Germany although plebiscites in two of the provinces showed an overwhelming majority in favour of union, economic disintegration appeared inevitable unless aid were forthcoming from some outside sources. An appeal was made to the League, and in September 1922 a plan was formulated for the financial and economic rehabilitation of the country and was adopted by the representatives of the principal European Powers. The unrestricted issue of paper notes was stopped in the next month and confidence began immediately to return. The programme of reorganization also included a reduction

of the number of ministries, reform of the system of tax collection, and the release of 100,000 employees in state industrial activities. Despite the prompt response to remedial action, however, it was realized that the flotation of a new loan was an indispensable part of the whole plan, and 132 million Austrian gold crowns had actually been advanced by neighbouring foreign governments during 1922 in anticipation of this issue.

The loan, floated in June 1923, took the form of a government guaranteed loan, repayable before 1943, and was issued in Austria, Belgium, Czechoslovakia, France, Great Britain, Holland, Italy, Spain, Sweden, Switzerland, and the United States, in bonds of various denominations and in various currencies, for amount sufficient to yield an effective sum equivalent to 630 million Austrian gold crowns (£33·6 millions, nominal). Officially, the object of the loan was to repay those short-term debts, incurred in anticipation of the loan, which are mentioned above, and to liquidate the budget arrears of 1923 and 1924 during the completion of a programme of financial reform. In effect, the loan served to provide the basis which secured financial and monetary stability in Austria. A bank of issue, independent of government control and having the sole power of note issue, was established with a capital of 30 million Austrian gold crowns, and exchange stability was maintained from October 1922 onwards.

Guarantors of the Austrian Loan

	<i>Per cent.</i>
Great Britain . . . . .	. 24½
France . . . . .	. 24½
Czechoslovakia . . . . .	. 24½
Italy . . . . .	. 20½
Belgium . . . . .	. 2
Sweden . . . . .	. 2
Denmark . . . . .	. 1
Holland . . . . .	. 1
	<u>100</u>

Security for the loan was effected by a first lien on the Customs and Tobacco Monopoly. A reserve fund in foreign currencies was also in the Trustees' hands, and was originally equal to one half-year's complete service. Further security could also be called for if the yield from the assigned revenues was insufficient to meet the service. The precise association of the League with the issue is defined in a Council Resolution of the 4th October 1922, in which the Council 'approves . . . the scheme submitted. . . . It agrees to accept the duties and responsibilities involved. . . .' The guarantee

by various governments of the principal and interest of the bonds covered 585 out of the 630 million gold crowns which comprised the total issue, the portion which was not guaranteed being chiefly an advance from the Swiss Government of 20 millions and the Spanish *tranche* which was the subject of a special arrangement with the Spanish Government.

In 1925, at the request of the League Council, a thorough inquiry into the Austrian financial and economic situation was made by MM. Layton and Rist which afforded ample evidence of the extent of the recovery which had followed the issue of the loan. This was especially marked in the financial sphere, stability of exchanges, and sound budgetary finance being thoroughly restored. The same could not be said of general economic conditions, however. The deflation which had accompanied stabilization had caused an enormous increase in unemployment, and industrial production remained at a low level in striking contrast to the feverish activity of the immediate post-war years. It was a situation, moreover, which the investigation showed would be very little remedied by increasing industrial efficiency or further deflation, since it was due, not to inflated costs, but to the high tariff walls by which Austria was surrounded and which effectively excluded her from any really wide international market. That Austria's position was nevertheless relatively sound was generally agreed by 1926, and the League's Commissioner-General, who had resided in Vienna since the end of 1922 and supervised the whole administration of the loan resources and the collection of the service, was withdrawn in the middle of 1926.

This optimism, which was accompanied by a large inflow of foreign capital, mostly on short-term, was based on very unstable foundations. The difficulties of the situation became glaringly apparent in 1930, when a further international loan was made to Austria, the subscribers being the United States, Great Britain, Holland, Italy, Sweden, and Switzerland. This loan, which is due to be completely repaid in 1957, and which is secured by the receipts from the Customs and the Tobacco Monopoly, was issued nominally to pay for improvements to the Austrian railways and the postal and telegraph administration. In reality, it provided the Austrian banking system with foreign exchange sufficient to postpone the collapse for a further ten months.

Default on Austria's external obligations was again imminent in 1933 and was prevented by a further international loan of 300 million schillings. Towards the end of 1934 the foreign exchange provided by this loan was nearly exhausted, and, for a third time,

default was staved off by the conversion of the League Loan of 1923 to lower rates of interest.

Given political stability and further time to make the necessary economic readjustments, it is possible that Austria may be able to re-establish something approaching equilibrium in her economic system. She cannot, however, hope to make herself economically self-sufficient, but must depend on foreign trade which cannot increase until the tariff barriers which are maintained by neighbouring states for political reasons are lowered or destroyed altogether.

The following tables show Austria's position on foreign capital account at the end of 1932. Unfortunately no data is available regarding the amounts due to creditors in different countries.

*Republic of Austria: External Debt in Foreign Currencies,
31st December 1932**

(In millions of gold schilling)

Owed by	Funded	Medium-term	Short-term	Total
State	1,299.2	416.9 ^b	100.0 ^c	1,816.1
Provinces and municipalities	465.7	11.9	..	477.6
Transport	14.4	13.2	33.2	60.8
Charitable institutions	4.0	..	..	4.0
Banks	41.9	3.3	978.4 ^d	1,023.6
Industry and Commerce	186.3	58.2	82.0	326.5
Total	2,011.5	503.5	1,193.6	3,708.6
(£ millions)	(75)	(20)	(45)	(140)

* From Moody's *Manual of Investments*.

^b Includes 408.7 millions of gold schilling for relief debts.

^c Advance by the Bank of England consolidated by the Austrian Government International Guaranteed Loan 1933/53.

^d Includes 90.0 millions of re-discount credit granted by the Bank for International Settlements, which was funded in 1933, and 524.9 millions of short-term bank credits of which 410.2 millions relate to the Credit-Anstalt.

*Service Requirements of External Debt, 1932**

Owed by	Interest	Amortization	Total
State	100.9	56.0	156.9
Provinces and municipalities	27.7	11.7	39.4
Transport	4.6	5.5	10.1
Charitable institutions	0.3	0.2	0.5
Banks	62.7	103.9	166.6
Industry and commerce	23.8	9.4	33.2
Total	220.0	186.7	406.7
(£ millions)	(8.3)	(7.0)	(15.3)

* From Moody's *Manual of Investments*.

Hungary.

Encouraged by the success which attended the Austrian reconstruction, Hungary made a similar appeal to the League in 1923. The economic situation was, however, much less desperate despite grave political difficulties, since Hungary is primarily an agricultural country with no city comparable in size to the Austrian capital, and much more nearly self-supporting. From the point of view of League financial assistance, the situations of the two countries were very similar. It was natural, therefore, that in dealing with the problem the League should follow essentially the same plan as that which had been put into execution in Austria. Success followed even more quickly. In addition to the provisions 'designed to secure stabilization of the Hungarian currency and balancing of the budget on a permanent basis through taxation by 30th June 1926', the scheme also required 'satisfactory political relations between Hungary and its neighbours and especially the conclusion of agreements for encouraging commerce with other countries in the same region'. The loan¹ floated in July 1924 at 7½ per cent. was such as to yield in the aggregate an effective sum of 250 million Hungarian gold crowns (£14,200,000). It was issued in eight separate *tranches* in Czechoslovakia, Great Britain, Holland, Hungary, Italy, Sweden, Switzerland, and the United States, in the form of twenty-year bonds redeemable before 1944. This sum was raised without difficulty, although, unlike the Austrian Loan, the issue was not guaranteed by the government of any creditor country. It was secured by a first charge on customs, sugar tax, tobacco, and salt monopolies. Further security was provided by a Reserve Fund in foreign currencies in the Trustees' hands originally equal to one half-year's complete service. If the yield of the assigned revenues should fall below 150 per cent. of service, additional security could be demanded. As with the Austrian Loan, service and amortization payments were due monthly, to be paid into the hands of the Trustees in foreign currencies. A Commissioner-General with the same duties as his counterpart in Austria was appointed.

Budget equilibrium was reached with great rapidity and, although a deficit of 100 million gold crowns had been expected for the financial year beginning June 1924, there was in fact a surplus. The following year was equally favourable, so that two years after the control had begun—which was the minimum period contemplated—the reconstruction work had been successfully concluded. Only about one-fourth of the reconstruction loan had been used to meet deficits,

¹ See also p. 95.

the balance being available for productive investment. Accordingly the Commissioner-General was withdrawn in the middle of 1926, leaving the country in a thoroughly sound financial position and with her bonds at a premium in the creditor countries.

The government of Hungary, however, continued to borrow abroad after 1926 both on long- and, in 1930, on short-term. In 1931 a moratorium was declared on transfers abroad, and since that date default has occurred either wholly or in part on all the foreign obligations of the Hungarian Government. As in the case of Austria, though for slightly different reasons, the lowering of tariff barriers is an essential condition for Hungarian recovery. Economic stability for her rests on the development of exports of agricultural produce to her more industrialized neighbours, a development which can only occur if tariffs are lowered and if agricultural prices rise substantially.

The external indebtedness of Hungary has been estimated as follows:

*Kingdom of Hungary: External Indebtedness,
December 1932^a*

(In millions of Pengő)

<i>Owed by</i>	<i>Long-term</i>	<i>Medium- and short-term</i>	<i>Total</i>
State	1,252 ^b	310	1,562 ^b
Public bodies	486	25	511
Municipal enterprises . . . . .	..	36	36
Charitable institutions	30	..	30
National bank . . . . .	..	145	145
Corporations, banks, &c.	703	1,322	2,025
Total	2,471 ^b	1,838	4,309 ^b
(\$ million)	(91.5)	(68.1)	(159.6)

^a From Moody's *Manual of Investments*.

^b This includes the debt of the Caisse Commune, which is shown at its face value; it has, however, been recapitalized at one-third of that value and a deduction of 600 million pengő should therefore be made from the above figures.

Poland.

Poland was one of the last of the new European states to establish a stable currency after the war. Equilibrium in the budget and on the foreign exchanges appeared to have been reached in 1924, but the government could only keep the budget balanced by means of increasing issues of notes and coins of small denomination. The

inflation so caused forced the exchange to depreciate. This depreciation was brought to an end, and stability was finally established in 1927-8 as the result of three different factors, viz.: the government ceased its inflationary issues of currency as the first step towards internal equilibrium; the fortuitous circumstance of the Coal Strike in Britain in 1926 greatly increased Poland's foreign balances; finally, a stabilization loan of \$72 millions, subscribed chiefly in New York, enabled a more permanent stability to be attained.

In addition to the Stabilization Loan of 1926, other foreign investments in state and municipal issues were made both before and after that date. It is estimated that the total amount of foreign capital invested in Poland in 1930 was \$1,158,801,000, of which about 40 per cent. was in government and municipal bonds, 20 per cent. in issues of Polish industries, and a further 20 per cent. in banking and commercial credits, mainly on short-term. About 40 per cent. of the capital issues of Polish industries were held by foreigners in 1930, principally by French, German, American, and Belgian investors, in that order.

Poland's present difficulties arise partly from her political position, which necessitates large expenditure on armaments which would not be justified on purely economic grounds. Her foreign exchange position has also been affected by the fall in agricultural prices. Real recovery depends on the same factors which have already been mentioned in the case of other central European countries.

The following tables give some interesting statistics of foreign investments in Poland:¹

Republic of Poland: External Indebtedness, 1929 and 1932

(In millions of zlotys)

	1932	1929
State debt	4,514	3,744
Local government debt	213	229
Private debentures and mortgage bonds	425	317
Foreign holdings in Polish enterprises	2,009	1,800
Cash loans	1,600	1,828
Branches of foreign enterprises	500	558
Merchandise credits	200	1,152
Bank credits	292	676
Other credits	203	89
Total	9,956	10,393
(£ millions)	(379.2)	(395.9)

¹ Taken from Moody's *Manual of Investments*.

Nationality of Foreign Capital Invested in Polish Joint-Stock Companies, 1st January 1933

	<i>Per cent. of total foreign capital invested</i>
French	24.4
German	23.4
American	21.9
Belgian	10.0
British	4.9
Austrian	3.5
Dutch	2.8
Swiss	2.8
Swedish	2.3
Italian	1.5
Czechoslovakian	1.1
Other	1.4
	100

Foreign Capital Invested in Polish Joint-Stock Companies, 1st January 1933

<i>Industry</i>	<i>Number of companies</i>	<i>Total stock capital (millions of zlotys)</i>	<i>Per cent. held by foreigners</i>
Petroleum	35	273	84.0
Mining, foundry	49	920	77.1
Metal	154	244	28.8
Electro-technical	39	104	47.4
Electric works	21	185	75.4
Mineral	78	106	21.5
Chemical	117	205	41.6
Lumber	97	47	25.9
Paper	28	85	25.8
Graphic	43	36	2.1
Textile	153	528	28.1
Clothing	25	18	0.8
Leather	28	18	24.6
Foodstuffs	148	168	16.0
Sugar	58	168	9.5
Agricultural	11	9	..
Building	69	35	19.2
Hotel, health resort	20	22	..
Entertainment	7	3	4.8
Transportation	74	218	28.5
Precision products	7	3	10.8
Trade	153	63	17.2
Total	1,414	3,460*	46.7

* £131.8 millions.

The Balkans.

The only Balkan countries to receive League Loans were Greece and Bulgaria. Greece borrowed, in 1924 and 1928, £19·7 millions in this way, and Bulgaria obtained a total of £8·8 millions in 1925 and 1928. These countries, and their neighbours, Roumania, Yugoslavia, and Albania, have all borrowed larger or smaller sums abroad in other ways.

The finances of the Greek Government have been partly under the control of an International Financial Commission since 1898 and this has enabled the government to borrow abroad at slightly more favourable rates than would otherwise have been obtained. It seems clear, unfortunately, that the foreign funds obtained by Greece both through the League Loans and by other means, were not used in ways which would have been dictated by purely economic considerations. The chief creditors of Greece are Great Britain, the United States, and Holland, who all lent money at various times in the post-war period. The Greek Government also obtained small amounts through the Kreuger interests, and the total amount of foreign capital invested in Greece was estimated at £115 millions in 1930.

In 1932 the Greek Government went into partial default on the gold loans of 1889, 1893, and 1898. In April 1933 the League of Nations sent a delegation of experts to investigate financial conditions at the request of the Greek Government. In November, after negotiations, the government offered to transfer 27½ per cent. of the interest of its external debt in 1933-4 and 35 per cent. in 1934-5. These proposals were not put into operation completely until April 1935. When the Greek Government desired to extend this arrangement for a further year, bondholders resisted in a determined fashion, pointing out that the undoubted improvement visible in every branch of the Greek economy was such as to warrant an offer of at least 50 per cent. of the full contractual debt service.¹ The offer of the Greek Government was accordingly declined. Many observers believe that the Greek Government is in a position to make better offers to its external creditors and that its default must, in some measure, be due to unwillingness rather than inability to pay.

The League Loans to *Bulgaria* were secured respectively by excise and customs revenues. Their purposes were to enable certain short-term debts to be repaid, to assist in the settlement of refugees and to provide foreign funds for currency stabilization, for the repayment

¹ See *Third Annual Report of the League Loans Committee* (London), June, 1935. Also below, Chapter XIV, p. 298.

of floating debt, and for railway reconstruction and improvement. Apart from investments in government securities, the foreign capital in Bulgaria in 1929-30 was estimated at 7,094 leva (about £10½ millions). Nearly 40 per cent. of this was invested in industry and 37 per cent. represented credits to private banks.

Roumania did not receive a League Loan, but the government borrowed £37.5 millions in London and New York in 1922, and further amounts in 1929 and 1931 in London, Paris, and New York through the Monopolies Institute. Being the fortunate possessor of petroleum deposits, Roumania was a field for considerable direct investment by British, American, and French interests which now control a large part of the oil production and the heavy industry of the country. The fall in the prices of oil and agricultural products coupled with rather indifferent government administration precipitated foreign exchange difficulties. Some attempt to re-establish stability has, however, been made as the result of recommendations by M. Charles Rist, who conducted an investigation into Roumania's economic and financial situation in 1932.

Yugoslavia has also borrowed abroad on a considerable scale since the war. Most of the government's external debt is held in France, but a part represents loans by the United States. The economic condition of the country was reasonably sound up to 1929, but started to deteriorate with the fall in agricultural prices which began in that year. Further loans from France in 1931 failed to prevent an almost complete collapse, and strict exchange control has been instituted. Most of the foreign capital invested in industries in Yugoslavia is French and there are, particularly, several direct investments by Skoda interests. As in the case of Hungary, revival of trade and economic stability depends partly upon a rise in agrarian prices and partly on political developments.

The smallest Balkan state, *Albania*, has, of course, received only a little foreign capital. Most of this has been invested by Italian interests for political reasons.

Other European Countries.

Statistics of foreign investment in *Czechoslovakia* are not very satisfactory. The external government debt was estimated at about £51 millions in 1930. Of this amount, slightly less than half was due to the United States, and the remainder to Great Britain, France,

and Italy. Another estimate placed the external public debt at 1,457 million Swiss francs in 1930, and other external debt at 580 million Swiss francs. The United States Department of Commerce estimated that American investments in Czechoslovakia amounted to \$33 millions at nominal values in 1933 (direct, \$5 millions and portfolio, \$28 millions). A large part of the private external debt must be due to French lenders who have invested large sums as part of their government's policy of strengthening the Little Entente.

The following estimates, quoted in Moody's *Manual of Investments, 1934*, give some idea of the relative sizes of the different kinds of foreign investments in Czechoslovakia, but they appear to under-estimate the volume of private indebtedness. They are also interesting in that they show in some measure the extent of Czechoslovakian investment in other countries.

Czechoslovakia

	1932	1931
<i>Foreign debt.</i>	(in millions of Kc)	
Government debt	8,838	8,344
Municipalities' debt	397	412
Total public debt	9,235	8,756
Private long-term debts	1,275	1,193
Private short-term debts	323	665
Bank accounts	757	1,178
Total private debt	2,355	3,036
Total external debt	11,590	11,792
(\$ millions)	(83·8)	(85·3)
<i>Foreign assets.</i>		
Government	503	536
Private long-term loans	732	913
Private short-term credits	107	34
Bank accounts	1,960	1,974
Total external assets	3,302	3,457
Net external indebtedness	8,288	8,335
(\$ millions)	(59·9)	(60·3)

There remain two states which received League Loans: Estonia and Danzig. These are the only borrowers who now meet the service on their League Loans in full according to the original contract.

Financial advice had been sought from the League Financial

THE DEBTORS

Committee by the government of *Estonia* in 1924. In 1926, when further reforms were contemplated it was decided to remodel the whole monetary mechanism by three national statutes issued in pursuance of a protocol of that year. These provided for (1) a law to reform the bank of issue and amend the statutes of the bank, (2) a law for the transfer to the bank of the function of issuing notes, (3) a new currency law. In particular the newly created central bank was not to make unsecured loans or to give long-term credit.

It was in connexion with this last point that a loan became necessary. A considerable quantity of long-term industrial securities was in the possession of the bank and these were taken over by the government and transferred to a Mortgage Institution created for the purpose. Accordingly the 7 per cent. Banking and Currency Reform Loan was floated to effect this purchase, to provide capital for the new bank, and to provide working capital for the new Mortgage Institution. Issued in June 1927 in three separate *tranches* in Britain, Holland, and the United States, the loan amounted in all to £1,500,000 and was secured by a first charge on excise on tobacco, beer, matches, &c. That it was successful in its object is shown by the exchange stability and budgetary soundness of *Estonia*, which would certainly not have been achieved but for the timely aid afforded by a League Loan.

The following table shows the composition of the external government debt:

External Debt of the Estonian Government, 1st January 1933^a

<i>Due to</i>	<i>Amount (Thousands of ekrs).</i>
United States Government	64,385
British Government:	
Relief debt	2,756
War debt	11,299
Railway loan	642
Vickers, Limited	148
Swedish Government	413
Swedish Match Trust	7,600
League of Nations Loan (1927):	
United States share	14,115
British share	8,204
Total	109,562^b

^a From Moody's *Manual of Investments*.

^b About 8,003,400.

As *Danzig* has been a Free City since the war under the administration of the League, and not within the territory of any sovereign

state, it was necessary for any loans which might be required to be raised externally. The two Danzig Loans are, therefore, in a somewhat different class from the remainder of the League Loans in that they represent ordinary municipal borrowing conducted, by virtue of its control, through the League of Nations. They do not represent credits, such as the Refugee Loans, granted to a country with extraordinary liabilities, and cannot properly be called reconstruction or stabilization expenditure, consequently they were not the subject of the same procedure as the other League Loans. In April 1925 a British banking firm offered for public subscription the Danzig (Municipality) 7 per cent. Mortgage Loan of £1,500,000. In June 1927 a further loan of £1,900,000 was issued in London and Amsterdam (these markets supplied £1,500,000 and £400,000 respectively). The loans were both easily raised and have been fairly successful on the London market despite the doubts which have been felt at various times for the general safety of the Polish Corridor and the independence of the city.

The other countries which were formed from parts of the former Russian Empire, Latvia, Lithuania, and Finland, have also borrowed smaller sums from most of the principal European lenders. Lithuanian difficulties, it should be noted, have been enhanced by almost continual political disturbances. Finland, on the contrary, has been more peaceful. It has conducted much of its foreign borrowing through Sweden.

The Scandinavian countries Norway, Sweden, and Denmark have tended to look to Great Britain as the chief source of foreign capital. Sweden has also borrowed in the United States, and has exported capital to most European countries chiefly through the Kreuger interests. From the point of view of British lenders, the soundness of borrowers in Scandinavian countries has been increased in recent years by their adherence to the 'sterling bloc'.

Borrowing by European governments after the war was not predominantly for the creation of revenue-producing assets, but neither was it unproductive, in a social, or even in an economic sense. Investments by Great Britain, France, and the United States were demanded by the political assumptions of the time, for if the plight of the central European countries was not alleviated, and if the new nations were not made sufficiently strong to maintain their independence, there would inevitably have been civil upheavals and defensive alliances detrimental to the security of the rest of Europe and to the new international system. But before investors could be

tempted to lend money where it was most needed, it was necessary that currencies should be stabilized, that an attempt should be made to balance budgets, and that the advance towards general inflation should be checked. Thus, the first loans were made in order to provide borrowers with foreign exchange reserves, to establish central banks and supply them with capital, and to fund short-term debts at home and abroad. The largest of these 'first-aid' credits was the Dawes Loan. Its success in restoring confidence in the Reichsmark was so striking that investors soon lost their fears (and their caution) about granting loans to Germany.

Under the circumstances, it is useless to examine how far loans were productive in a narrow economic sense. Stabilization and relief loans were necessary; if they were not represented by income-producing assets they were an essential condition of obtaining further capital which could be invested in a more self-liquidating manner. It was the borrowing undertaken after opportunities had been provided to establish finances on a sound footing which calls for condemnation in many cases. For several debtor governments *continued* to borrow for unproductive purposes, and what may be excused as an expedient cannot be condoned as a matter of policy. It was this post-stabilization borrowing which was one of the primary causes of the later difficulties of most European countries.

THE BRITISH EMPIRE.

One of the characteristic features of the borrowing of the British Dominions and colonies (except Canada) has been the large amount of the external indebtedness contracted by public authorities relatively to the total amount of foreign capital employed. This is shown clearly in the table on p. 225 above, part of which is recapitulated below.

External Public Indebtedness of Certain Countries as a Percentage of the Total Foreign Capital Employed, 1930

	<i>Per cent.</i>
New Zealand	81
Roumania	78
Japan	74
Australia	73
India	68
South Africa	62
Canada	20

Of the six countries showing the highest percentages in the above table, four are British. That similarly high percentages would be

shown for the colonies is indicated by the fact that of £2,187 millions of British capital estimated to have been invested in the Dominions and colonies in 1930, £1,080 millions or 49·4 per cent. was represented by holdings of government and municipal securities.

Though the volume of government borrowing abroad has been, therefore, relatively large, these loans have, in the Dominions at least, been used mainly for the purchase of productive assets. In South Africa about 80 per cent. of the expenditure from loans floated between 1910 and 1931 was spent on income-producing capital goods.¹ In Australia £786 millions or 91 per cent. of the loan expenditure of the States before 1933 was officially classified as productive, i.e. spent on public works or primary production, and the Commonwealth debt in 1933 stood at £397 millions of which £283 millions represented war debts and £114 millions debt for public works and kindred purposes. Including both war and peace-time borrowing by the Australian Commonwealth and States, it therefore appears that about 70 per cent. of the capital raised—which in all amounted to some £1,250 millions—had been used for productive purposes. If only peace-time borrowing is included, over 90 per cent. of the debts were represented by income-producing assets. The enormous increase in the burden of unproductive debt during the war years is also reflected in Canadian figures; almost the whole of the national debt of about £70 millions in 1914 represented investments in public works such as railways and canals, but the bulk of the £560 millions debt in 1934 had been contracted for war purposes. In India the official classification put 90 per cent. of the central and provincial government debt in the productive category in 1929–30 compared with only 70 per cent. in 1921–2.

These statistics refer to loans raised internally as well as externally, but they serve to emphasize the fact that almost the whole of the peace-time borrowing of British countries has been undertaken for productive purposes, however defined. And since it is usually necessary to offer better security to external than to domestic investors, it may be assumed that a larger proportion of this external borrowing has, in fact, been spent on the creation of capital goods than these figures tend to show. There is little doubt that most of the capital which the Dominions and colonies have raised abroad has been used in a more or less productive manner.

Holders of British Empire securities have benefited from the high

¹ i.e. excluding from the total loan expenditure the cost of war, defence, police, unemployment insurance, meeting deficiencies in revenue, and raising loans.

standard of financial morality and from the prudence with which governments have, in most cases, administered their finances, from the fact that the exports of the larger Dominions and colonies are comparatively well diversified, from the rise in the price of gold, and from the British policy of preferential tariffs. Regarding the financial integrity of British countries, there is little that need be said in view of the experience of recent years. There has been only one case of default on Empire loans.¹ The prudence of raising so many loans in the United Kingdom may perhaps be questioned, but there have been few examples of over-borrowing. Since the war both the Bank of England and the Treasury have exercised a general scrutiny over the borrowings of Dominion and colonial governments, and very flagrant over-borrowing has thereby been prevented. Empire borrowers themselves, realizing the dangers inseparable from the possession of a large external debt, have taken measures to prevent obligations from growing to an excessive size. Australia tended to over-borrow more than any other part of the Empire, but the Australian Loan Council undoubtedly curtailed the use of overseas capital and the external debt was thus smaller than it might otherwise have been.²

The diversification of exports among the larger British countries may not perhaps appear exceptional in comparison with industrialized nations, but, if compared with the majority of South American republics, they must seem fortunate in this respect. Wool in Australia, gold and wool in South Africa, wheat and flour in Canada, and cotton in India form the staple exports, but not one of these countries is dependent on as few as two commodities for more than 60 per cent. of its exports. In addition, the British Empire is by far the most important producer of the one commodity which has been greatly enhanced in price during the depression—gold. In 1933 the British Empire produced 64·7 per cent. of the total gold extracted in the world, and if Russia is excluded the percentage is 73 per cent. It is significant that Empire countries produced 82 per cent. of the gold raised in debtor countries (i.e. excluding from the world total the production of Russia and the United States of America).³ Gold has risen in price in terms of sterling by more than two-thirds since before the depression, and the benefit to South Africa, which produces almost half the world's gold, to

¹ The action of the Province of Alberta in 1936.

² See above, Chapter V, pp. 85 and 96-8.

³ Preliminary estimates suggest that the British Empire produced about 53 per cent. of the total in 1935, or, if Russia be excluded, about 65 per cent.

Canada, which (excluding Russia) is second largest producer, and to Australia, which ranks fourth, has been immense. India, too, has gained, since she has been able to sell a part of her enormous gold hoards at a substantial profit. The rise in the price of gold has thus been an important factor in helping the British Empire to survive the economic difficulties of the last few years.

The British policy of preferential tariff treatment for the exports of Empire countries has also made it relatively easier for these countries to find a market for their goods in the United Kingdom and to maintain their service payments. Whether, in fact, this tariff policy will in the long-run make it any easier for Empire countries is more doubtful, but it has certainly facilitated the payment of Empire obligations as compared with those of non-Empire countries.

Canada.

During the last generation Canada has had recourse to foreign capital in two major periods, roughly from 1900 to 1913 and from 1920 to 1929. In the earlier period the bulk of the capital was borrowed for constructive purposes of all kinds; about £550 millions was lent to and invested in the country during the fourteen years, of which some £360 millions came from Great Britain and £130 millions from the United States. The remarkable economic growth of Canada was primarily due to the abundance of foreign capital thus available for the development of natural resources. The largest number of loans were for purposes of railway construction; next in importance was the borrowing of governments and municipalities; third, industrial enterprises; fourth, land and lumber companies; and fifth, mining.

In the decade since the war the foreign capital inflow has been of a somewhat different character. There was a steady reduction in the total funded debt of the Dominion between 1920 and 1930, but municipal borrowing increased. Direct investment by United States enterprises increased enormously; by 1930 such holdings amounted to about £420 millions. 'Under the spur of high commodity prices and ready markets we borrowed to modernize and expand our productive equipment. Arterial highways, municipal improvements, commodious dwellings for our working and leisure hours, railways, stock speculation in New York, and industry—notably power and paper—bloomed under the beneficent rays of borrowed capital.'¹

The extent to which American capital has displaced British in the

¹ Innis and Plumpton, ed. *The Canadian Economy and its Problems* (Toronto, Canadian Institute of International Affairs, 1934), p. 225.

financing of Canada since the war, and the growth of Canada's internal savings are illustrated by the following tables:

British and Foreign Investments in Canada

(\$ millions)

	1914 ^a	1919 ^a	1929 ^a	1934 ^b
British	2,712	2,607	2,128	2,734
United States	904	1,800	3,609	3,983
Other	178	174	155	96
Total	3,794	4,581	5,892	6,813

^a *Report of the Royal Commission on Banking and Currency in Canada* (Ottawa, The King's Printer, 1933), p. 53.

^b *Canada Year Book, 1936* (Ottawa, The King's Printer, 1936), p. 891.

Canadian Bond Issues, 1910-35^a

	Amount (\$ millions)	Percentage placed in . . .		
		Canada	United States	Great Britain
1910	231	17.0	1.5	81.5
1911	267	16.9	6.6	76.5
1912	273	13.8	11.4	74.8
1913	374	12.2	13.6	74.2
1914	273	12.1	19.8	68.1
1915	342	43.7	42.1	14.2
1916	317	33.5	64.9	1.6
1917	756	74.6	24.7	0.7
1918	764	94.9	4.7	0.4
1919	909	76.9	22.5	0.6
1920	319	32.8	67.2	..
1921	400	50.3	45.5	4.2
1922	483	46.0	53.5	0.5
1923	493	82.2	17.2	0.6
1924	593	64.6	34.3	1.1
1925	459	56.8	42.2	1.0
1926	560	50.2	48.0	1.8
1927	608	49.2	49.0	1.8
1928	424	48.5	48.0	3.5
1929	628	52.4	43.2	4.4
1930	705	51.8	46.5	1.7
1931	1,250	85.8	13.6	0.6
1932	473	80.0	17.1	2.9
1933	570	76.5	10.5	13.0
1934	638	83.0	7.8	9.2
1935	1,017	84.0	15.9	0.1

^a Figures for 1910-31 from the *Report of the Royal Commission on Banking and Currency in Canada*, p. 107; for 1932-5 from the *Canada Year Book, 1936*, p. 934.

The diversity of the types of investment in Canada is illustrated by the following table:

British and Foreign Investments in Canada, 1st January 1934^a
(\$ millions)

Type of Investment	By Residents of the United Kingdom	By Residents of the United States	By Residents of Other Countries	Total
Government securities ^b	568	1,113	3	1,684
Railways	1,181	745	24	1,950
Other public utilities ^c	180	564	8	752
Industries:				
Wood and wood products	93	364	1	458
Mining, &c. ^d	146	219	4	368
Metal industries	73	324	4	402
Other industries	188	263	8	459
Merchandising and service	72	144	4	219
Insurance	67	93	2	162
Finance and mortgage	156	93	34	283
Miscellaneous ^e	10	60	5	75
Total	2,734	3,983	96	6,813

^a *Canada Year Book, 1936, p. 891.*

^b Includes Dominion, provincial, and municipal securities.

^c Traction, light, heat, power, telephone, &c.

^d Includes clay products and quarrying.

^e Includes agricultural lands, summer residences, prospecting, &c.

British investors favoured railway securities, mines, finance, real estate, and insurance. Those in the United States were chiefly concerned with manufacturing industries, mines, railways, and public utilities. To pay the service on its foreign debt and dividends on the investments, Canada requires some £55 millions a year, but this is partly offset by similar receipts to the amount of £10-15 millions, leaving a net outward movement of about £40 millions a year.

The extent to which Canada has become a capital exporter is, perhaps, not generally realized, and the table on the next page may be, therefore, of some interest.

In 1929-30 Canada's exports of agricultural and vegetable products amounted to 32 per cent. of her total exports of commodities; and animals, and animal, fish, and dairy products amounted to 12 per cent. of the total. Forty-four per cent. of her total exports, therefore, consisted of commodities whose prices fall very sharply at the outset of the depression. Exports of raw materials and

*Canadian Investments Abroad, 1st January 1930**

(In millions of Canadian dollars)

	<i>In Great Britain</i>	<i>In the United States</i>	<i>In other countries</i>	<i>Total</i>
Canadian Government credits and balances abroad	0.4	15.5	30.8	46.7
Balances of chartered banks abroad	19.6	58.8	19.6	98.0
Foreign securities held by banks	25.9	15.5	26.7	68.1
Foreign investments by insurance companies	22.1	215.5	112.9	350.5
Direct industrial investment	1.0	154.5	198.6	354.1
Miscellaneous	11.9	562.1	290.0	863.9
	80.9	1,021.9	678.6	1,781.3

* Estimates of the Canadian Bureau of Statistics, *Canada Year Book, 1933*.

unmanufactured goods accounted for 68 per cent. of total exports. Another kind of export the value of which was considerably reduced by the depression is the expenditure of foreign tourists in Canada; the net receipts on this account were \$185 millions in 1929.

Against this it must be remembered that Canada's exports of manufactured goods, whose prices did not decline with such rapidity, amounted to over \$400 millions in 1929-30, that Canada was on balance a capital exporter between 1920 and 1929 and that the balance of trade, although unfavourable in the first and last years, was over the whole decade favourable to the extent of £250 millions. This is in striking contrast to the period 1900-13, when Canada had an increasingly adverse trade balance as a result of large imports of producers' goods (used, for example, for railway construction) which were paid for by external borrowing.

At the onset of the depression Canada was therefore in a relatively strong position. Her ability to meet external obligations was increased by the fact that she had become adjusted to maintaining a favourable balance of trade, that her economic structure was reasonably well diversified for an agricultural country,¹ and that the national debt, despite the sums borrowed for war purposes, represented to a considerable extent capital invested in revenue-producing assets. There is, however, one aspect of the structure

¹ Particularly in that she possessed large unexploited deposits of gold and other metals, the production of which has increased considerably in recent years.

of the national debt which may at times throw an added burden on to the exchanges. Although only 20 per cent. of the public debt has been issued abroad, 55 per cent. of the total debt of the Dominion, provincial, and municipal governments and of the guaranteed corporations is represented by bonds which are payable at the holders' option in foreign currencies. The Dominion Bureau of Statistics estimated that out of £1,900 millions outstanding indebtedness of this type on 31st December 1932, £472 millions or 25 per cent. were actually held in the United States and £338 millions or 19 per cent. in Great Britain. Thus, 44 per cent. was held abroad in a form which would, under certain conditions of the exchanges, mean that payments would have to be made in United States dollars or in sterling. The potential burden thus thrown on debtors when the Canadian exchange is weak, is augmented by the close connexion which exists between the Montreal and New York money markets. The difficulties in which some of the Western Provinces and municipalities have found themselves have been in no small measure due to this factor.

Newfoundland.

The position of Newfoundland is unique in that it is the only self-governing Dominion ever to have relinquished that status. The government, which, in addition to normal governmental activities, had large interests in many commercial enterprises, was very badly administered throughout the whole post-war period. External capital was used to finance a good deal of unnecessary public works construction, and the possibility of any return on such investment is very remote indeed. Deficits in the ordinary budget were also financed in this way. Loans were contracted in Montreal, London, and New York by the government and by private firms, and there was also a large amount of direct investment by Canadian and American firms, particularly in the pulp and paper industry and in iron mines. The service charges on the government debt could not be met in 1931 and temporary loans for this purpose were made by Canadian banks. In 1932 the British Government advanced the necessary funds, and in 1933 took over the responsibility for Newfoundland's external indebtedness. The burden of debt charges has been substantially reduced by a conversion operation which was carried out under the auspices of the British Government; but a further period of reorganization and reconstruction will be necessary before Newfoundland can again achieve complete financial independence.

Australia and New Zealand.

Long-term foreign investments in Australia and New Zealand amounted in 1930 to about £945 millions (excluding inter-governmental debts). Most of this capital was invested in the bonds of the various governments. In Australia private investments by foreigners were estimated at £175 millions, or only 22·6 per cent. of the total foreign long-term capital employed in the country, and in New Zealand private borrowing, including direct investments, amounted to some £20 millions, or only 11·6 per cent. of the total external liabilities. Governmental borrowing has been conducted on a huge scale, but rather spasmodically. Australia had an export surplus of merchandise in every year from 1892 until 1912 and again from 1916 until 1920. Between 1920 and 1930, on the other hand, there was an import surplus in all but three years. New Zealand has had an export surplus ever since 1885 with the exception of only three years, 1908, 1920, and 1926.

Estimates of the Australian balance of payments show that Australia had a small favourable balance of trade and a further small balance abroad on account of service items and short-term investment in London from 1919 to 1929. These items, however, formed together less than 40 per cent. of the amounts paid abroad as service charges on the external debt, the balance being made up of borrowing by governments and private firms, and exports of gold. New Zealand, on the other hand, had a relatively large export surplus of services, merchandise, and specie during this period. The foreign credits created by this surplus were approximately doubled by new investments in New Zealand by British and foreign lenders. If interest payments and new investments abroad by New Zealand are set against this, it appears that New Zealand's foreign assets increased by a small amount over the period.

Both Australia and New Zealand are agricultural countries, but New Zealand is to a much greater extent pastoral. In 1930-1 butter, cheese, eggs, and meat accounted for 66 per cent. of the exports from New Zealand and only 14 per cent. of those from Australia, 37 per cent. of the latter's exports being wool and 21 per cent. wheat and flour. Thus non-food products are of greater importance to Australia, which was materially to her advantage during the depression. Another factor which favourably influenced the ability of both Dominions to meet their external debt service was the productive manner in which almost the whole of the peace-time borrowings of the governments were expended. Debts were, however, incurred on a large scale, especially during the period 1925-8 in Australia, and in both

countries the indebtedness per head is very high. Interest and amortization of the public debt cost New Zealand £11 millions or 44 per cent. of the national revenues in 1930-1. In Australia, Commonwealth, State, and local governments remitted abroad £30 millions during the same year. There is little doubt that both countries have, in fact, borrowed abroad almost to the maximum point at which service payments can be maintained without causing tremendous internal disturbances. International trade is of great importance to both Dominions, and the value of exports is therefore a most vital consideration from the point of view both of financial integrity and the internal standard of living.

*India.*¹

Estimates of the amount of foreign capital invested in India in 1930 vary between £565 and £700 millions. The debt of the government of India payable in sterling amounted to about £366 millions in 1930, and a further amount of between £20 and £25 millions was owed by State and municipal governments. Of the investments in private industry (£200-£250 millions) over half was in trading and manufacturing industries; banking and loan companies and insurance companies together absorbed rather more than one-fifth, steamship, railway, and other transport enterprises about 13 per cent., and tea plantations and mines about 5 per cent. each.

The largest part of this investment is, of course, British, but a small amount, estimated at \$39 millions in 1930, comes from the United States. British investments are both direct and portfolio, but there has been a tendency for the former to predominate in recent years, because the government has given special encouragement to firms having rupee capital and a number of Indians on the board of directors.

Investment in India has been, on the whole, very satisfactory, judged by the criteria employed in this chapter. There has been little unproductive government borrowing, and India has been able to maintain a favourable balance of trade over a long period. Difficulties were experienced in 1931, but default was avoided and since then the financial position has improved. This recovery may be attributed to three factors: first, that the rupee has been maintained on a sterling standard; second, that the high prices of the precious metals have called out large supplies from hoards in India which

¹ Jather and Beri, *Indian Economics* (Bombay, D. B. Taraporevala, 2 vols., 1928); Anstey, *The Economic Development of India* (London, Longmans, 1929); Dubey, *The Indian Public Debt* (Bombay, D. B. Taraporevala, 1930); Shah, *Sixty Years of Indian Finance* (Bombay, D. B. Taraporevala, 1927).

increased her foreign balances; and thirdly, since most of the obligations of the Government of India are trustee securities in Great Britain, the Indian Government has been able successfully to carry out favourable conversion operations in London and to borrow cheaply on short-term.

India is now at a critical stage in her economic and political development, and forecasts of future trends of foreign investments are therefore dangerous. It seems obvious, however, that India's need for capital will be met in future more and more from internal sources. With the development of the banking system and the lowered cost of investment the desire to hoard capital rather than to invest it will probably diminish. If more internal capital is used the interest rates paid to foreign investors will tend to fall, and less capital will flow in from abroad. These trends appear to be fairly clearly marked, but it will be a long time before the amount of British capital invested in India decreases very much. Investments in India must remain for many years one of the chief sources of Britain's overseas income.

South Africa.

It is estimated that £260 millions of foreign capital were invested in South Africa in 1930. Of this amount £156 millions consisted of the external debt of the Union Government. The remaining £100 millions represents principally investment in municipal securities, railways, and mines. The foreign capital came chiefly from Great Britain; but smaller amounts were furnished by the Netherlands and the United States.

Since gold is one of the most important of South Africa's exports, little difficulty has been experienced during the depression in meeting the service payments on external debt. Helped by the devaluation of the South African pound, a phenomenal rise in the price of gold, and a credit policy designed to prevent internal inflation, South Africa has suffered since 1932 from a surfeit rather than a shortage of foreign balances. These have been used to pay off a large part of the external debt of the country; but they have tended to be more than sufficient even for this, and inflation is still feared by the South African monetary authorities. In short, South Africa's position is unique; instead of cursing the foreign investor for 'exploiting her natural resources', she has been blessing him for absorbing her too plentiful supplies of foreign exchange.

The other parts of the British Empire are all debtors on capital account. Great Britain had, in 1930, about £250 millions invested

in her smaller dependencies. A few of the colonies have also borrowed from the larger Dominions and the United States; both Canada and the United States have made investments in the British West Indies, Bermuda, British Honduras, and British Guiana, and Australia and New Zealand have interests in Fiji and other British possessions in the Pacific. All these colonies are primary producers, and their credit standing depends more upon the prices of food and raw materials than upon any other single factor.¹

A survey of investment in the British Empire would be incomplete without a passing reference to three more or less independent states which have close financial connexions with Great Britain: Palestine, Iraq, and Egypt. A large part of the government debt of these countries is held in London, and their political status has encouraged considerable private investments in industries and public utility undertakings, the largest investments being directly or indirectly connected with the petroleum industry.

THE FAR EAST.

China and Manchuria.

The most comprehensive survey of foreign investments in China has been made by Professor C. F. Remer.² He puts the total of such holdings at between U.S. \$3,000 and U.S. \$3,500 millions for 1931. These figures do not, however, represent the gross foreign investment in the sense in which it has hitherto been understood in this study, and are therefore not strictly comparable with those which have been given for other countries. Remer sets out to ascertain the 'sources within China from which an income is received or is normally to be expected by persons who are not Chinese'. Thus the property of racial minorities more or less permanently resident in China, as, for instance, the colony of Russians, is included, as well as the holdings of those resident outside the country. Hence the volume of foreign investment in this sense does not closely correspond to the nominal capital upon which interest and dividends have normally to be transmitted into foreign currencies. According to Remer's calculations of the balance of payments, interest, dividend, and amortization payments transmitted abroad in 1930 equalled about U.S. \$100 millions or some 3 per cent. on the total volume of

¹ With the possible exception, in the case of Bermuda for example, of the tourist trade.

² C. F. Remer, *Foreign Investments in China* (New York, Macmillan, 1933). See also a convenient summary of some of Remer's figures in the League of Nations, *Balances of Payments, 1931 and 1932*, pp. 64-8.

foreign investments as defined above. The smallness of this figure may perhaps be taken as an indication that up to one-third or even one-half of the volume of foreign investment, as Remer has calculated it, does not yield interest and dividends in foreign currencies.

The earliest form of investment by foreigners in China was in the coast town trading-stations. Later, government loans appeared, but from the middle of last century most of the capital has been employed in business undertakings owned, managed, and in part staffed, by foreigners. The total volume of foreign capital employed in China was approximately doubled between 1902 and 1914 and again doubled between 1914 and 1931. Business investments totalled \$2,532 millions and accounted for nearly 80 per cent. of the foreign capital employed in the country in 1931. Transport, import and export companies, manufacturing and real estate were the most common forms of undertakings conducted by foreigners. External government obligations amounted to U.S. \$710.6 millions in 1931, of which \$427.6 millions were used for the 'general purposes of the Chinese government', \$248.5 millions were railway obligations, \$20.3 millions had been devoted to communications other than railways, and \$14.2 millions represented external municipal indebtedness.

In 1931 Great Britain was still the largest foreign investor in China, having invested U.S. \$1,189 millions, or 36.7 per cent. of the total foreign investment. Japan's investments were almost as large, estimated at \$1,137 millions, or 35.1 per cent. of the total, with Russian capital third, at about \$273 millions, and American, fourth, at \$197 millions. Britain and Japan each owned about 32 per cent. of the government debt, and France, Belgium, Italy, and the United States also held large amounts. With regard to the business investment, it is of particular interest in the case of China to note the geographical distribution of the various foreign holdings. About three-quarters of the British interests are in Shanghai, and about two-thirds of the Japanese holdings represent investments in Manchuria. As far as can be ascertained, Japan and Russia were, in 1931, the only two countries with large interests in Manchuria, though Remer suggests that British and American investments in this region might have amounted to not more than U.S. \$40 millions.¹

¹ Some further information on investments in Manchuria is given in the Lytton Report (League of Nations series of publications, 1932, VII. 12, pp. 121-2). 'According to a Japanese source of information, Japanese investments were estimated in 1928 at about 1,500,000,000 yen, a figure which, if correct, must have grown to-day to approximately 1,700,000,000 yen. A Russian source puts Japanese investments at the present time at about 1,500,000,000 yen for

A further quarter of the Japanese interests are in Shanghai. Of the British, Japanese, Russian, and American investments together some 46·4 per cent. are in Shanghai, 36 per cent. in Manchuria, and only 17·6 per cent. in the whole of the rest of China, including Hong Kong. In other words, apart from Manchuria, foreign capital in China is still employed almost exclusively in the coast towns.

The amount of foreign capital in use in China is extremely small per head of the population, and most of it is used more or less directly in export industries. For this reason, and as a result of the fall in the gold price of silver after 1920, there was little difficulty in meeting the service payments on China's foreign indebtedness. The rise in the price of silver since 1933 consequent upon the purchases of the United States Government, however, caused a sharp reversal of this position, although payments are still maintained in respect of many private investments. The default of the Chinese Government has been the result of political rather than economic upheavals.

*Japan.*¹

Japan has made very considerable foreign investments, but she is still a net debtor on capital account, although it is difficult to say

the whole of Manchuria, inclusive of the Kwantung Leased Territory, and at about 1,800,000,000 yen for the Three Provinces, the bulk of the Japanese capital being invested in the Leoning Province.' 'A recent Russian estimate for North Manchuria only, which the Commission was not able to verify, indicates the United Kingdom as the next largest investor with 11,185,000 gold dollars, followed by Japan with 9,229,400 gold dollars, the United States of America with 8,220,000 gold dollars, Poland with 5,025,000 gold dollars, France with 1,760,000 gold dollars, Germany with 1,235,000 gold dollars and miscellaneous investments 1,129,000 gold dollars, making a total of 37,784,000 gold dollars. For South Manchuria similar figures are not available.' A statement given by the South Manchurian Railway, which the Commission was not able to verify, puts Japanese investments in Manchuria on 31 March 1931, at the following amounts:

	<i>Yen millions</i>
South Manchuria Railway Company (including affiliated undertakings and companies, &c.)	1,063
Japanese Government's guarantee: Loans to Chinese Government	99
Japanese Corporations: Loans to Chinese Government and individuals	20
Japanese Corporations: Capital funds invested	439
Japanese individuals: Capital funds invested	95
	1,716 (\$122·3 millions)

Since the date of these figures the Chinese Eastern Railway has been sold to Japan by Russia for 170,000,000 yen.

¹ Statistics from Moody's *Manual of Investments*.

THE DEBTORS

by how much. Some idea may, however, be gained from the following table:

Japan

	<i>Interest and dividends paid to foreigners</i>	<i>Interest and dividends received from foreigners</i>
	(In million yen)	
1927	102·7	99·6
1928	108·0	93·1
1932	108·3	25·4
1933	143·7	19·4

Foreign investments in Japan in June 1933 were estimated at 2,077 million yen, distributed as follows:

Foreign Investment in Japan, 30th June 1933

(In million yen)

	<i>Amount</i>	<i>Interest</i>
Government	1,390	73
Municipal	233	13
Private bonds	454	27
	2,077	113
(£ millions)	(148)	(8)

In addition there is a considerable amount of 'direct' investment by foreign firms.

The principal lenders to Japan have been Great Britain and the United States. British investment in Japan in December 1930 was estimated at £63 millions, and at the same date United States investments were about \$445 millions, \$61 millions being 'direct' and \$383 millions 'portfolio'. American investments in Japan in December 1933 were estimated at \$426 millions, distributed as follows:

United States Investments in Japan, December 1933

(In million U.S. dollars)

'Direct':	
Missionary and philanthropic	8
Business investments	60
'Portfolio':	
Japanese Government bonds	151
Municipal bonds	40
Government guaranteed bonds	52
Securities issued by private firms	115
	<u>426</u>

There has been little or no difficulty in connexion with service payments on foreign investments in Japan, whose credit standing would consequently be very high, were it not for the continued threat of war in the Far East. With continuing industrial development, however, it is more than likely that Japan will become a net creditor on capital account within a short period. Even in the midst of depression there have been increases in Japanese investments in Asia, and continued repatriation of foreign-owned securities. Among other problems raised by Japanese progress, therefore, is that of the future of European and American investment in the Far East, for it is possible that the profitability of such investment will be less in future than in the past.

LATIN AMERICA.¹

South America suffered from several circumstances which tended to accentuate rather than to diminish the full force of the depression. In the first place the honesty and prudence with which finances have been administered has not always been unexceptionable; secondly, South American countries often produce only one or two important commodities for export; and thirdly, many of the natural resources are owned by foreigners in such a way that only a small part of the proceeds from the sale of exports remains in the beneficial ownership of nationals of the exporting country. The history of investment in South America throughout the last century has been one of confidence followed by disillusionment, of borrowing cycles followed by widespread defaults, and of a series of alternating repudiations and recognitions of external debts. Willingness to maintain service payments has certainly been less high than in the British Empire, and excesses were inevitable under the conditions which existed while the United States was investing such huge sums in these countries. The Leguia affair in Peru, and other evidence brought to light by the investigations of the United States Senate, showed unmistakably that much South American borrowing was marked by lack of foresight and financial mismanagement if not by even more unsavoury incidents. The ability of the most credit-worthy governments to avoid default must necessarily be impaired if any considerable part of the nominal value of loans has not, in fact, been put to the use for which it was intended.

¹ See the forthcoming survey of the South American Republics by the Royal Institute of International Affairs.

The dependence of each republic on one or at the most two products in order to earn foreign exchange is very marked; Argentina is the only important exception. Before the depression tin constituted 73 per cent. of Bolivian exports, coffee 71 per cent. of Brazilian and 61 per cent. of Colombian, nitrates and copper 84 per cent. of Chilean, petroleum and copper 58 per cent. of Peruvian, and oil 76 per cent. of Venezuelan. Such a situation is not necessarily dangerous at all times, but in the face of such a general fall in prices as that which occurred between 1929 and 1933 there was little that could be done to defend these countries from the full impact of the depression. It was obviously impossible to increase the number of different commodities produced for export in such a short time, and although attempts to do this are being made, many years must elapse before all the republics cease to be dependent upon exports of one or two products for their necessary supplies of foreign exchange.

In addition to the development of new export industries, South American republics have also directed their attention to the production for home consumption of many manufactured products which were formerly imported from Great Britain, the United States, and elsewhere. Among such goods which are now produced in appreciable quantities in many republics may be mentioned textiles, leather, saw-mill products, furniture, metal manufactures including machinery and tools, pottery and china-ware, cement, drugs and cosmetics, clothing, rubber goods, fertilizers, cigarettes, and paints and varnishes. If such development continues, as seems probable, the balance of payments of these countries will undergo radical change. They will import raw materials instead of manufactured goods, and their surplus of exports—which may well increase—will be used to pay for capital to develop industries which will compete directly with the export industries of the creditor countries. For such a change, the creditors have partly to thank themselves. If the exports of debtors are so restricted by tariffs that service payments cannot be met, the only alternative is a reduction of imports. By its attempt to be a net exporter both of capital and of commodities, the United States may have killed the goose that laid the golden egg, for neither kind of export can be as large again as it was in the post-war boom.

The problems raised by the foreign ownership of minerals in South America, though not unique, are certainly more numerous than in other parts of the world. A very large part of the mineral output of the continent is foreign controlled; foreign corporations, mainly American, have obtained mineral concessions from the republics,

usually in exchange for a loan, and have then proceeded to extract and export the minerals as rapidly as possible. This type of ownership makes the statistics of the balances of trade of several of the republics very misleading, for a part, and sometimes a large part, of the proceeds from the sale of the minerals accrues, not in the currency of the republics concerned, but in United States dollars or in sterling. The only receipts of a country whose natural resources are foreign owned (after the usual loan and the inflow of capital for equipment purposes) are in the form of wages, payments for materials used, and transport charges. The exports of many of the republics, therefore, do not provide them with quantities of foreign exchange which are nearly equal to the total value of those exports. In such circumstances, the difficulties of meeting service charges on the 'portfolio' investments of foreigners are, of course, considerably enhanced, and the republics have had to obtain the funds needed to pay the interest on their foreign debt by means of taxes and royalties imposed on the export industries.¹ This has been done with success in certain cases, notably by Venezuela, but foreign corporations have frequently refused to make new loans except on condition that such taxation should not be imposed.

*Argentina.*²

In Argentina, as in most Latin American countries, a very large part of the external debt was contracted for unproductive purposes. The Finance Minister classified the purposes for which loans had been raised as follows:

Argentina: Public Loans Contracted 1922-7, according to Purpose
(In thousands of paper pesos)

<i>Purpose</i>	<i>Amount</i>	<i>Per cent. of total</i>
Consolidation of the floating debt, including that of railways and sanitary works departments	545,650	45.3
For various public works and sanitary works	472,124	39.4
Armaments	146,798	12.1
For supplementary credits or unbudgeted expenditures	39,189	3.2
	1,203,761	100.0
	(£68,590,300)	

¹ It should be noted that the funds so obtained are, of course, in local currencies.

² See Peters, *The Foreign Debt of the Argentine Republic* (Baltimore, Johns Hopkins Press, 1934).

Of this increase in the funded debt, 813,884,525 paper pesos, or approximately two-thirds, was external. At least 60 per cent. of the borrowing was unproductive. As Peters expresses it: 'Success in obtaining funds abroad made possible the persistence of the deficits, which would otherwise have forced a more rational consideration of the [budgetary] problem.' The provincial and municipal governments were even more reckless in the purposes for which they borrowed; the United States lent £27 millions to Argentine municipalities and provinces between 1924 and 1928 and almost all the loans were unproductive and the subject of excesses.

Argentina first borrowed abroad in 1824, but until 1880 loans were few and far between. During the 'eighties expansion was accelerated and the transformation of the country from an undeveloped pastoral community into an important agricultural producer was begun with the aid of foreign capital. Loans followed one another in rapid succession. Default and the Baring crisis of 1890 were followed by a ten-year period of readjustment, during which the government assumed responsibility for provincial obligations and restored the country's credit. Complete service had been resumed by 1901, and from that time until the war borrowing was conducted again on an enlarged scale, though with much greater caution: Argentine credit was, in fact, higher during these years than at any other period before or since.

During the war Argentina, as a non-belligerent, like all the other countries in South America except Brazil, was affected by adverse financial and trading conditions less than many other agricultural nations. There was an increase in the floating debt, but during the war years Argentine finances were on a sufficiently sound footing to enable her to lend \$250 millions to the allies. It was during this period that the country first came to rely on capital from the United States instead of from Great Britain, and since that time by far the largest part of the foreign borrowing has been conducted in New York. The period during which Argentina was received most favourably in the American market extended from about 1924 until 1927; direct investment by United States enterprises continued throughout the 'twenties. By 1930 United States investments in Argentina amounted in value to about \$808 millions, of which \$449 millions were portfolio holdings—about 72 per cent. in national, 19 per cent. in provincial, and 9 per cent. in municipal government bonds—and \$359 millions were direct investments, mainly in power, transport and communications, banking, meat packing, and oil companies. British holdings of Argentine securities have tended to

decrease since the war, both because a considerable part of the United States direct investments during this period took the form of purchases of enterprises previously owned by Great Britain, and because, in the absence of any considerable new investment, the process of amortization helped to reduce the volume of capital outstanding. In 1930 British investment amounted to about £370 millions, of which some 57 per cent. was in railways and 16 per cent. in government bonds.

Argentina is primarily a food-producing country. In 1929, 30 per cent. of her exports were wheat and flour, 18 per cent. maize, and 17 per cent. meat and meat products. She had, moreover, remained a capital importer from 1920 to 1931. The fall in the value of Argentina's exports began in the autumn of 1928, and in 1929 their gold value was 10 per cent. lower than in the previous year. This decline in exports was accompanied by an almost complete cessation of capital imports, but there was no corresponding deflation. Budget deficits continued under the Irigoyen administration, and the extent of the currency depreciation is perhaps illustrated by the fact that export values declined only 39 per cent. between 1928 and 1931, measured in pesos, as against a fall of 58 per cent. in gold prices. According to Sir Otto Niemeyer, the depression was less severe in Argentina than in many other countries, partly because her exports are relatively well diversified compared with some other South American states. The government finances have to bear a considerable weight of debt, much of which has been incurred for unproductive reasons. Service of the public debt, more than half of which was paid to foreigners, required 31.9 per cent. of the 1932 budget; but, even so, the central government avoided default, although many provinces and municipalities ceased payment on their external debt. The government was able to meet its foreign obligations by a rigid control of foreign exchange rates; it has a prior claim on available supplies of foreign exchange, with the result that the 'official' buying rate for sterling has been lower than the rate available to private buyers by from two to five pesos in the pound. It has been asserted that the rate for non-government transactions represents an artificial depreciation of the peso; but no real evidence has been adduced in support of such a conclusion and therefore the complaints continually made by British-owned railway companies that they are making enormous exchange losses are difficult to understand. The government maintains a wide margin between its buying and selling rates for sterling, and this may cause losses to those who have to make remittances in both directions, but railway

companies, who are buyers, and not sellers, of sterling, can never suffer anything but a purely hypothetical loss on exchange transactions. In addition to rigid exchange control, restrictions were placed on industrial profits; but depression was so acute that these were only operative in very rare cases. The government, then, was able to maintain its credit abroad partly at the expense of private firms; but since the good credit of government is a most important prerequisite of stability, such a policy is probably justifiable from a long run point of view.

*Brazil.*¹

The amazing fluctuations which the Brazilian economy has undergone are probably unrivalled in the New World. It is still an agricultural country, but the products which it has exported have undergone great changes. It has been a 'one-crop' country, except for transitional periods, throughout the last three hundred years, but the chief export has been changed several times during that period. In the seventeenth century Brazil was the world's largest supplier of sugar; in the eighteenth century gold became of greater importance, only to be succeeded by cotton. In the nineteenth century the supremacy in cacao was won and lost, and then rubber became the staple export at the beginning of this century, only to be replaced by coffee. Each branch of production has been developed in turn almost to the total exclusion of all others. It appears that yet another change is now in progress, for coffee, which constituted some 71 per cent. of Brazil's exports in 1929, may yet be rivalled by cotton and fruits. Brazil is thus to be contrasted in this respect with Cuba, which is a 'one-crop' country whose staple export, sugar, has remained unchanged for a long period. Despite the amount of foreign capital which has been invested in the country, Brazil remains very largely undeveloped and a potential field for an even larger amount of investment. Before such investment can take place, however, there must be a greater diversification of her industries, she must become an economic entity rather than a mere political federation, her communications system must be extended, and, finally, the social status of her people must be raised by education, by better government, and in many other ways. This is an enormous task which has hardly yet been begun.

There are divergent estimates of the volume of foreign capital invested in Brazil. Normano gives the following figures:²

¹ See J. F. Normano, *Brazil: A Study of Economic Types* (Univ. of North Carolina Press, 1935), especially chapters ii and vii. ² *Op. cit.*, pp. 215-16.

Foreign Investments in Brazil

(£ millions)

	1916	1928-30		Total
		Direct	Portfolio	
United States	10	44 ^a	71 ^a	115 ^a
Great Britain	240	131 ^b	151 ^b	282 ^b
Other	210	150 ^c	100 ^c	250 ^c
Total	450	325	322	647

^a End of 1930.^b End of 1928.^c Obtained by applying the British coefficient of growth.

It is probable that this over-estimates both British and other European holdings. British investments (in quoted securities alone) were estimated by Sir Robert Kindersley at £151 millions in December 1930, which seems to coincide with Normano's estimate of 'portfolio' investments. But British 'direct' investments and investments by other European countries seem to be overstated. French investments amount to about Fs. 2,300 millions, and there can be few German investments, since the older ones must have been confiscated when Brazil joined the allies during the war. It appears that £520 millions is a more probable figure for total foreign investments at about 1930.¹

Investment has proceeded at a slower pace since the war than in the early years of this century. Between 1908 and 1914 foreign capital flowed into Brazil at the rate of about £27 millions a year, whereas Normano estimates on the basis of his figures that between 1916 and 1930 this yearly influx fell to £14 millions. Certainly the foreign-owned public debt has increased more slowly. Between 1900 and 1911 the external debts of the federal, State, and municipal governments increased from £48 millions to £145 millions, compared with an increase of from £176 millions to £230 millions between 1921 and 1931.

Moreover, since the war, the States and not the federal government have borrowed the largest sums abroad, in further contrast to the pre-war period. Nearly all the capital invested in government bonds since 1921 has been of American origin, and Sir Otto Niemeyer calculated, in 1931, that Great Britain had £100,569,751 nominal capital outstanding in these securities after a century of lending, as against \$143,336,998 of United States money lent during a decade.

¹ Cf. Dr. Mata, *Weltwirtschaftliches Arch.* iv (1929, i), pp. 13-15; Kimber's *Record of Government Debts*, &c.

About 35 per cent. of the external debt has therefore been contracted in the United States in one-tenth of the period during which Brazil has been borrowing abroad. A large part of the remaining United States investment has been in public utilities and branches of American firms, whereas railways and the development of raw materials have attracted British investors.

The crisis which the Brazilian economy was called upon to face was intensified rather than initiated by the decline in imports of foreign capital in 1929. The national finances had for long been disturbed and, although exchange rates fluctuated less than in many other South American countries during the 'twenties, reliance was increasingly being placed upon foreign capital imports in order to effect a balance in the budget and to support the price of coffee. The value of Brazilian exports fell from £95 millions in 1929 to £66 millions in 1930 and to £50 millions in 1931. Payment at the rate of 5 per cent. on the whole of the external indebtedness would require some £26 millions a year. Moreover, the difficulty of securing the means with which to pay the service on the public debt was enhanced by the fact that payment is made out of the gold revenues which are nearly all collected from customs dues. Thus, the more imports were restricted in the attempt to obtain a sufficiently favourable balance to permit debt service payments to be maintained, the smaller were the revenues out of which this item of expenditure was to be met. By 1931 the whole gold revenue was not sufficient to cover the foreign debt service. Meanwhile the gold reserve had fallen; in September 1929 it amounted to £31.1 millions, in August 1930 to £14.1 millions, and by December 1930 it had disappeared altogether. The revolution in 1930 disturbed production and finances, and although the provisional government grappled in a determined manner with the problem of the budgetary deficit, it was not equal to such a strain on its resources. In a country dependent to such a degree upon the demand for one commodity in world markets, developments of this character cannot be entirely unexpected, and only a radical change in the Brazilian economy as a whole can eliminate these difficulties in the long run. For the present, the best that can be done is to arrive at an agreement with foreign creditors for the adjustment of their claims, and such an agreement has already been reached for a short period.

Other Latin American Countries.

Four republics in South America are exporters of the raw materials of industry rather than of food products. Bolivia relies chiefly on tin,

Venezuela on petroleum, Chile on nitrates and copper, and Peru on petroleum and copper. About £250 millions of foreign capital has been invested in Chile, approximately £115 millions in Peru, £80 millions in Venezuela, and a much smaller amount, say £35 millions, in Bolivia. Beyond the fact that their exports fall into the same category there is little similarity between these countries in economic structure and weight of indebtedness, or in the history of their foreign borrowing.

Chile, in point of size the smallest of the four countries, has been borrowing abroad for the longest period, possesses the largest volume of external indebtedness both absolutely and per head of population, and is one of the most highly developed nations, industrially and commercially, in the whole of South America. The first Chilean loan was floated in London in 1822, and until 1914 almost the whole of the country's external financing was conducted in Great Britain. Since that date, however, most of the foreign loans have been placed in the United States.¹ The external public debt on the 31st December 1933 amounted to £91,448,171, of which £53,535,100 represented United States Loans, £29,871,271 British Loans, and £8,041,800 Swiss Loans.² British investment has been attracted chiefly into government bonds and railways, in which about £21 millions has been placed, and in the development of the nitrate industry. American investments, on the other hand, have been very largely direct; some \$441 millions had been invested in American corporations operating in Chile by 1931. According to the best estimates available it appears that in 1930 United States investments in Chile were about twice as large as those of Great Britain: £144 millions of American capital and £68 millions of British. Sir Robert Kindersley places British holdings of quoted securities only at £49 millions.

The dependence of the whole Chilean economy upon the production of nitrates is an example of the dangers of over-specialization in exports. With the increased production of synthetic nitrates, especially during and since the war, the foreign capital invested in Chile has been jeopardized to an ever-increasing extent. It is true that larger quantities of copper have been exported, and at the beginning of the depression copper exports were about equal in value to nitrate exports;³ but the fall in the prices of both commodities in subsequent years had a catastrophic effect upon the whole Chilean

¹ See F. W. Fetter, *Monetary Inflation in Chile* (Princeton Univ. Press, 1931).

² Corporation of Foreign Bondholders, *Report*, 1934, p. 133 f. Amounts converted at £1 = U.S. \$5 = Sw. Francs 15.

³ It should be noted that the production of copper in Chile is entirely controlled by foreigners.

economy. Exports fell in value from \$276,623,000 in 1929 to \$99,546,000 in 1931 and to \$27,709,000 in 1932; the favourable balance of trade declined from \$81,545,000 in 1929 to \$10,819,000 in 1932. Such a collapse in a country which, it is estimated, normally exports 50 per cent. of its national production, must inevitably cause default, however drastic the budget economies or determined the deflation.

In common with the other republics of South America, Chile took advantage during the boom years of the offers of issuing houses in the United States to borrow money on terms which almost completely overlooked the inherently unstable character of her economy. The mistake was perhaps the more easy to make in view of the high credit record which Chile had had in the past, but there was a considerable amount of foreign borrowing from 1926 onwards in order to meet budgetary deficits and for other non-productive purposes. In short, borrowers in Chile were too myopic and issue houses in New York, even if they saw farther, did not mention some of the relevant facts and thereby prevented investors from making a true estimate of the risks involved. In such circumstances over-borrowing was inevitable.

Bolivia has a comparatively small external public debt. It amounted in July 1931 to about \$62 millions, which consisted almost entirely of capital raised in the United States ostensibly for railway purposes. A somewhat larger amount has been invested directly by American corporations in tin mining, but, in contrast to mineral development in most other countries of South America, a large part of the capital of the Bolivian tin industry is owned at home. The recent war with Paraguay has so upset the national economy that no useful estimate can be made of the ability of the country to pay its external debt service in the long run.

Peru is another country which has turned to the United States for capital since the war. British investors remained unwilling to advance further sums to Peru in view of the unfortunate results of previous experiments in this direction. About £26 millions of British capital is invested in Peru, some 75 per cent. of which represents the securities of the Peruvian Corporation. This Corporation was established just before the war and took up certain large government concessions, including the whole of the then existing state railways, in settlement of defaults on past obligations. No dividends have ever been paid on its £9 millions of ordinary stocks. About one-third of the American capital has been invested in government securities and the

rest in petroleum and copper production. These two industries are almost entirely owned, managed, and controlled by foreigners, mostly by the United States, and together account for about 60 per cent. of Peru's exports. This fact makes it important to remember that the total value of Peru's exports exceeds the total amount of foreign exchange which these exports make available to citizens of that country by the amount of the interest and 'profits' on direct investments by foreign companies. Some of the proceeds from the sale of petroleum are, of course, returned to Peru to pay wages and other operative costs and local taxes, but the relative firmness of petroleum prices has not benefited that country as much as might be expected at first sight, because such a large part of the proceeds goes to shareholders and others in foreign countries. Despite favourable petroleum prices, the value of Peru's exports in 1932 was only a third of that of 1929. This fall caused a financial collapse and led to currency depreciation and moratoria in 1931.

Venezuela is in a unique position compared with the other countries of South America, since it has entirely paid off its external public debt. This feat was accomplished in 1930, largely through the taxation of petroleum exports, which in 1929 accounted for more than three-quarters of the total exports. Another distinctive feature of investment in Venezuela is that the volume of British capital in the country has tripled since before the war. Royal Dutch Shell controls nearly one-half of the oil produced, and the Standard Oil Company of New Jersey controls, through its subsidiaries, slightly less than one-third of the total production. The prosperity of Venezuela is as closely dependent upon oil-production as Chile used to be upon nitrates, and as Bolivia and Brazil have been upon tin and coffee respectively since the war. Oil-production in 1929 was about seventy times greater than in 1921, and Venezuela for a time ranked second among the petroleum producers of the world. It is impossible to avoid a comparison between post-war Venezuela and pre-war Chile, for, should the supplies of petroleum give out, or the demand price fall, prosperity might similarly decline. The great difference is, however, that Venezuela has taken this opportunity of extinguishing its external public debt, and this fact may make some future borrowing for constructive purposes more justifiable than in the case of Chile.

Cuba.

Cuba is dependent mainly on two crops, sugar and tobacco; consequently the present position of her finances is similar to that of

several South American countries. Most of the foreign investment in Cuba has been made by the United States, though there are some British holdings. The total of these investments in 1930 was estimated at \$1,450 millions, of which \$1,067 millions was United States capital (\$936 millions 'direct' and £131 millions 'portfolio'). British investments amounted to about £37 millions. The distribution of American investments is approximately as follows:

United States Investments in Cuba

	<i>Per cent.</i>
Sugar properties	53
Railroads	8
Public utilities	7
Government bonds, &c.	7
Real estate	10
Industry and Mining	6
Tobacco, &c.	3
Other	6
	100

Of the British investment about 80 per cent. was in railroads and 14 per cent. in government bonds.

COLONIES.

In addition to their investments in foreign countries, the principal lenders have also made considerable investments in colonial countries, their own as well as those belonging to others. The total size of this investment cannot be determined with great accuracy, but some estimates are available. The investments of Great Britain within the British Empire in 1930 have been estimated at £1,987 millions by Sir Robert Kindersley. Of this amount, £1,745 millions is invested in Canada, Australia, New Zealand, South Africa, Newfoundland, and India, which leaves only £242 millions for investments in the colonies proper. To this should be added perhaps £50 millions for investments in non-quoted securities, making a round total of approximately £300 millions. Roughly £70 millions of this represents investments in government and municipal securities; investments in railways account for about £30 millions, and mines and public utilities together for about £25 millions.

French colonial investments are estimated at 16,000 million francs (£152.4 millions), of which about 3,750 millions are invested in government or government-guaranteed securities, the remainder being in private enterprise. This estimate of 12,250 million francs (£116.7 millions) employed privately in the colonies is very high when

compared with M. Louwers's estimates of 7,495,750,000 francs (£71·4 millions); the latter was, however, obtained by adding together the outstanding capital of all companies operating in the colonies as shown in *L'Annuaire des entreprises coloniales, 1934*, and this method might easily lead to an under-estimate.¹

The same authority has also given estimates of Dutch and Belgian colonial investments. Investments in the Dutch East Indies are given as nearly 7,000 million florins (£437·6 millions), of which 2,500 million florins are in private enterprise. Investments in the Belgian Congo, he says, amounted to 20,000 million Belgian francs (£687·8 millions), of which 9,136 million Belgian francs (£314·2 millions) had been absorbed by private enterprise.

Estimates of investments by the United States in Alaska, Porto Rico, and Panama are not available; but the United States Department of Commerce has estimated that investments in the Philippines in 1930 amounted to \$167 millions. Of this, \$82 millions consisted of 'direct' investments and \$71 millions of government and government-guaranteed securities. American investors have also placed considerable sums in the colonies of other powers, mainly in the form of 'direct' investments; at a rough estimate, the total of such investments in 1930 was about \$225 millions.

CONCLUSION

Capital was obtained by almost every country in the world from Great Britain, the United States, or France during the ten years which followed the war. Investments in different countries, however, varied considerably both in their effects and their desirability. The foreign capital which was used for the reconstruction of Europe was very desirable and very necessary, but the amount which, in the end, was sent to this area was more than the debtors could hope to repay. This is also true of investments in Latin America, but for a different reason. Capital invested in Europe was very largely used for 'unproductive' purposes; it resulted in a rise in the standard of living in the borrowing countries, but did not increase the efficiency of their export industries to an extent sufficient to enable most of them to meet the full service payments on their indebtedness. Investments in Latin America, on the other hand, were more usually of a 'productive' character; they did, very often, tend to increase the efficiency of the borrowers' export industries. Unfortunately these industries, almost without exception, were engaged in the production

¹ O. Louwers in an address given before L'Institut Royal Colonial Belge in 1934.

of goods for which the world demand was at that time inelastic. The creditors, in other words, were unwilling to import greatly increased quantities of these goods when their prices fell, and the borrowers were, therefore, no better able to meet their obligations than were their European contemporaries. In the case of the British debtor countries, on the other hand, the situation was different. Investments were usually made for 'productive' purposes, and the export industries of the borrowing countries produced a wider variety of commodities, so that they were not so hard hit as those of Latin America by a decline in prices; in particular, almost all the British Dominions number gold among their exports. The burden of service payments was, moreover, relatively light for most British countries since all of them could borrow more cheaply in London (and Canada more cheaply in New York) than any other external borrowers. Finally, they were assisted in the depression by Imperial tariff policies. The fortunate position of investments in the British Empire to-day is, however, no proof, that over-borrowing did not take place. On the contrary, it is more than probable that Australia, although she did not default, was tempted to borrow a good deal more than the condition of her domestic economy would have warranted. A similar criticism may also be made of the borrowing of Newfoundland, of Canada, and, perhaps, of New Zealand.

The history of events during the depression and the problems which debtors had to attempt to solve, when they found themselves faced with concomitant declines in the volume of foreign capital which they could borrow and in the prices of their exports are discussed more fully in the next chapter.

CHAPTER XIV

INTERNATIONAL INVESTMENTS IN DEPRESSION

INTERNATIONAL lending on a large scale ceased in 1930. Since that date there have been developments of tremendous importance in this, no less than in other, branches of economic activity. Even before the depression had made itself felt in industrial countries, a decline in overseas investment had begun, and this soon became catastrophic. Debtors were placed in an increasingly difficult position. Faced with a fall in their export prices and with supplies of new capital completely cut off, they responded in different ways. Some defaulted on their external obligations; others sought to reduce the weight of their indebtedness by a variety of methods. The incomes which creditor countries received from their overseas assets declined, and fundamental adjustments in their balances of payments were forced upon them.

The Decline in New Investment.

Since the war, the years in which creditor countries invested the largest sums abroad were 1927 and 1928. During 1929 the volume of new foreign investment fell, and despite a slight recovery in 1930 continued to fall until 1935. The volume of new foreign investment by the United States, Great Britain, France, and the Netherlands during these years is shown on p. 282. It is doubtful whether the figures given for each country are strictly comparable with those for other countries, but the trend is, perhaps, sufficiently illustrated.

The flow of new funds for external investment from these four countries had fallen by 1929 to about three-quarters of its volume in the years 1925-8, and later shrank (if measured on a gold basis) to one-tenth of that amount.

Moreover, not merely did the amount of new investment by creditor countries decline precipitously, but such countries even became, in certain cases, net importers of capital. Their amortization receipts tended to exceed the amount of capital subscribed to new issues, and the sale of securities brought about a further back-flow of funds. The United States became a net importer of long-term capital in 1931. During the depression her sales of domestic and foreign securities to buyers in other countries were considerably larger than corresponding purchases, and receipts in the form of redemption, sinking fund, and amortization payments have exceeded new foreign issues and direct investment ever since 1931. In Great

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Britain new overseas issues were, according to Sir Robert Kindersley, smaller than repayments on old securities in 1932, but not in any other year. The export of short-term capital from the United States, which until 1934 was sufficiently large to offset the inward movement of long-term funds, afforded little relief to debtors, for, in periods of monetary disturbance, short-term capital exports by creditor countries tend to move towards other creditors rather than towards debtor countries.

New Overseas Investment by Certain Creditor Countries, 1929-34

	New issues ^a	United States		Great Britain New issues ^b
		Direct investments	Total	
	(\$ millions)			(£ millions)
1925-8 av.	1,067	274	1,341	120
1929	635	335	970	94
1930	832	253	1,086	109
1931	213	196	409	46
1932	27	36	63	29
1933	10	91	101	38
1934	nil	48	48	43

	France New issues ^c	Netherlands New issues ^c	Total Gold Index ^e
	(Frs. millions)	(Gulden millions)	(Av. 1925-8 = 100)
1925-8 av.	426 ^d	263 ^f	100
1929	1,100	99	74
1930	1,400	196	81
1931	3,725	36	39
1932	1,645	23	12
1933	400	nil	11
1934	nil	140	10

^a Nominal capital value, excluding refunding issues, issues for United States possessions, discounts, and underwriters' commissions.

^b Midland Bank estimates.

^c New foreign issues floated in France, excluding loans to French colonies.

^d Average 1926-8.

^e New issues on foreign account.

^f Average 1927-8.

^g Index of gold value of new overseas investments by these four countries.

One method of measuring the increased strain which was thrown upon debtors by this decline in new foreign investment is to compare the relative sizes of new investment and interest and amortization receipts in the balances of payments of creditor countries. Sufficiently detailed figures are only obtainable for the United States and Great Britain, and even in these two cases they are useful merely

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as illustrations of the general trend, since the two sets of statistics are not strictly comparable.

New Issues for External Borrowers and Amortization, and Interest and Dividend Receipts in the U.S.A. and Great Britain

(U.S. figures \$ millions; British figures £ millions)
(- = capital export; + = capital import)

	Average 1925-8	1929	1930	1931	1932	1933	1934
<i>United States:</i>							
New foreign issues ^a and direct invest- ments	-1,341	- 970	-1,086	- 409	- 63	-101	- 48
Amortisation re- ceipts on private debts ^b	+ 302	+ 276	+ 250	+ 257	+ 172	+123	+ 114
Interest and divi- dends on private long-term capital abroad	+ 720	+ 876	+ 838	+ 563	+ 396	+487	+432
Balance of above items	- 319	+ 182	- 6	+ 411	+ 505	+509	+498
<i>Great Britain:</i>							
New capital sub- scribed through overseas issues ^c .	- 93	- 96	- 98	- 41	- 37	- 83	- 63
Capital repayments. Net interest and dividends ^d	+ 50	+ 49	+ 39	+ 27	+ 48	+ 67	+ 42
Balance of above items	+ 207	+ 203	+ 161	+ 156	+ 161	+144	+154
<i>Great Britain and U.S.A.:</i>							
Balance of above items (in old gold dollars)	+ 686	+1,172	+ 776	+1,101	+1,070	+790	+730

^a Nominal capital excluding refunding issues, issues for United States possessions, discounts, and underwriters' commissions.

^b Including bond redemption and sinking fund payments.

^c In part Sir Robert Kindersley's figures; in part estimated.

^d This is a net figure; i.e., unlike that for the United States, it makes an allowance for interest and dividend payments made to foreigners by Great Britain and is therefore lower than the gross income from British foreign investments; but it also includes earnings on short-term capital abroad.

Between 1925 and 1928 the United States was investing abroad larger sums than she received from other countries in interest, dividend, and amortization payments, but Great Britain's receipts were

considerably in excess of her new external investments. Together, the debtors of Great Britain and the United States were called upon to pay over \$675 millions a year more to these two countries than they received in new loans and investments. This burden was nearly doubled in 1929; in 1930 the receipts of the United States in interest and amortization payments approximately equalled her new investments, but Britain's debtors found themselves in much the same position as in the period 1925-8. With the decline in new foreign investment after 1930, debtors' burdens were once more increased. One effect of Great Britain's departure from the gold standard was substantially to lighten the weight of indebtedness in many cases, but during 1932 this was offset to a considerable extent from the point of view of the world as a whole by a further decline in new foreign investment by the United States. The amelioration during 1933 was partly due to the fact that the United States went off gold, which reduced the gold value of payments to be made, and also to some increase in the volume of new investment by both creditor countries.

The United States first ceased to lend abroad on the old scale when the internal investment boom developed in the latter part of 1928. As the prices of domestic equities began to rise at a rapidly increasing rate, American investors turned their attention to these opportunities for capital appreciation; they ceased to be interested in fixed-interest-bearing securities, either American or foreign. But, although new foreign issues floated in the United States had been reduced to nearly one-half of their previous size by 1929, direct foreign investment did not decline to the same extent. By 1931 the index of new direct foreign investments by United States corporations had only fallen (average 1925-8 = 100) to 71.5, compared with a decline from 100 to 20 over the same period in the index of new foreign issues publicly floated. In Great Britain no such decline in the volume of new issues occurred until 1931, although the somewhat heavier volume of repayments reduced the effective volume of new capital which was exported. London continued to export long-term capital on only a slightly diminished scale during 1928 and 1929, largely because the alternative attractions of domestic investment were not so great as in the United States.

After the initial reduction in the volume of new investment during the Wall Street boom, a vicious circle set in. Debtors' difficulties were increased and as their payments declined, investors were further discouraged. The increased lending during 1930 which was a last, almost frantic, attempt to stave off disaster, accomplished little, because even in that year debtors were in need of considerably larger

quantities of foreign exchange than in the pre-depression period. Thereafter, of course, the depreciation of sterling reduced the gold value of payments to be made to Great Britain. This was, however, followed by a further decline in new investment, partly as the result of government pressure. The effects of the Treasury embargo on new foreign issues must not, however, be over-estimated, for it is unlikely that many foreign borrowers could have attracted the attention of British investors even in the absence of official discouragement in 1932 or 1933. In the United States, foreign issues had already fallen to a negligible amount before the Johnson Act was approved in April 1934. Although there may be reason for thinking that, latterly, these restrictions upon capital movements have acted as a deterrent to new investment, during the worst years of the depression the decline was mainly the result of purely economic considerations.

Debtors as a whole were faced with the greatest difficulties in 1931 and 1932. After that date there were improvements in certain directions, and a period of consolidation similar to that which followed each major international crisis in the past began. The relief that the debtors of Great Britain obtained from the fall of sterling appears to be such that, ever since 1931, the gold value of net interest payments made to the United Kingdom has been considerably smaller than in the period 1925-8, although, in terms of sterling, British income from overseas investments has improved considerably since 1932. Debtors of the United States were faced with greater difficulties when that country ceased to invest abroad, and the income of the United States from its overseas investments is still relatively very small. As the result of the inability (and, sometimes, the unwillingness) of debtors to remit service payments for one cause or another, the losses of creditors were considerable between 1931 and 1935.

The Problems of Debtors.

Maintenance of service payments upon the foreign capital invested in a country is affected by a number of factors. In the first place, creditors' receipts will be dependent not merely upon the ability but also upon the willingness of debtors to pay. Many countries have discontinued service payments on their foreign debts even when their financial position was sufficiently sound to enable such payments to be made. Usually, defaults of this nature have taken place when the possibility of obtaining fresh supplies of capital seemed remote, and when appearances suggested that there was little to be gained—

except in prestige—from the fulfilment of obligations. New governments which have risen to power on a wave of nationalist sentiment have frequently repudiated the debts of previous régimes, and, more often than not, have only been driven to compromise with the foreign creditor when the need for capital once more became urgent.

From a strictly orthodox point of view it may be held that default need never take place if a sufficiently ruthless deflation is carried out, and that therefore there can be no 'economic' reasons for not making payments in full. Those who hold this view maintain that 'budgetary' and 'transfer' difficulties are inseparable, which, in strict theory, they are. Thus, it is argued that transfer difficulties arose in Germany because deflation was not carried out sufficiently drastically, and that had this been done, budgetary and therefore transfer difficulties would not have arisen; but it is not suggested that this would have fallen within the realms of practical politics. In any case, this argument cannot apply when default is the result of certain uncontrollable causes, for example, political events such as wars or sanctions, 'Acts of God' such as earthquakes or tornadoes, or, in the case of a country dependent upon a single export, a very great change in the world demand for that commodity.

In a large number of cases, default occurred as the result of factors in the economy of the country concerned which might have been controlled to some extent by its government. The most important of these are: the volume of foreign indebtedness relatively to the wealth and industrial position of the country; the character of the investment and the nature of the revenue-producing assets which have been created by it; and the diversity and stability of the country's export trade. That the debtor's ability to transfer service payments is partly dependent upon the volume of the foreign investment, relatively to the standard of living and taxable capacity of the population and to the wealth of the country, is obvious. With regard to the character of the investment, the obligations which impose the heaviest burdens are those which do not represent any kind of productive expenditure; at the other extreme are those which automatically earn their service payments in foreign exchange. The character of the debtor's exports is of importance because, in whatever type of undertakings foreign capital has been invested, whether it be infant welfare centres or battleships, cattle-raising or heavy industry, the earnings of this investment in foreign exchange will be wholly dependent upon the prices which the exports of the country concerned can command in foreign markets.

There have been a number of unsatisfactory features about a very

large part of the investment in foreign government bonds since the war. In the British Empire the tendency was to over-borrow, but funds were very largely utilized in a productive manner. In Latin America debts were lighter, but finances were managed in a much less orthodox manner. In Europe, even apart from the very necessary stabilization loans, a considerable part of the borrowing was undertaken for financial purposes, rather than for the development of national resources. Wherever much of the borrowing was unproductive, it may be safely concluded that an even larger part was not self-liquidating.

The ability of debtors to maintain service payments on their external obligations was in many cases impaired by the heavy volume of capital which they had imported and by the illiquid and unproductive nature of a large part of the debts contracted. But, for as long as Britain and America continued to invest abroad vast sums of money every year, these difficulties remained only potential. They became actual when the flow of long-term capital diminished and finally sank to an almost imperceptible stream.

Even before this happened, all was not well with many debtors—especially with the important class of agricultural countries. There was a tendency for agricultural prices to decline during the period 1924–8, although the movement was by no means well marked or of uniform incidence. World stocks of agricultural commodities rose throughout the latter half of the 'twenties; wheat between 1925 and 1929 by 104 per cent., cotton by 40 per cent., coffee between 1926 and 1929 by 80 per cent., and sugar during the same period by 65 per cent.¹ The countries which produced these commodities had all obtained considerable sums from abroad in loans and investments, and much of this capital was used directly or indirectly to hold stocks of commodities off the market in a manner which masked the underlying situation and delayed the ultimate fall in prices. For most agricultural debtors the turning-point came during 1929. In the attempt to make up deficiencies in their international income they released stocks, and the consequent fall in prices served in many cases only to make the situation worse.

During this single year the value of the export trade of certain debtors fell by an unprecedented amount. Meanwhile, as is well known, the prices of the manufactured goods which these countries import did not decline to any comparable extent. The countries which suffered most from the fall in prices were those whose exports were not diversified, and whose industrial development was such

¹ See Royal Institute of International Affairs, *World Agriculture*, p. 89.

that it did not enable production to be directed quickly into more profitable channels. Those suffered least which could develop other industries, and, by means of tariff barriers, reduce imports in order to retain a favourable export balance.

Percentage Reduction of the Value of Export Trade of Certain Countries, 1929-30

Chile	42.1
Argentina	35.6
Union of South Africa	30.7
Brazil	30.6
British Malaya	28.9
Australia	26.3
Canada	25.1

The principal difficulties of debtors have been caused by changes in relative prices, and it is therefore necessary to examine at this point the nature of the falls in commodity prices during the depression.

*Decline in Average Gold Export Prices, 1929-34**

	<i>per cent.</i>		<i>per cent.</i>
1. Raw silk (Japan)	84	15. Wool (Argentina)	57
2. Copper (United States)	75	16. Sugar (Czechoslovakia)	57
3. Butter (Denmark)	73	17. White cotton piece-goods (U.K.)	54
4. Wheat (United States)	71	18. Cement (Germany)	54
5. Grey cotton tissues (Japan)	68	19. Passenger motor-cars (U.S.A.)	53
6. Petrol (United States)	68	20. Bacon (Denmark)	52
7. Coffee (Brazil)	68	21. Tea (Ceylon)	48
8. Rubber (British Malaya)	66	22. Pig-iron (U.K.)	47
9. Newsprint paper (Canada)	65	23. Coal (U.K.)	39
10. Maize (Argentina)	65	24. Steel girders (Belgium)	36
11. Silk tissues (France)	64	25. Tin (British Malaya)	32
12. Cotton (United States)	63	26. Mowing machines (Germany)	14
13. Chilled beef (Argentina)	61		
14. Mechanical wood-pulp (Finland)	61		

* League of Nations, *Review of World Trade, 1934*, pp. 14-15.

Price falls were very irregular, but were most marked in the case of raw materials exported by agricultural countries and of food. Export prices of raw materials (such as coal and pig-iron) exported by industrial countries, of most manufactured articles of consumption, and of various capital goods have been much firmer. The gold prices of all raw materials and semi-manufactured goods entering into international trade fell between 1929 and 1934 by 60 per cent., foodstuffs by 58 per cent., and manufactured articles by 50 per cent.

The discrepancies between the price movements of articles entering into international trade caused the imports of agricultural countries to become more expensive in terms of their exports. In other words,

the terms of trade moved against primary producers. Nations with heavy external obligations on account of debt service were forced to attempt to alter, in a very short period of time, the whole character of their balances of payments in order to obtain the necessary quantities of foreign exchange. To take only one example, that of Australia, the reduction in the prices of her exports forced her to send abroad about three times as much wheat, wool, and other commodities in 1930-1 as in 1924-5 to meet the service charges on her foreign debt, and about twice as much in order to purchase her imports. A variation of 1*d.* a lb. in the price of wool makes a difference of about £3 millions sterling in Australia's credit balance, and between 1923 and 1929 the average price she obtained for her wool fell by about 10*d.* a lb.¹

The difficulties to which debtors have been subjected in the endeavour to maintain service payments are appreciated by every one. Australia was no isolated example; her experiences were fortunate compared with those of some other primary producing countries. Every debtor was confronted by falling export prices, by a decline in capital imports, and by the necessity of meeting the service on loans fixed in terms of gold, dollars, sterling, or francs. In considering these difficulties, the importance of international movements of short-term capital should not be overlooked, since these were directly responsible for the plight of many debtors after 1931. But the most important single factor was the growth of tariffs. So long as Britain and the United States continued to lend freely, the dependence of debtors upon their export trade was obscured. Neither in lending nor in borrowing countries was it generally appreciated that debtors could only pay the service charges on their debts by means of an export surplus of goods and services. The United States in particular, and other lenders to a lesser extent, refused to allow the debtors to have larger export surpluses when they ceased to borrow. The industrial interests of the lending countries were helped by tariffs at the expense of the financial interests which became unable to collect their just debts. At the same time, debtors who did not pay in full were ostracized.

Three Debtor Countries.

As examples of debtors' difficulties since 1930, it is interesting to trace the experiences of a few borrowing countries in some detail. The countries which have been chosen are Germany, Australia, and Canada—three of the world's largest debtors.

¹ See *World Agriculture*, p. 110.

Germany's difficulties were becoming serious as early as 1929, when, with rising security prices at home, Americans became less willing to lend abroad. The volume of new loans declined sharply, and Germany had to find other means of obtaining her necessary supplies of foreign exchange. This was achieved temporarily, partly by renewed borrowing by the Reich Government—the Kreuger and Young Loans—and partly by a restriction of German imports. The crisis came, however, in July 1931, and short-term creditors were forced to accept the conditions of Standstill Agreements, and long-term creditors received even scantier redress, but no default of interest or amortization payments on external obligations occurred until the debt moratorium of July 1933. The German Government has always been determined to maintain the gold value of the Reichsmark, and in pursuit of this policy, rigid deflation was imposed between July 1931 and June 1932. Although this had the most beneficial results from the point of view of the balance of payments, it caused severe distress internally. Unemployment increased rapidly, and the usual effects upon trade and industry were reinforced by growing political as well as economic uncertainty. Before the end of 1932, however, the period of deflation was brought to an end with the fall of Dr. Brüning. In order to alleviate unemployment, the government began to finance inflationary public works and other schemes. The effect on the German balance of payments was immediate and disastrous, and the reserves of the Reichsbank began to diminish at an alarming rate despite exchange restrictions. The pressure on the exchanges increased with the advent of Herr Hitler, and it finally became necessary to declare an external debt moratorium in order to prevent the reserves of the Reichsbank from disappearing altogether. The table on the next page shows the changes which have taken place in Germany's balance of trade. Unfortunately, the figures for recent years are not altogether satisfactory, since no allowance has been made for imports which have been purchased with blocked marks; in so far as this method of payment has been adopted, the balance has, of course, been improved.

It is not to be wondered that the desperate efforts of the Brüning administration to maintain the service on the external debt should have met with disfavour, since they reduced the value of external trade by more than 60 per cent. and necessarily caused widespread unemployment. That they were unsuccessful in the end was due to the concomitant decline in the value of German exports, which was largely the result of the tariff policies of many countries, particularly Great Britain.

Germany's Balance of Trade, 1927-35

(Rm. millions)

<i>Year</i>	<i>Exports^a</i>	<i>Imports^b</i>	<i>Balance^c</i>
1927 . .	10,801	14,228	- 3,427
1928 . .	12,055	14,051	- 1,996
1929 . .	13,483	13,447	+ 36
1930 . .	12,036	10,393	+ 1,643
1931 . .	9,699	6,727	+ 2,872
1932 . .	5,739	4,667	+ 1,072
1933 . .	4,871	4,204	+ 667
1934 . .	4,167	4,451	- 284
1935 ^d .	4,270	4,159	+ 111

^a Exports of domestic produce.^b Imports for home consumption.^c Excess of exports (+), of imports (-).^d Including the Saar territory from 18 Feb. 1935.

This decline in exports was arrested only in 1935, and the consequent difficulty of obtaining foreign exchange has had most serious effects on the German economic system. Supplies of gold have gradually diminished and there has been an acute shortage of certain raw materials and foodstuffs. It appears that these difficulties are, for the moment, being overcome; but they are far from completely solved. Their ultimate solution may result in the creation within Germany of industries for the production of goods formerly imported on such a scale as to injure materially the export industries of both raw material producers and the two great creditor countries.¹

Australia, whose difficulties were also very great, has met the service on her public external debt in full, but only by rigid deflation and control of imports. Trouble began in 1929 with the cessation of new lending and the simultaneous fall in the prices of Australia's exports. Prior to this, Australia had been borrowing continuously from abroad, chiefly from Great Britain, and this had sufficed to pay for an import surplus and the interest due on past loans. Wheat and wool prices had, however, been well maintained, and Australian governments had been induced by the resultant wave of prosperity to spend considerably more than they received in taxes. The deficits of the Commonwealth and State governments in 1929-30 amounted to about £1 15s. per head of the population. Before equilibrium could be restored, these deficits had to be wiped out, and imports reduced relatively to exports. In order to achieve this, the following measures

¹ See below, pp. 323-7, for a discussion of how German import restrictions have influenced the ability of other debtors to make the service payments due to Great Britain.

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were taken, viz. a great increase in import duties, drastic reduction of government expenditure, increased taxes, compulsory conversion of the internal debt, exchange depreciation, and voluntary conversion of a large part of the government's external sterling debt. The effects of these measures on the balance of trade is clearly shown in the following statistics.

*Australia's Balance of Trade 1928-35**

(£ '000 sterling)

<i>Year</i>	<i>Exports</i>	<i>Imports</i>	<i>Balance</i>
1928	134,108	139,138	— 5,030
1929	123,048	145,172	— 22,124
1930	85,674	94,441	— 8,767
1931	70,871	43,477	+ 27,394
1932	76,309	53,188	+ 23,121
1933	90,196	55,371	+ 34,825
1934	78,779	67,231	+ 11,548
1935	91,381	77,801	+ 13,580

* Merchandise only.

In 1929 Australia had an import surplus of £22 millions; in 1930 this was reduced to £9 millions, and there were export surpluses in all the succeeding years, the largest being in 1933, when it amounted to nearly £35 millions. This, as has already been pointed out, was accomplished partly by means of increased import duties, partly by exchange depreciation, and partly by internal deflation. Two other factors have been of great assistance. The first is the great increase in wool prices which took place in 1933 and 1934 as shown in the following table:

*Average Price of Australian Wool**

(Index 1931 = 100)

1928	249	1932	101
1929	223	1933	134
1930	123	1934	146
1931	100	1935	137

* Compiled from a table in the *Journal of the Royal Statistical Society*, Part III, 1936, p. 358.

This advance in prices after 1932 was the result of the absence of large world stocks of wool, of a short clip in 1933, and of changing fashions with regard to wool. Australia's exports of this commodity—her principal export—increased both in value and in quantity in 1933, larger amounts being sent particularly to Europe and Japan.

Secondly, Australia is a gold producer, and her exports of this metal have increased rapidly as the result of the rise in its price. These exports have not been included in the table of the balance of trade given above, so that the favourable balance is even greater than that shown. In 1930 Australia produced about 467 thousand fine ounces of gold and in 1934 about 887 thousand fine ounces, almost all of which was exported. This has, of course, been of very great assistance in building up her balances of foreign exchange.

The existence of these favourable factors does not minimize the importance of Australia's achievement. Her debts have been paid only by means of the most rigid economies, which could not have been forced upon her people unless they were ready and willing to recognize their obligations to lenders in other countries. At the Premier's Conference of January 1931, the Premier of New South Wales, Mr. Lang, proposed that interest payments on the external debt should cease until the lenders had agreed to accept lower rates, but this suggestion was flatly rejected by the Conference. The reduction in the interest burden of the external debt was carried out in a strictly orthodox manner, though it must be admitted that Australia was particularly fortunate in that a large part of her debt could be repaid by conversion just at the time when interest rates in London were most favourable to such a proceeding.

As the result, then, partly of fortuitous circumstances, but largely of her own determination, the economic position of Australia to-day, although certainly far from 'normal', compares very favourably with that of other countries. But far-reaching changes in the economic structure of the country are taking place, and any judgement of the probable future of Australia must take account of these, as well as of the tariff policies of those countries which are Australia's principal markets, Great Britain, Germany, and Japan.

In Canada, as in Australia, the Dominion Government has met its obligations in full, and, in fact, there have been defaults on only the smallest fraction of the external debt of other public authorities. Canada's economic position was, however, very serious for some time, although its basic soundness has been clearly demonstrated by the marked recovery of the past eighteen months.

Canada is not so dependent as Australia upon exports of agricultural products, although these form, of course, a considerable part of her total exports. They are, however, supplemented by forest and mineral products as well as manufactured goods, and this diversification of exports has been of great assistance to Canada since the prices of many minerals and of secondary products have not fallen so far as

those of most agricultural products. Canada has also benefited as a gold producer from the recent high prices of that metal. On the other hand, opportunities for converting the external debt have been fewer than in the case of Australia, since most of it is payable in New York where conditions have, until recently, been less favourable than in London.

Canada's balance of trade became unfavourable in 1929, but efforts to correct it were not made until 1930, when heavy import duties were imposed. At the same time, negotiations with other countries were begun in an attempt to increase exports.

Canada's Balance of Trade, 1927-35

(\$ millions)

<i>Year</i>	<i>Imports for home consumption^a</i>	<i>Exports of domestic produce^b</i>	<i>Balance</i>
1927 . . .	1,087	1,218	+131
1928 . . .	1,222	1,350	+128
1929 . . .	1,299	1,182	-117
1930 . . .	1,009	886	-123
1931 . . .	628	605	-23
1932 . . .	453	494	+41
1933 . . .	401	532	+131
1934 . . .	513	653	+140
1935 . . .	550	729	+179

^a Including silver bullion.

^b Including silver bullion and gold bullion obtained direct from mining operations.

That this policy was successful is shown clearly by the trade statistics quoted above. The adverse balances of 1929, 1930, and 1931 were more than offset by the increasingly favourable balances of the succeeding four years. Besides trade agreements and import duties, three other factors have been responsible for this: the depreciation of the Canadian dollar against the United States dollar after 1931,¹ the government's control of wheat sales, and the great increase in the production of gold and of certain base metals.²

Deflation in Canada resulted as much from events in the United States as from internal policy. Although there have been conversions of the internal debt, compulsory wage reductions, and increased taxes, there have also been direct attempts to reflate. Unemployment has been relieved principally by public works financed

¹ The average quotation of the United States dollar in Montreal in 1931 was \$1.043; 1932, \$1.135; 1933, \$1.095; and 1934 \$0.990.

² For note 2 see opposite.

by cheap borrowing, often on short-term, and, at one time, by a limited use of the government's power to issue paper money. Deficits have accumulated and the debts of public authorities have reached astronomical dimensions, so that about 37 per cent. of the revenue raised by public authorities in Canada is now used to pay the interest on their debts.

The accumulating debts of the governments of Canada would be unimportant if they were all internal, since a little inflation would make them easy to bear, but many of them are payable in foreign currencies. For this reason currency depreciation, which might help export industries, and internal inflation, which might help domestic industries, are both dangerous, since they tend to increase the burden of the external debt. If, of course, inflation in Canada were to proceed *pari passu* with inflation in the United States, it would not have such harmful effects since a large part of Canada's external debt was contracted in New York.

The total debt of the Dominion government is about \$4,163 millions,¹ and that of the provinces and municipalities \$1,415 millions and \$1,386 millions respectively. The total public debt of the country is, then, nearly \$7,000 millions or about \$650 per head of the population. The interest charges on this debt amount to roughly \$300 millions per annum, an average rate of interest of about 4½ per cent. and an average expenditure of \$27·73 per head per annum. Of the total public debt, at least \$2,250 millions is due to persons who can demand interest payments in currencies other than Canadian dollars, so that it may be estimated that the service of the external debt requires an expenditure of about \$8·90 (£1 17s.) per head per

¹ See an article by Professor Stephen Leacock in the *Morning Post*, 6 July 1936. This figure includes the debt of the Canadian National Railways of \$1,155 millions.

The following table shows this clearly:

Canada—Exports

(\$ millions)

	<i>Gold bullion</i>	<i>Non-ferrous metals and their products</i>
1930-1 . . .	nil	95·7
1931-2 . . .	44·9	69·1
1932-3 . . .	50·6	42·6
1933-4 . . .	99·0	81·8
1934-5 . . .	96·7	94·6
1935-6 . . .	83·4	129·1

annum.¹ The national income of Canada is estimated at about \$3,200 millions per annum at the present time, or slightly more than \$300 per head. Thus, nearly 10 per cent. of the annual income of the community is used to pay the interest on the public debt, and nearly 3 per cent. to pay the interest on the public external debt.²

But this is not a complete picture, since the bonded debt of private enterprise which is owed to persons outside the country has not been considered. Unfortunately, it is not possible to measure this very exactly. Investments in Canada by residents of other countries amount to about \$6,500 millions, of which \$2,250 millions has already been discussed. If it is permitted to guess that half the remainder is in fixed-interest-bearing obligations, it is found that \$2,125 millions of private debt is owing to residents in other countries who can expect to receive a fixed annual return, probably in their own currencies. Finally, owners of \$2,000 millions or more of equity interests in Canadian industries must receive some return, though it is not so urgent that they should do so in bad years. In sum, these external debts call for an annual expenditure of about \$250 millions, which is partly offset by foreigners' interest payments to Canadian investors; these payments have amounted to slightly more than \$50 millions in recent years.

The net interest payments which are due to residents of other countries are, it is seen, much larger than the balance of trade which is available, and the difference is usually bridged partly by the expenditure of foreign tourists in Canada and partly by imports of capital. The income from these sources was, however, greatly diminished during the depression, and the balance was effected by sales of Canadian-owned foreign funds. These are now, fortunately, no longer necessary because the favourable balance of trade and the expenditure of tourists have both increased to such an extent that foreign exchange is now readily obtainable for the payment of interest on the external debt.

Canada has now emerged from the trough of depression and her economic position is very sound relatively to that of many debtor countries. Yet one minor word of warning may be permissible. The prices of several of Canada's more important agricultural exports have been maintained partly by government subsidy and partly by 'Acts of God'—drought and frost. These latter factors

¹ The amount of interest payments due in foreign currencies has varied very widely in recent years as the result of exchange fluctuations.

² In Australia the annual service of the public external debt alone cost about £4 12s. per head of the population before the recent conversions.

cannot be expected to continue, and the former can only do so by means of internal inflation. Canada's successful recovery deserves the highest praise; but the problems of agricultural production in the West and of her railway systems, as well as other questions of a more political nature, must be solved before complete recovery can be said to have been achieved.

League Loans.

Inasmuch as the origin of the League Loans was considered in some detail in the last chapter it is, perhaps, worth while to analyse briefly their present position.¹

The Austrian Loan was converted and the original holders paid off in 1935, so that, technically, it no longer exists. The new issue is guaranteed by the governments of the lending countries in much the same manner as was the original loan. There was thus no default on the Austrian Loan, and the same is true of the two loans to Danzig and the loan to Estonia, none of which was guaranteed in any way by foreign governments.

The interest on the League Loan to Hungary has not been paid in full since the 1st February 1934. In that year 50 per cent. of the amount due was transferred, and some bondholders subsequently accepted a further five per cent. in full settlement. In 1935 and 1936 50 per cent. of the interest was transferred and the remainder deposited in blocked pengő. The Hungarian Government has expressly recognized the special position and claims of the League Loan, and is, apparently, paying as much as is possible at present. Sinking fund payments have been entirely suspended.

Default first occurred on Bulgaria's indebtedness on the 15th November 1932. In 1933 about 50 per cent. of the interest due on her two League Loans was paid; in 1934 only 32½ per cent. was paid, and in 1935 only about 21½ per cent. Despite considerable pressure, and the outspoken opinion of several foreign observers to the effect that Bulgaria could well afford to transfer more than this, the Bulgarian Government refused to agree to pay more than 21½ per cent. in 1936. The sinking fund has, of course, been completely suspended.

'One of the reasons advanced by the Bulgarian Government for their failure to offer to transfer a higher percentage of the interest was the fact that most of the new trade with free currency countries, such as the United Kingdom, was in commodities for which most or all of the foreign exchange need not be surrendered to the National Bank. But the growth

¹ The following information was obtained from the *Fourth Annual Report* of the League Loans Committee (London), August 1936.

of such trade is a new and satisfactory feature, and it should not be impossible for the Bulgarian Government to acquire some part of the resulting exchange for the purpose of meeting its public obligations.¹

The full service on the League Loans to Greece was provided until 1932. Since April 1932, however, no provision whatever has been made for sinking funds, and interest payments have been made only in part in foreign currencies. Following a long dispute between the bondholders' representatives and the Greek Government, the latter agreed (22 Aug. 1936) to transfer 40 per cent. of the interest due for the years 1935-6 and 1936-7. This is an advance of only 5 per cent. on the offer made by the Greek Government and rejected by the bondholders' representatives in February 1935; and these representatives appear to have agreed to this offer very grudgingly. 'They were', it is said, 'convinced that it did not represent the maximum effort which Greece could make to minimize the heavy sacrifices which the bondholders have had to make.'² They appear, however, to have agreed that, in view of the political situation in the debtor country, this was likely to be the highest offer which could be obtained.

Defaults on League Loans, though heavy, have not been as serious as those suffered by holders of some other sorts of bonds. The fact remains, however, that of the total outstanding amount of £61,100,000 for all League Loans in 1935, full service payments (interest and sinking fund) were made on only £23,300,000 or 38 per cent., and that serious default occurred on £27 millions³ or nearly 45 per cent. of the whole amount. This is not a record of which the original advocates of League Loans could be very proud.

The Incidence and Extent of Default.

It is not easy to define exactly what is meant by default on external indebtedness. Strictly speaking, non-fulfilment by a debtor of any of the clauses of a loan contract might be regarded as a default, but the possibility that new terms may be agreed upon between debtors and creditors with regard to the conditions of a loan, or that debtors may make loan service payments in part, or in other than the contractual manner, may give rise to different degrees of default, and even to different opinions as to whether default has or has not taken place.⁴ A complete enumeration cannot here be made of all the

¹ Loc. cit., p. 9.

² Loc. cit., p. 10.

³ Greece, £19 millions, and Bulgaria, £8 millions.

⁴ Thus, for instance, the vexed question of gold clauses in foreign loans has led certain creditors to stigmatize debtors as defaulters when such default is denied by the debtors and even, after legal process, in the courts of the creditor

possible ways in which debtors can avoid their full contractual obligations although continuing to pay something by way of loan service, nor even of the great variety of devices which have been adopted during the depression in order to reduce service payments and transfer difficulties without going into complete default. A distinction should, however, be preserved between default and repudiation: although defaults have been frequent during the last few years, repudiations have been very rare.

Before the depression the principal defaulted obligations outstanding were those of Russia, Mexico, and Ecuador, of certain provincial and municipal governments in Argentina and Brazil, and of certain States of the United States. Calculations of the Corporation of Foreign Bondholders indicate that the approximate principal outstanding in these defaulted obligations in 1930 was £1,772 millions, of which Russia's share amounted to some £1,745 millions.¹ Only a very few defaults had taken place between the end of the war and 1930, and the principal affected amounted to only just over £6 millions, the bulk of which represented losses in Brazilian States and municipalities. Many pre-war debts had been written down during that period, but in nearly all cases there were agreements to this effect between debtors and creditors. Thus, despite the large volume of unsettled obligations outstanding at the beginning of the depression, it is true to say that the world had been free from any substantial measure of default on international obligations for more than ten years.

Creditor countries began to sustain losses through defaults on a large scale in 1931, in which year moratoria were declared by many South American states. But effective default on a full year's coupons did not, in most cases, take place until 1932. A statement of defaults at the 1st June 1932 prepared by the Council of Foreign Bondholders showed that, excluding Mexican and Russian securities, full contractual service payments were not being remitted on £120,597,624 and \$11,181,900 of foreign stocks and bonds, and £17,308,550 of foreign corporation stocks. Thus, there was complete or partial default on about £140 millions invested in foreign governments and municipal securities. It should not, however, be concluded that the consequent losses to British investors have been as large as these

countries. Unless otherwise stated, default is here taken to mean the non-payment of principal or interest of a debt without the consent of the creditor to the postponement. For a discussion of the terms of loan contracts see below, Appendix II, pp. 347-55.

¹ See *Report of the Council of the Corporation of Foreign Bondholders, 1934*, pp. 503-5.

figures would tend to indicate, for there is reason to assume that a large proportion of these bonds was held in other countries.

It is difficult to obtain any precise indication of the volume of British capital invested in the defaulted bonds of foreign governments and municipalities. The Council of Foreign Bondholders has discontinued its practice of giving totals of government and municipal loans in default, owing to the impossibility of obtaining exact figures for the English portions of certain loans. Sir Robert Kindersley's estimates are, however, useful in this connexion. The outstanding capital invested in bonds of foreign governments in complete or partial default which were listed on the Stock Exchange on the 1st January 1935 was (excluding Russian and Mexican securities) approximately £180 millions. A comparable figure for foreign municipalities was £23 millions. At the end of 1933 only about 56·3 per cent. of the capital invested in the bonds of foreign governments quoted on the London Stock Exchange was British, and a comparable figure for foreign municipalities was 74·6 per cent.¹ Although details are not available for each loan separately, it may be permissible to apply these percentages, which refer to the British-owned portion of the whole of the listed bonds in these two types of securities, to that part of the holdings which have gone into default. Such a calculation shows that the nominal volume of British capital invested in defaulted foreign government bonds is probably not more than £100 millions, and in defaulted foreign municipal bonds about £17 millions.

These estimates may, perhaps, be compared with Sir Robert Kindersley's figures of the nominal amount of British capital invested in these bonds. His estimates for 1933 indicate that the nominal value of British investments in foreign government bonds was £298,840,000, and in foreign municipal bonds, £33,666,000. Accordingly, it appears that approximately one-third of the British capital invested in foreign government bonds has suffered from some degree of default and that about half the British holdings of issues of foreign municipalities are in a similar position. These calculations are subject to a wide margin of error, but they serve to show that the nominal volume of British capital invested in the bonds of foreign governments and municipalities which was not receiving its full contractual service payments at the beginning of 1935, amounted to approximately 35 per cent. of the total volume of British investment in these classes of securities.²

¹ *Economic Journal*, Sept. 1935, p. 442.

² Russian and Mexican bonds have been excluded throughout.

The loss of interest which British investors sustained through their holdings of foreign government and municipal bonds has been calculated by Sir Robert Kindersley. He gives the following figures relating to the total loans outstanding irrespective of the domicile of the holder.¹

Service in Default 1931 to 1933
(Government and Municipal Loans)

(£'000s)

	<i>Interest</i>	<i>Sinking Fund</i>	<i>Total</i>
1931 . . .	1,453	1,095	2,548
1932 . . .	9,044	5,413	14,457
1933 . . .	9,544	7,745	17,289
Total	20,041	14,253	34,294

Interest and sinking fund due and unpaid to British and other investors between the end of 1930 and the end of 1933 amounted to £34·3 millions (interest £20 millions; sinking fund £14·3 millions). Of this total the amount due to British investors was only £19·3 millions (interest £11·1 millions; sinking fund £8·2 millions). Details of non-payment of interest only are given for later dates, and it is estimated that the total amount of interest lost to British investors on their holdings of foreign government and municipal bonds was £16 millions during the four years, 1931 to 1934.

It is more difficult to obtain reliable data as to the extent of the losses which have been incurred by British investors on their holdings of overseas industrial debentures. The amounts received as interest on loan capital in British, colonial, and foreign companies operating abroad fell from £38 millions in 1929 to £27 millions in 1933. Expressed as percentages of the total outstanding, the interest on loan capital in British companies operating abroad fell from 4·75 per cent. in 1929 to 3·2 per cent. in 1933, and on foreign and colonial companies from 4·9 per cent. in 1929 to 4·2 per cent. in 1933. Owing to the complications introduced by the writing off of old capital, by new investment, by exchange fluctuations, and by the movement of securities, it is not possible to state how far interest receipts declined owing to defaults. Nevertheless, from causes connected with the depression, the average yield on over £700 millions of British capital invested in the debentures of companies operating overseas declined from 4·8 per cent. in 1929 to 3·7 per cent. in 1933.

Geographically, by far the largest number of defaults have

¹ *Economic Journal*, Sept. 1934, p. 369.

occurred on South American and central European bonds. Defaults on Latin American bonds began in 1931, whereas default did not become prevalent in central Europe until 1932, and Germany's moratorium was declared in July 1933. Thus during 1932 the service in default on foreign government and municipal bonds listed in London was £14,457,000, of which Latin America accounted for £12,212,000 or about 85 per cent.,¹ Europe for £2,109,000, and China for £136,000.

A series of interesting calculations on British investment in Latin America have been given for a number of years in the *South American Journal*. Figures are given for the total volume of capital outstanding, for that proportion of the total which is receiving no interest or dividends, and for the average rate of return on the volume of capital outstanding including all dividends, bonus shares, interest receipts, &c. These results are not comparable with those obtained by Sir Robert Kindersley, mainly because they include all sterling securities issued by Latin American borrowers whether these are held by British investors or not. Both fixed-interest-bearing and equity investments are included.

In 1929, when less than 24 per cent. of the British investments in Latin America were in default, the average rate of interest received on the whole body of investment was $4\frac{1}{2}$ per cent., whereas in 1934 no interest was received on 60 per cent. of the investment, and the average return had fallen to little over $1\frac{1}{2}$ per cent. Heaviest losses have been incurred in railways; the yield on government securities has not fallen to the same extent. The lower rate of earnings on the total volume of capital during 1934 was partly the result of conversion operations, and the amount of outstanding securities on which no interest was paid declined for the first time since 1929.

Despite the large number of central European defaults after 1931, the loss of income to British holders of these bonds tended to be smaller, not merely because the volume of British capital invested in Latin America was about three times as large as in Europe, but also because most European governments made greater provisions for the transfer of service payments. In the case of European bonds, although there were defaults on sinking funds, interest payments have usually been made in whole or in part in local currency and transfer moratoria imposed.

¹ 'In 1935, from the figures available, the total British capital invested in Argentina in Government railway and miscellaneous stock, and quoted on the London Stock Exchange, was £446 millions on £204 millions [or 45·7 per cent.] of which no interest was paid in 1935.' Mr. C. L. Baillien, in a letter to *The Times* dated 17 June 1936.

*British Investments in Latin America**

(£ millions)

	Government bonds.			Railways.			Banks and shipping			Miscellaneous.			Total.		
	Amount	No In-terest	Average rate of interest	Amount	No in-terest	Average rate of interest	Amount	No in-terest	Average rate of interest	Amount	No in-terest	Average rate of interest	Amount	No in-terest	Average rate of interest
1913	316	5	4.4	458	61	4.2	34	.. ^b	10.1	191	17	5.5	999 ^c	82	4.7
1923	347	58	3.9	483	164	3.4	52	7	5.7	270	104	3.8	1,152	333	3.8
1929	338	50	4.2	496	135	4.0	43	1	6.7	336	102	5.4	1,214	289	4.5
1930	337	49	4.3	509	158	3.5	43	10	5.3	316	72	5.7	1,205 ^c	290	4.3
1931	329	58	3.7	508	205	2.3	45	17	3.1	339	134	4.2	1,222	415	3.2
1932	318	188	1.9	490	322	1.5	47	35	1.1	331	176	2.8	1,185	720	2.0
1933	315	185	1.9	493	348	1.3	47	35	1.2	347	226	2.0	1,202	791	1.7
1934	345	123	2.0	490	345	1.3	40	28	1.4	330	213	1.9	1,206	708	1.6

* Abbreviated from figures in *The South American Journal*, 16 Nov. 1935, p. 465.

The countries included are:

Argentina	Colombia	Cuba	Paraguay	Nicaragua	Chile
Venezuela	Peru	Ecuador	Salvador	Honduras	Bolivia
Brazil	Uruguay	Mexico	Guatemala	Costa Rica	Panama

^b £200,000.

^c It will be noted that these estimates are considerably higher than those of Dr. Feis and Sir Robert Kindersley for 1913 and 1930 which have been quoted above, Chapter IX, p. 121, and Chapter X, p. 142. The explanation appears to be that the above estimates have made no deduction on account of sterling securities owned by persons not resident in the United Kingdom.

The most important European debtor is, of course, Germany. As the result of pressure applied by the British Government, British holders of Dawes and Young Loans are receiving service payments in full, in sterling. The service on the German 7 per cent. Potash Bonds is also being met in full. Other British creditors are receiving payment in 4 per cent bonds of Konversionskasse für Deutsche Auslandsschulden. This institution issues bonds in payment of equal nominal amounts of interest instalments on long- and medium-term indebtedness (including interest, distributed profits, rents or leases, and similar payments of a recurring nature) in respect of which corresponding payments in Reichsmarks have been made to Konversionskasse by German debtors.¹

Whereas British, French, Italian, and Swedish holders of 7 per cent. Dawes and 5½ per cent. Young Loans receive payments in full in their local currencies, holders in Holland and Belgium receive 3½ per cent. in foreign currency and the balance in Dawes marks and Young marks respectively. American holders receive 5 per cent. and 4 per cent. respectively in dollars and the balance in Dawes and Young marks.

Four per cent. Funding Bonds of Konversionskasse were issued² only to nationals of those countries having separate transfer agreements with Germany, viz. the United Kingdom, Switzerland, Holland, Sweden, Belgium, France, and Italy. Nationals of other countries received payments in 3 per cent. Funding Bonds. Holland has, however, renounced its right to receive 4 per cent. Funding Bonds for the year ended the 30th June 1937, and the German-Swiss Agreement was denounced by the German Government as from the 30th June 1936. Except in these two cases, Funding Bonds will be used as heretofore until the 30th June 1937. It is, however, the policy of the German Government to discontinue the issue of these bonds at the earliest possible date, since they are causing a continual increase in the public external, long-term debt. If, therefore, the foreign exchange position improves materially, a new method of meeting these payments may be expected to be instituted.

It appears that the United States suffered somewhat more heavily from defaults on her foreign holdings than did Great Britain, partly because the German Government does not pay in full the American holders of Dawes and Young Loans, &c. But the data necessary for an accurate comparison between the two countries'

¹ The agreements providing for this method of payment expire on 30 June 1937.

² Up to 30 June 1936.

investments are difficult to obtain. The progress of defaults is seen in the following table:

*Interest Defaults on Foreign Dollar Bonds**

(Principal Amount Involved in New Defaults)

	\$
Prior to 1 Jan. 1931	392,226,100
During 1931	521,957,500
" 1932	826,144,200
" 1933	1,145,503,700
" 1934	211,744,100
" 1935	2,787,000

* Bulletin No. 85 of the International Institute of Finance, 6 April 1936, p. 4. The total of these amounts does not equal the total in default on 31 Dec. 1935 because of subsequent changes in the amount of bonds outstanding and in the status of individual issues.

New defaults reached their peak in 1933, but had declined to almost negligible proportions by 1936. In fact the total of bonds in default on interest payments was greater at the end of 1933 than at the end of 1935, despite the \$215 millions of new defaults during the two years. This was due in part to the resumption of service payments on all outstanding Austrian dollar bonds as well as on the City of Tucuman (Argentina) and Paulista Railway (Brazil) loans; but the principal cause of the decline in the total of outstanding defaulted bonds was the purchase and cancellation of the bonds by their foreign issuers, a procedure which substantially reduced the volume of outstanding German bonds, for example.

Bonds were also repurchased on a large scale without cancellation, and it was estimated that not more than 60 per cent. of the total amount of foreign dollar bonds outstanding at the end of 1935 were actually owned by United States citizens.

The status of all outstanding foreign dollar bonds at the end of 1935 is shown in the tables on pp. 306-7. In addition to the defaults on interest payments, \$254,196,240 of bonds were in default on both principal and interest, \$900,000 were in default on principal only, and \$74,869,800 were in default on sinking fund only.

At the end of 1935 there were \$7,490 millions of foreign dollar bonds outstanding. Of these, \$2,055 millions were in complete default on interest payments and \$755 millions were in partial default, making a total of \$2,810 millions, or 37½ per cent. of the total, in default on interest payments. The heaviest defaults had occurred on Latin American bonds, for 80.5 per cent. of the total capital outstanding in these bonds was in default. Fifteen Latin American

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debtor countries were responsible for \$1,866 millions or 25 per cent. of the total of bonds outstanding, and for \$1,501 millions or 53½ per cent. of the total of bonds in default. Only two of these countries have avoided all defaults on their bonds—the Dominican Republic and Haiti; all the bonds of nine countries were in partial or complete default; and the amount of defaulted dollar bonds in the remaining four countries ranged from 25·3 per cent. of the total outstanding in the case of Argentina to 93·2 per cent. in the case of Brazil.

*Status of All Publicly Issued Foreign Dollar Bonds, 31 Dec. 1935**

Country of issuer	Amount outstanding	In default as to Interest ^b		Country of issuer	Amount outstanding	In default as to Interest ^b	
		Amount	Per cent.			Amount	Per cent.
	(\$ millions)				(\$ millions)		
Austria	64·2	..	..	Argentina	351·2	88·8 ^d	25·3
Belgium	153·5	..	..	Bolivia	59·4	59·4	100·0
Bulgaria	16·9	16·9 ^c	100·0	Brazil	349·2	325·1 ^f	93·2
Czechoslovakia	26·8	1·1	4·1	Chile	308·0	308·0	100·0
Danzig	3·9	..	..	Colombia	156·1	156·1	100·0
Denmark	148·8	1·0	0·7	Costa Rica	8·8	8·8 ^h	100·0
England	20·1	..	..	Cuba	123·8	75·0	60·6
Estonia	3·6	..	..	Dominican Republic	16·3	..	..
Finland	40·9	..	..	El Salvador	12·6	12·6	100·0
France	135·7	..	..	Guatemala	2·2	2·2 ⁱ	100·0
Germany ^d	886·9	883·6 ^e	99·9	Haiti	0·6	..	..
Greece	26·9	26·9 ^c	100·0	Mexico	295·5	295·5	100·0
Hungary	56·9	56·9 ^d	100·0	Panama	15·6	14·4 ^m	77·5
Irish Free State	1·3	..	..	Peru	91·3	91·3	100·0
Italy	218·0	..	..	Uruguay	63·4	63·4 ⁿ	100·0
Luxembourg	8·0	..	..		
Netherlands	70·2	..	..	Latin America	1,866·3	1,500·7	80·5
Norway	158·1	..	..		
Poland	99·2	..	..	Australia	255·1	..	..
Roumania	10·9 ^h	10·9	100·0	China	5·5	5·5	100·0
Russia	75·0	75·0	100·0	Japan	368·5	..	..
Sweden	86·7	86·7	100·0	Canada	2,613·4	81·2	3·1
Yugoslavia	63·5	63·5 ^g	100·0	Newfoundland	5·2	..	..
Europe	2,376·1	1,222·5	51·5	TOTAL	7,490·0	2,809·9 ^c	37·5

* Compiled from tables in Bulletin No. 85, issued by the International Institute of Finance, 6 April 1936, pp. 10-15.

^b Most issues in default as to interest were also in default as to sinking fund.
^c Partial interest offered in cash on this amount.
^d Including the Saar.
^e Partial interest offered in cash on \$169·0 millions; interest was being deposited in Reichsmarks by most German issuers, but was not available to bondholders.
^f Of this amount, partial interest was being offered in cash on \$6,578,600; payment up to 5 per cent. per annum in foreign currencies was offered in cash on \$50,269,300; and no interest was paid on \$58,000.
^g Partial interest offered in cash on \$9,970,500.
^h Estimated amount outstanding of American *trussels* of Kingdom of Roumania Monopolies Institute Loan.
ⁱ Interest offered in cash and scrip or funding bonds on \$69·4 millions; partial payment offered in cash on \$12·0 millions; no interest being paid on \$7·4 millions.
^j Partial interest offered in cash on \$318·5 millions.
^k Interest offered in scrip or funding bonds on this amount.
^l Partial interest offered in cash on this amount.
^m Interest offered in cash and scrip or funding bonds on \$11·4 millions.
ⁿ Partial interest offered in cash on \$52·9 millions.
^o Of this total, interest was offered in cash and scrip or funding bonds on \$80·7 millions; partial interest offered in cash on \$615·0 millions; interest offered in scrip or funding bonds on \$8·8 millions; interest offered (up to 5 per cent. per annum) in foreign currency on \$50·2 millions; and no interest paid on \$2,056·1 millions, or 73 per cent. of the total amount in default as to interest.

European borrowers, who had issued \$2,376 millions or 31·8 per cent. of the total bonds outstanding, had defaulted on interest payments on over half of these and were thus responsible for 43·2 per cent. of the total in default. But these defaults had occurred on the

Interest Defaults on Foreign Dollar Bonds, 31 Dec. 1935^a

Country of issuer	National governments		States, provinces, departments		Municipalities		Private companies		Total				
	Amount outstanding	Interest in default	Amount outstanding	Interest in default	Amount outstanding	Interest in default	Amount outstanding	Interest in default	Amount outstanding	Interest in default			
	(\$ millions)	Per cent.	(\$ millions)	Per cent.	(\$ millions)	Per cent.	(\$ millions)	Per cent.	(\$ millions)	Per cent.			
Bulgaria	16.9	16.9	100.0	..	..	..	..	..	16.9	16.9	100.0		
Czechoslovakia	18.7	..	..	..	..	6.9	1.1	16.0	28.8	1.1	4.1		
Denmark	102.8	..	..	..	..	83.1	..	..	13.8	1.0	7.5		
Germany (including the Saar)	150.9	150.9	100.0	84.8	84.8	100.0	72.8	72.2	99.9	578.9	576.2	99.9	
Greece	26.9	26.9	100.0	..	..	..	..	..	..	..	..	..
Hungary	6.6	6.6	100.0	..	..	..	..	..	..	..	..	..
Roumania	10.9	10.9	100.0	..	..	..	..	..	..	..	..	..
Russia	75.0	75.0	100.0	..	..	..	..	..	..	..	..	..
Sweden	..	..	..	..	..	..	..	..	86.7	86.7	100.0	86.7	
Yugoslavia	53.6	53.6	100.0	..	..	..	..	..	10.0	10.0	100.0	63.6	
Europe	1,056.9 ^b	840.8	82.3	106.6 ^b	84.8	79.1	265.9 ^b	104.5	39.8	946.9 ^b	692.8	78.2	2,876.1 ^b
Argentina	241.6	..	..	87.0	81.4	93.6	23.6	7.4	32.8	..	..	..	351.2
Bolivia	59.4	59.4	100.0	..	..	..	..	..	..	..	..	..	59.4
Brazil	144.7	144.7	100.0	140.8	119.8	84.9	61.1	61.1	100.0	2.6	..	..	349.2
Chile	175.4	175.4	100.0	..	..	..	..	..	..	..	..	..	308.0
Colombia	61.2	61.2	100.0	60.0	60.0	100.0	22.1	22.1	100.0	22.7	22.7	100.0	166.1
Costa Rica	8.8	8.8	100.0	..	..	..	..	..	..	..	..	..	8.8
Cuba	65.9	40.0	45.0	..	..	..	..	..	..	35.0	85.0	100.0	123.8
El Salvador	12.6	12.6	100.0	..	..	..	..	..	..	..	..	..	12.6
Guatemala	2.2	2.2	100.0	..	..	..	..	..	..	..	..	..	2.2
Mexico	58.5	58.5	100.0	8.8	8.8	100.0	..	..	..	233.8	233.8	100.0	295.5
Panama	15.1	11.4	75.8	..	..	..	0.4	..	..	8.1	8.1	100.0	18.6
Peru	87.2	87.2	100.0	1.2	1.2	100.0	2.9	2.9	100.0	..	..	..	91.3
Uruguay	52.9	52.9	100.0	..	..	..	10.4	10.4	100.0	..	..	..	63.4
Latin America	1,024.7 ^b	704.4	68.8	292.2 ^b	265.1	90.8	140.1 ^b	124.5	89.0	409.3 ^b	406.7	99.5	1,866.8 ^b
China	5.5	5.5	100.0	..	..	..	..	..	..	..	..	..	5.5
Canada	405.8	..	..	808.5	..	..	247.6	0.4	0.2	1,351.5	80.8	6.0	2,613.4
TOTAL	2,886.6 ^b	1,050.7	37.1	1,070.8 ^b	849.4	82.6	722.8 ^b	229.4	31.8	2,860.7 ^b	1,180.4	41.8	7,490.0 ^b

^a Abbreviated from a table in Bulletin No. 85 of the International Institute of Finance, 6 April 1936, pp. 12-13.

^b The total outstanding includes issues of borrowers in countries in which there has been no default; see table on p. 306.

bonds of relatively few borrowers. Twenty-three European borrowers are listed in the table on page 306, but the defaults on the bonds of eight of these—Germany, Sweden, Russia, Yugoslavia, Hungary, Greece, Bulgaria, and Roumania—accounted for 99.8 per cent. of the total interest defaults on European bonds. If Germany and Russia are excluded, out of a total of \$1,414 millions of bonds outstanding, default had occurred on only \$264 millions or 18½ per cent.

The value of defaulted bonds issued by borrowers outside Latin America and Europe was only \$81.7 millions or 2½ per cent. of the total outstanding. The defaulting borrowers were in Canada and China.

The detailed table on p. 307 shows how the defaulted bonds were distributed as between classes of borrowers. The bonds of the governments of twenty countries were in complete or partial default; the total of such bonds being \$1,051 millions, or 37½ per cent. of the total of bonds in default. Of this total, Latin American governments were responsible for \$704 millions; there were only three Latin American governments which had not defaulted on their dollar bonds, but these included the largest single borrower, Argentina. Seven European governments had defaulted on \$341 millions of dollar bonds or 12 per cent. of the total of foreign bonds in default; but, of this amount, German bonds accounted for \$151 millions and Russian bonds for \$75 millions.

Of the remainder, States, provinces, and departments were responsible for \$349 millions of the bonds in default, municipalities for \$229 millions, and private companies for \$1,180 millions. Defaults in the two former categories occurred chiefly on Latin American bonds, although the total of European bonds in default was also very large. Defaults on the bonds of States, provinces, and departments concerned 32.6 per cent. of the total outstanding of such bonds. For European bonds alone (German borrowers were the only defaulters), this proportion was 79 per cent., and for Latin American bonds, 91 per cent. Default affected 31.8 per cent. of the capital invested in municipal bonds: Latin American 89 per cent. and European 39 per cent. Of the total of private companies' bonds in default, German firms had failed to pay full interest on \$576 millions, or 49 per cent., and Mexican firms on \$234 millions, or 20 per cent., leaving only \$370 millions, or 31 per cent. for firms in all other countries. This latter amount was divided as follows: Latin America \$173 millions, Europe \$117 millions, and Canada \$81 millions. 41.3 per cent. of the outstanding bonds of industrial borrowers were in default: Latin America 99.5 per cent., Europe 73.2 per cent., and Canada 6 per cent.

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The following table shows how the depression affected the receipts and payments of the United States on interest and dividend account.

*Interest and Dividend Receipts and Payments of the United States**
(\$ millions)

	<i>Paid by foreigners to U.S. Investors</i>	<i>Paid to foreigners investing in U.S.</i>
1925 . . .	520	165
1926 . . .	735	268
1927 . . .	800	281
1928 . . .	893	359
1929 . . .	979	414
1930 . . .	916	300
1931 . . .	662	126
1932 . . .	461	68
1933 . . .	487	103
1934 . . .	493	126
1935 . . .	421	146

* Excluding inter-governmental debt.

The fall in interest payments to the United States occurred entirely on holdings of foreign securities, partly through default and similar measures preventing payment, and partly as the result of the repatriation of securities by overseas debtors. Interest receipts from direct investments rose with the increase in American investment of this type. The increase in interest payments to foreigners was the result partly of increased dividend payments by United States firms, and partly of an increase in foreigners' holdings of American securities.

The increase in foreign investments in the United States was one of the most remarkable features of the recent depression. The following table shows the extent to which the United States has been a capital importer in recent years.

*Long-term Capital Movements in the United States Balance of International Payments**

<i>Net imports (+) or exports (-) of long-term capital</i>	<i>(\$ millions)</i>
1925	-487
1926	-602
1927	-723
1928	-662
1929	-137
1930	-267
1931	+219
1932	+217
1933	+49
1934	+202
1935	+462

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A recent investigation by the Department of Commerce estimates that foreign long-term investments in the United States amounted to \$5,035 millions in 1935.¹ Unfortunately, no comparable figures are available for earlier years. These investments were classified as follows:

Foreign Investment in the United States, 31 Dec., 1935

<i>Class of security</i>	<i>Amount (\$ millions)</i>
Portfolio Investments:	
Common stocks	2,015
Preferred stocks	329
Bonds	607
Other investments	1,039
Total	3,990
Direct investments*	1,045
TOTAL	5,035

* 'Direct investments' are defined as representing foreign holdings of bonds or shares of 'American corporations, exclusive of financial institutions, in which foreign corporations or foreign shareholders have the controlling voice in management as a result of their stock interest'.

Nationality of Foreign Investors in the United States, 31 Dec. 1935

<i>Nationality</i>	<i>Amount of holdings (\$ millions)</i>	<i>Per cent. of total</i>
British	1,374	27.3
Canadian	1,008	19.9
Dutch	784	15.7
Swiss	399	7.9
French	282	5.6
Other	1,190	23.6
	5,035	100.0

There seems no reason to assume that the position of the United States as a considerable borrower on long-term which is shown in the above figures will be reversed in the near future. If interest rates remain relatively low in Great Britain, British investors—and particularly institutional investors—may be expected to increase considerably their holdings of dollar securities. The consequences of this development from the point of view of the balance of payments has been discussed in Part I.

The experiences of French investors in recent years have undoubtedly been even less fortunate than those of their British and American contemporaries. No attempt has been made to ascertain

¹ *Balance of International Payments of the United States, 1935*, p. 56.

with any precision the geographical distribution of French capital abroad, but it is certain that the bulk of her foreign investments are in central Europe—one of the principal defaulting areas. France managed to prevent several of her debtors from defaulting for a short period in the early days of the depression by means of large official and semi-official advances, especially to the countries of the Little Entente. French investments in other parts of the world such as Great Britain, the United States, and Latin America, if not the subject of default, have nevertheless received considerably reduced service payments in terms of francs.

There has been a tendency for losses through foreign defaults during the depression to be overestimated; not all, nor even the majority of overseas bonds proved to be bad investments. The British Empire, in whose bonds over £1,700 millions of British and American capital had been invested, paid most of its obligations in full. Losses were incurred predominantly in two regions, Latin America and central Europe. Even in these two areas, however, figures of the total outstanding volume of defaulted bonds give an exaggerated impression of the losses which creditors experienced. The interest which British investors in overseas bonds lost through defaults between the beginning of 1931 and the end of 1934 was certainly not in excess of £60 million or about 15 per cent. of the income which would have been earned, had all fixed interest bearing securities received full payment throughout. A comparable estimate of American losses would probably not exceed \$600 millions. On the basis of these figures it appears that the losses of both countries which, spread over four years, might have amounted to £180 millions represented not more than one quarter of the total income which British and American foreign and overseas bonds, amounting to roughly £3,800 millions, might have been expected to earn during that period. In other words, defaults reduced the incomes of the two principal creditor countries from their holdings of external fixed interest-bearing obligations by not more than one-quarter, measured in dollars and sterling. In the event of the liquidation of part of the blocked accounts these losses would be further reduced, and in so far as creditors have utilized such accounts in the past the pecuniary losses from defaults have been smaller than this suggested figure.

Reduction of the Burden of Indebtedness.

Faced with a decline in the amounts they were able to borrow abroad, those debtors who avoided default usually attempted to reduce the burden of their indebtedness by other methods. Two

principal ways of doing this were open to them; either they could endeavour to reduce the annual service payments to be made on approximately the old volume of overseas debt, or else they could try to reduce the volume of that debt itself. The first of these two methods—that of conversion—has been more acceptable to creditors and pursued by the more credit-worthy borrowers. The second has in many instances been an adjunct of default. Nevertheless the conditions under which it is possible to redeem bonds and to convert them into securities bearing lower rates of interest are fairly narrow, and this method of reducing the burden of indebtedness has, with a few exceptions, not afforded very great relief to debtors.

The success of a conversion operation is obviously dependent upon the willingness of bondholders to accept a lower rate of return on their securities than that to which they have previously been accustomed. Should a large proportion of them be expected to demand repayment in cash, the borrower would be unable to find underwriters for his issue except at a prohibitive price. Thus conversion possibilities will be the greater, the smaller are the alternative lines of equally profitable investment open to the bondholder. But if the moment is extremely unpropitious he may well prefer to dis-invest altogether—to obtain repayment on his previous holdings without purchasing any other securities.¹ Conversion operations are, then, only possible when the ruling long-term rate of interest is lower than that payable on old bonds, and when investors have sufficient confidence not to seek repayment in cash on a large scale. Of course, bondholders will voluntarily accept a lower rate of return only on securities which are not in default on interest or sinking fund. In addition, only those bonds that are callable either at the option of the borrower or at a convenient date can readily be converted. Bonds which are in default or on which there is no early redemption date are, however, sometimes converted by arrangement with the bondholders. Such agreements are not in accordance with the terms of the original loan contract and are not, properly speaking, conversions at all.

At any given moment it is, therefore, possible to convert only a very small proportion of the outstanding volume of indebtedness.

¹ In this connexion an important factor has been the increase in the volume of investment by professional investors such as insurance companies, building societies, and similar corporate institutions. Their growth has been a factor tending to make conversion operations as a whole more successful, for such investors must necessarily avoid dis-investment as far as possible, whereas the small private bondholder may be much more willing to liquidate his holdings under unfavourable conditions.

During the latter part of 1931 and the beginning of 1932 it is probably true to say that debtors who could not meet their existing debt charges without severe internal deflation had no alternative but to default. But the first prerequisite to widespread conversion was established in June 1932 when the British War Loan operation reduced the effective long-term rate of interest in London at one stroke by more than 1 per cent. Even then, however, the vast majority of the bonds and debentures listed on the London Stock Exchange did not fall within the conversion zone. The *Economist*¹ undertook a survey of all British company debentures (including railways) convertible before 1942, taking as its limit only those fixed-interest-bearing securities quoted at or above par and assuming that bondholders would be willing to accept minimum rates of interest of 4 per cent. for popular utility debentures and 4½ per cent. for holdings with a fair industrial risk. It was then found that out of a listed total of £945 millions of bonds, debentures, &c., only £105 millions fell within the conversion zone. Subsequently² a similar survey of preference and preferred ordinary shares showed that £1,612 millions nominal was outstanding in these types of securities which was, for the most part, not convertible during the life of the companies under British company law before 1929. A further £33 millions was invested in 'Trade Facilities' securities which are governmentally guaranteed. Hence, out of a total of approximately £2,600 millions only a very small part fell within the conversion zone, and up till February 1935 only £104 millions or about 4 per cent. had in fact been converted. As the *Economist* has expressed it, 'the long-term interest charges of British industry as a whole, it is clear, have not been significantly alleviated by conversions during the last two and half years.'³

The table on page 314 shows the extent and distribution of the conversion and refunding operations of overseas borrowers in London. The preponderance of Dominion, particularly Australian, conversions is obvious and the other classes of borrowers are almost negligible in comparison. The saving of interest charges to borrowers in British countries is indicated by the fact that the difference between the weighted average yields on their old and new securities was 1.5 per cent. in 1932, 1.7 in 1933, 0.8 in 1934, 1.7 in 1935, and 1.8 in 1936.⁴

Conversions began after the completion of the 5 per cent. War Loan

¹ 30 July 1932.

² 23 Dec. 1933.

³ 2 Mar. 1935, p. 484.

⁴ Bank of England estimates.

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operation in about October 1932, but did not involve large amounts until the last weeks of that year. The largest conversion operations by overseas borrowers were those of Australia. The first Australian Government conversion took place in October 1932, and between that date and July 1936 some £199 millions of Commonwealth and State Loans were redeemed. The saving in interest appears to have been nearly as large, proportionately, as that of the British Government, i.e. about $1\frac{1}{2}$ per cent. The table on the opposite page gives a complete list of Australian conversion loans for this period. These twelve issues have resulted in an annual saving of interest payments of £3,174,846 sterling, or £3,979,000 in Australian currency.

*United Kingdom**Refunding and Conversion Issues for Overseas Borrowers, 1932-6.**

	1932	1933	1934	1935	1936
			(\$ millions)		
British countries:					
Dominion Government	12.1	89.8	53.2	43.7	41.0
Other Government	6.0	26.1	12.1	14.3	..
Local authorities	0.3	1.7	6.2	..	0.3
Industrial	6.0	12.0	3.4	4.2	1.9
Total	24.4	129.7	68.9	62.2	43.2
Foreign countries:					
Government . . . . .	..	..	22.2	..	12.4
Local authorities . . . . .	..	..	0.9	2.5	1.9
Industrial	0.1	..	3.1	6.9	1.5
Total	0.1	..	26.2	9.4	15.8
TOTAL	24.5	129.7	97.3	71.7	59.9

* Bank of England Estimates (Bank of England, *Statistical Summary*, Jan. 1936 and Jan. 1937).

The importance of other Dominion and colonial conversions has been small in comparison; together they have converted less than half this volume of obligations. Even less impressive in point of size have been the operations of foreign governments and municipalities. Until 1934 they were excluded altogether from the London market under the Treasury embargo, but, after two small issues for Iceland and Finland in March and May 1934, the Argentine Government converted £13 millions between June and December of that year at terms which represented only a comparatively small reduction in interest payments (as contrasted with sinking funds), and Austria obtained a $1\frac{1}{2}$ per cent. interest reduction on the British *tranche* of

her League Loan. Only one foreign municipality, Bergen, undertook any operations in the London market during that period.

*Australian Loan Conversions in London**

<i>Date</i>	<i>Amount</i>	<i>Old rate of interest</i>	<i>New rate of interest</i>	<i>Issue price</i>
	£	<i>per cent.</i>	<i>per cent.</i>	
Oct. 1932	12,380,959	5½	3½	97½
Feb. 1933	9,621,846	4	4	100
May 1933	11,409,965	6½	3½	99
July 1933	17,221,191	6	4	99
Sept. 1933	20,951,226	5½ and 6	3½	98
Dec. 1933	16,647,349	5 and 5½	3½	99
Feb. 1934	21,636,550	5 and 5½	3½	97
Nov. 1934	14,801,806	3 to 5	3½	99
Jan. 1935	22,384,000	5	3½	100
July 1935	13,469,981	3 and 5	3	100
Jan. 1936	21,657,000	5	3	95½
June 1936	16,551,403	3 to 4½	2½	99
Total	198,513,276			

* See *The Financial News*, 3 Jan. 1936 and 4 June 1936.

The only overseas borrower, then, that has reaped any considerable benefit from the low interest rates in London has been Australia, which has converted over one-quarter of its external debt. Other parts of the Empire have been handicapped chiefly by the fact that their bonds do not bear early redemption dates. Foreign government conversion operations have not only been fewer, but the reductions in their debt charges have tended to be smaller, and overseas industrial enterprises have converted only about £4 millions of nominal capital. In general, it appears that the pace of overseas conversions is likely to increase rather than to diminish. With the relaxation of the embargo on foreign loans, credit-worthy borrowers abroad may be expected to avail themselves of the cheap money facilities in London to an increasing extent. But the chief obstacle to conversion both inside and outside the Empire will perhaps lie for the immediate future, not so much in the unsoundness of individual debtors, as in the inability to call for conversion at an early date more than a small part of the loans floated since the war. Up to the present, conversion operations appear to have afforded relief to Britain's debtors to the extent of less than £10 millions a year.

On other markets it has not been found possible for foreign debtors to convert more than a very small proportion of their obligations. In New York the nominal capital involved in refunding operations by

foreign borrowers during the four years 1931-4 amounted to \$184 millions. This was distributed geographically as follows:

*Refunding by Foreign and Colonial Borrowers in the
United States 1931-5*

(Nominal capital, \$ millions)

<i>Country of borrower</i>	<i>Amount</i>
Canada	167.84
Germany	14.52
Argentina	10.09
Finland	5.00
Cuba	3.00
Hawaii	6.18
Porto Rico	3.78
Total	<u>210.41</u>

That Canadian borrowers should have conducted over 80 per cent. of all the foreign refunding operations in New York in these years is to be expected. That the amounts involved are not larger is to be explained chiefly by the relatively high rates of interest which ruled in New York until recently. In 1934, moreover, the operations of the capital market were further restricted by the Johnson Act.¹ The table on the opposite page illustrates the activities of foreign borrowers in New York in more detail.

In Paris, Amsterdam, Zurich, and Basle, refunding operations by overseas borrowers have not taken place on a large scale in recent years. The over-valuation of the currencies of these countries until September 1936, and the consequent efforts of their authorities to impose deflation in order to remain on the gold standard, kept interest rates at very high levels relatively to those elsewhere. Borrowers have found that at such rates there was little or nothing to be gained by conversion, and refunding operations were, therefore, conducted on a very small scale. There were, of course, some funding and refunding operations by foreign borrowers in these markets, including, for example, two Belgian issues in Paris in 1934, which were used for consolidating credits previously given by French banks, and for converting earlier loans, but these issues bear interest at 5½ and 5 per cent. respectively.

Only on the British market have conversions been possible on a large scale. The debtors who have succeeded in reducing their debt service charges in London have been fortunate, for those whose bonds were repayable during the last four years have had a means of obtaining relief, when other debtors, no less needy and no less credit-

¹ See above, Chapter XI, p. 196.

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worthy, could not secure such benefits. The series of Australian conversions greatly improved the financial position of this Dominion, which was by no means the most sound before the depression, and some of the effects of the heavy post-war borrowing have been mitigated. But Australia's problems cannot be completely solved merely by conversions.

Issues of Long-term^a Capital for Foreign and Colonial Borrowers in the United States, 1931-5^b

Year	Country of borrower	Number of issues	Nominal capital	Refunding	New nominal capital
1931	International	2	78-00	..	78-00
	Hawaii	1	5-00	..	5-00
	Japan	1	19-73	..	19-73
	Canada	35	178-97	53-37	125-60
	Cuba	1	3-00	3-00	..
	Porto Rico	1	0-50	..	0-50
	Total	41	285-20	56-37	228-83
1932	Germany	2	14-52	14-52	..
	Canada	5	73-37	44-02	29-35
	Total	7	87-89	58-54	29-35
1933	U.S.S.R.	2	3-95	..	3-95
	Canada	2	60-13	54-00	6-13
	Argentina	1	6-09	6-09	..
	Cuba	1	0-70	..	0-70
	Porto Rico	2	1-40	..	1-40
	Total	8	72-27	60-09	12-18
1934	Finland	1	5-00	5-00	..
	Argentina	1	4-00	4-00	..
	Total	2	9-00	9-00	..
1935	Canada	2	62-00	16-45	45-55
	Alaska	1	0-96	..	0-96
	Hawaii	4	6-99	6-18	0-81
	Porto Rico	4	4-03	3-78	0-25
	Total	11	73-98	26-41	47-57
	Total (1931-5)	69	528-34	210-41	317-93

^a i.e. having a currency of more than one year.

^b United States Department of Commerce estimates.

A less satisfactory but possibly more effective method of reducing the burden of indebtedness is for borrowers to repurchase blocks of securities issued on their behalf in the principal capital markets. Such action has sometimes followed defaults which have severely

depressed the prices of bonds on creditor stock exchanges and made it possible for debtor nations to repurchase securities for a fraction of their nominal value. Purchases have been conducted both by borrowing authorities themselves and by nationals of the borrowing country. The latter have benefited under exchange restriction schemes from the fact that service payments, which are blocked or only transmitted in part in foreign exchange, may yet be payable in full in local currencies. Default was not, however, the forerunner of all large-scale international bond movements during the depression. Nationals of certain countries purchased large blocks of their governments' securities on foreign markets in cases where such loans, particularly post-war issues, bore higher rates of return than comparable domestic flotations. In some cases the process of redemption was accelerated in order to diminish overseas indebtedness; in others, if the foreign government had instituted exchange control, exporters from that country used foreign balances to purchase bonds of their government abroad—rather than surrender the foreign exchange to their own government—in the belief that the bonds so purchased could be resold later if desired.

The extent to which debtors have taken advantage of the opportunity afforded by the low prices of their bonds to repurchase considerable blocks of their securities, is illustrated from the experience of the United States.¹ Between the end of 1930 and the end of 1934 the nominal value of United States long-term investments abroad declined by over \$2,000 millions from \$15,170 millions to \$13,114 millions. During the same period, however, this realization of assets brought in only \$566 millions, or just over one-quarter of the nominal value of securities sold. It would seem, therefore, that the bonds which have been repatriated have been mainly those which were heavily depreciated. Repatriation proceeded to such an extent that, of the total of approximately \$7,500 millions of foreign dollar bonds outstanding at the end of 1935, it was estimated that \$3,000 millions or 40 per cent. were held outside the United States. In so far as these bonds were held by nationals of the debtor countries who were compelled to accept service payments in local currencies, the burden of the debtors has been lightened.

Considerable blocks of foreign sterling securities have also been sold abroad since 1929. According to Sir Robert Kindersley's estimates the nominal amount of British long-term capital outstanding overseas fell from £3,738 millions at the end of 1929 to £3,665 millions at the end of 1933, or by £73 millions. The excess of

¹ See League of Nations, *Balances of Payments, 1934*, pp. 23-7.

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new capital issues for overseas account over amortization receipts during the same period was £78 millions. Hence it appears likely that net sales of outstanding securities to the total of about £150 millions took place during these four years. Undoubtedly the proceeds of the sales were not as large as this and, as was the case with dollar bonds, it may fairly be assumed that heavily depreciated securities formed the larger part of such sales. Certain details with regard to these transactions are given below:

Changes in the Nominal Value of British Overseas Investments during the Period 1930-3^a
(£ millions)

	Nominal value of investments at the end of		Increase (+) or decrease (-)	Amor- tization receipts	Change through new issues and move- ment of outstanding securities.
	1929	1933			
Loans to Dominion and colonial governments	1,081	1,147	+86	-81	+167
Loans to foreign governments	361	332	-19	-44	+ 25
Investments in British com- panies abroad:					
loan capital	385	387	+ 2	-27	+ 29
share capital	802	824	+22	..	+ 22
Investments in foreign and colonial companies:					
loan capital	403	350	-53	-29	- 24
share capital	436	345	-91	..	- 91
Various investments not in- cluded above	300	280	-20	..	- 20
Total	3,738	3 665	-73	-181	+108

^a Source: Sir Robert Kindersley's estimates as presented in the League of Nations, *Balances of Payments, 1934*, p. 26.

Sir Robert Kindersley suggests that the total balance in the last column is composed as follows:

New capital issues	+259
Balance of purchases and sales of old securities	-151

Two of the countries which have taken advantage of this method of reducing their external indebtedness are Chile and Germany. The Chilean Law of January 1935 concerning the resumption of service on the external debt contained provisions to expedite amortization.

The Council of the Corporation of Foreign Bondholders expressed its objections to this law in part as follows:

'The proposed application of amortization, whilst there is not sufficient revenue to provide a reasonable (not necessarily the contractual) rate of interest, has evoked the strongest protest. The Council has always upheld the principle that a Government which declares itself temporarily unable to meet the interest upon its External Bonds should not profit by the occasion to effect amortization at prices which are depressed by its own default. The whole amount available under present conditions should be applied to interest only.'¹

Germany has repatriated many of her bonds, which not only reduced her foreign obligations but has also stimulated her export trade.² Exporters found themselves in a position to sell their goods at apparently unprofitable prices if they could use part of the proceeds to buy cheaply, on foreign markets, German bonds which could be sold in Germany at or about par. According to the official German figures the total face value of securities repatriated between November 1931 and February 1934 was Rm. 781 millions, of which Rm. 549 millions came in through this 'additional' exports process. The actual purchase price paid abroad for this Rm. 549 millions of securities, whose nominal value measured in German currency had fallen after the depreciation of the dollar and of sterling to Rm. 365 millions, was only Rm. 183 millions.³ This suggests that profits could be made on such transactions which more than counterbalanced the losses on exports. These practices were officially approved by the German Government, but since the agreement with Germany's creditors in the spring of 1934, the repatriation of bonds through 'additional' exports has been limited. In general, it appears that the official German figures actually underestimate the extent to which repatriation has taken place since 1932, and there is little doubt that default has been accompanied, not only by a substantial alleviation in the burden of external interest and amortization payments, but also by a considerable decline in the total nominal value of the external debt itself.

There has also been some repatriation of the bonds of states which have not defaulted, but on a smaller scale. Argentina, Australia, and India have bought blocks of their bonds which were previously held abroad, and Japan has also found this an effective and profitable

¹ The sums used to buy back bonds in London under this law have been very small indeed.

² See C. R. S. Harris, *Germany's Foreign Indebtedness*, pp. 34-5.

³ *Ibid.*, p. 38.

method of reducing its external debt. It is believed that several of the British Dominions also buy blocks of their bonds in London in anticipation of payments which will have to be made for sinking funds and redemption. Part of the increased deposits of Empire and sterling bloc countries in London during the last few years have probably been used to acquire securities whose coupons would still be cashed in sterling. As the result, not of low prices of her bonds in London, but of her own peculiarly favourable circumstances, South Africa has redeemed a large part of her external debt. Among the post-war issues bearing interest at a comparatively high rate which have been favourites with foreign buyers may be mentioned those of Czechoslovakia. One country, Venezuela, paid off its external obligations completely during the depression, not by repurchasing its bonds, but by remitting double the amount required for the service of its debt.

The sums involved in these repatriations of bonds cannot be known accurately. The movement is further confused by the fact that refugee capital has also been invested in foreign bonds. As a result of the flight of American money to Great Britain in 1933, considerable holdings passed into American ownership, and the transfer of resources back to the United States in 1934 caused some part of them to be placed on the market once more. Moreover, conversions have also been used to repatriate external debts; in Argentina, Austria, Finland, and Sweden part of the external debt has been redeemed and replaced by internal conversion issues.

Nevertheless, the general trend is unmistakable. The tendency during the depression was for the burden of external indebtedness to be reduced wherever possible. When direct conversion operations were impracticable, debtors either repatriated their bonds or replaced them by loans raised on domestic markets. The sums involved in such security movements were considerably larger than those affected by external conversion operations. This was a period of retrenchment, internationally no less than domestically.

The Outcome of the Depression.

All the developments of the last few years tended to reduce the income which investors received from their holdings in other lands. The decline in new investment which increased the difficulties of debtors, their partly consequent defaults, the number of conversion operations, the repatriation of bonds, the liquidation of considerable quantities of long- and short-term credits, and the diminished returns on industrial holdings caused the incomes of *rentiers*

in all parts of the world to decline very considerably. In turn, there were inevitable readjustments in the balances of payments of creditor countries which have not, even now, been fully completed, and whose ultimate consequences will only be felt at a future date.

To take the case of Great Britain first, in the worst year of the depression the net income from overseas investments was, according to the Board of Trade figures, 40 per cent. lower than in the period 1925-30. This decline, which represented a loss of some £100 millions a year, was, according to Sir Robert Kindersley, reflected by a fall in the average yield on all classes of overseas investments from 6.17 per cent. in 1929 to 4.1 per cent. in 1933. In the United States net interest and dividend receipts (excluding war debts) fell from the peak of \$769 millions in 1930 to \$328 millions in 1934, or by about 57 per cent. The income of France from her foreign investments appears to have fallen from about Frs. 5,000 millions in 1929 to a low level of Frs. 1,163 millions in 1932, or by more than three-quarters. Together the net income of these three countries from their foreign investments fell from about \$2,135 millions in 1929 to approximately \$820 millions in 1933, or by some 61.5 per cent. (converted at the old gold parity).

Differences in the experience of creditors can be traced primarily to differences in the geographical distribution of their external assets. France, with her predilection for quasi-political European holdings, suffered chiefly from the worsening of conditions in central and eastern Europe; only in Germany did she manage to avoid major losses. The United States suffered as the result of her too abundant loans to Latin America and to Germany. British investors were relatively fortunate in so far as their loans to Empire countries are concerned, but they lost heavily in Latin America and to a smaller extent in central Europe.

Whether there appears to be reason for anticipating a revival of international investment in the future has been discussed in Part I. An answer can only be sought in terms of the basic conditions which give rise to international capital movements, and after an examination of how far those conditions which have obtained in the past may also be expected to be present in the future. One thing, however, may be said with some degree of certainty: that just as the character and the direction of the capital flow has been altered in the past as a result of experience gained in previous depressions, so we may expect similar changes in international investment in the future, following the shocks of the last few years. Indeed, such changes may already be discerned.

Most important was the increase in the amount of capital which was employed in purchasing securities floated on other markets. Investors who desired to place their capital abroad were compelled to adopt this method in the absence of new issues. In part, the movement of securities was stimulated by exchange fluctuations and by fears regarding the safety of different currencies, e.g. American purchases of large blocks of securities in London in 1933 and intermittent increases in French holdings in Great Britain. Currency instability is, however, only one of the factors which give rise to such movements. The disparities existing between interest rates in different centres provide the most obvious incentive to capital transactions of this sort, which, although they tend to reduce these disparities, may be expected to continue on a large scale in the absence of any substantial revival in new issues.

Other changes which will have important consequences for debtors have been taking place in the balances of payments of the United States and Great Britain.¹ Although the problems which were most important before the depression have now been largely solved by both countries, fresh ones have arisen in their places which will also require deep-seated adjustments. Great Britain in 1931 found herself in difficulties because she was faced with large withdrawals of short-term capital and a heavy import surplus of merchandise at the same moment. Until recently, because of the improvement in the balance of visible items, the reflux of short-term and amortization funds, and the cessation of new overseas investment through the most usual channels, difficulties seemed likely to arise, not through the weakness, but through the strength of the balance. But in view of the rearmament programme and the increasing import surplus which is the result of it, this fear is now seen to be illusory. But, in the United States, the problem is clearly that of avoiding the consequences of an over-active balance, rather than of one which is too passive.

The excess of imports into the United Kingdom between 1924 and 1929 was fairly constant, but fell somewhat during the depression. This import surplus is very largely purchased by means of interest payments arising from previous British investments abroad as is shown in the table on the next page. In the pre-depression period Britain's import surplus, however, did not arise from trade with her debtors in proportion to the volume of interest payments which they had to make to her. The chief debtor areas, the Empire

¹ See on this question an admirable section in the League of Nations, *Balances of Payments, 1934*, pp. 16-21. Also, an article by Folke Hilgerdt in *Index* (a publication of the Svenska Handelsbanken), Aug. 1935.

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and South America (except Argentina), which were principally agricultural producing countries, maintained during these years a large export surplus, not to the United Kingdom, but to the industrial countries of Europe and the United States, and Britain's import surplus arose chiefly out of her trade with these industrial countries rather than out of trade with her larger debtors. Indeed, such countries as India, Australia, Brazil, China, and Japan had, more often than not, a surplus of imports from Great Britain, so that, not only a part, but the whole of their considerable service payments had to be met by means of export surpluses to other countries.

United Kingdom: Import surplus and Income from Overseas Investments, 1913 and 1922-35

(£ millions)

<i>Year</i>	<i>Import surplus</i>	<i>Net income from overseas investments</i>
1913	145	210
1922	176	175
1923	208	200
1924	337	220
1925	392	250
1926	463	250
1927	386	250
1928	352	250
1929	381	250
1930	386	220
1931	408	170
1932	287	150
1933	263	160
1934	294	175
1935	261	185

In terms of goods, then, the interest on British overseas investments was paid by goods sent by the agricultural debtor countries to industrial Europe and the United States and passed on by these countries through exports of manufactured goods to the United Kingdom. A part of the British import surplus arose, of course, as the result of direct trade with her debtors, but by far the largest part was the result of triangular trade, and a part, at least, of both the following quadrilateral routes: Agricultural debtors—Germany—other European countries—Great Britain; or, Debtors—United States—continental Europe—Great Britain.

In 1931 this system broke down, and it is interesting briefly to trace the history of its fall. In June 1928 the French franc was legally stabilized on a gold basis, and with the stabilization large short-term

balances which had been held in London and New York by French and other investors began to be liquidated. This forced these centres to lend less on long-term to the debtor countries whose continuous borrowing in previous years had masked to a very great extent their dependence on multilateral trade. There was, consequently, a fall in the prices of debtors' exports, which benefited their creditors for a short period. The industrial boom in the United States, which occurred at the same time, had a similar effect: it attracted to the industries of that country capital which would otherwise have been available for the use of the debtor countries. At the same time, too, the United States and the principal countries of western Europe imposed a tariff on imports of agricultural products and raw materials, and, finally, Great Britain herself set up tariffs on imports of these classes of goods, and also on imports of manufactured articles.

Debtor countries were now forced to sell their agricultural products and raw materials on less advantageous terms, and industrial producers in Europe and the United States were prevented from selling their products to Great Britain. If the debtors were to pay their interest charges to Great Britain, they must do so by direct trade with that country rather than through the mechanism of multilateral trade. This is exactly what has happened. Both Britain's import surplus and her income from overseas investments have fallen, but the former now arises to a much greater extent than before 1930 out of direct trade with the debtor countries. The table on page 326 gives an approximate indication of the nature of these changes.

About 60 per cent. of Great Britain's overseas investments are in the British Dominions and colonies; but, in 1928, these countries bought from Britain more than they sold to her. This they were able to do, partly because they were borrowing fresh capital and the funds made available in this way offset the payments which had to be made on account of interest on their past borrowing, and partly because they were able to maintain a surplus of exports to certain other countries, which, in their turn, had an export surplus to Great Britain. On the other hand, Great Britain had an import surplus of the order of £200 millions as the result of her trade with Europe. In other words, over 55 per cent. of Britain's import surplus, which was mainly paid for by the interest on her overseas investments, arose out of trade with an area in which only 8 per cent. of those investments had actually been made. Similarly, British trade with the United States resulted in an import surplus of £131 millions (37 per cent. of the total import surplus) although her investments in that country amounted to less than 5½ per cent. of her total overseas investments. Ninety per cent.

United Kingdom

	Approximate distribution of long-term overseas in- vestments, 1930 ^a	Distribution of import surplus ^b	
		1928	1934
	per cent.	(£ millions)	
Australia	13.3 ^c	-13.5	19.1
India and Ceylon	14.5	-28.8	7.3
Canada	14.1	19.7	28.5
South Africa	7.1	-18.5 ^d	-22.2 ^d
New Zealand	3.3	19.9	23.7
British Malaya	2.9 ^e	-16.5	1.9
British West Indies	1.1	- 0.5	1.1
Other British countries	2.4	3.1	- 2.2
British Empire	58.7	-35.1	57.2
Russia	7.9 ^f	15.3	11.6
France		31.6	1.4
Germany		20.5	15.7
Netherlands		20.2	8.4
Belgium		25.6	5.6
Spain		7.6	5.9
Other European countries)	80.3 ^g	52.3 ^g	
Europe	7.9 ^f	201.1	100.9
Argentina	12.1	42.9	30.8
Brazil	5.1	-11.9	2.4
Chile	1.3	2.0	2.7
United States ^h	5.4	131.2	58.5
China	1.2	- 6.9 ⁱ	- 1.2 ⁱ
Japan	2.0	- 6.6	3.5
Other countries	6.3	35.2 ^j	29.4 ^j
Foreign countries	41.3	387.0	227.0
TOTAL	100.0	351.9^k	284.2

^a From Sir Robert Kindersley's estimates; see above, Chapter X, p. 142.

^b This represents the difference between the *retained* imports from, and the domestic exports to, each of the areas mentioned. A minus sign indicates that there was an *export* surplus.

^c Including South Sea Islands.

^d Rough diamonds and gold are excluded; if these had been included there would have been import surpluses in 1928 and 1934 of about £15 millions and £35 millions respectively.

^e Including non-British territory, especially the Dutch East Indies.

^f Including all of Turkey.

^g Excluding Iceland, Bulgaria, and Turkey.

^h Including Alaska.

ⁱ Including Manchuria in 1928, but *not* in 1934.

^j Including Iceland, Bulgaria, and Turkey in both years and Manchuria in 1934 only.

^k Including 'unknown' countries.

of Britain's total import surplus, therefore, arose out of her trade with countries in which only 13 per cent. of her overseas capital was invested.

But the position in 1934 was very different. The total import surplus had fallen from £352 millions to £284 millions, a decline of nearly 20 per cent.; but the changes in its distribution were even more striking. Instead of an export surplus of £35 millions, Great Britain now had an import surplus of £57 millions (20 per cent. of the total) as the result of her trade with Empire countries. The import surplus on account of trade with Europe had declined by 50 per cent. to £101 millions (35 per cent. of the total, compared with 57 per cent. in 1928) and that arising out of trade with the United States had fallen by 55 per cent. to £59 millions, but still accounted for the same proportion of the total import surplus as in 1928. In short, the United States and Europe supplied only 55 per cent. of Britain's import surplus in 1934, compared with 90 per cent. in 1928, and those countries which have large remittances to make to Great Britain as interest payments on their past borrowing are now doing so to a greater extent by means of direct trade with the creditor country and not, as formerly, by indirect trade *via* the United States or western Europe.

Until rearmament began in earnest, there was little evidence that the policies causing this change would be relaxed. Now, however, an increasing import surplus, and the possibility that it may be necessary to lower some of the British import duties, offer some hope that multilateral trade may recover something of its former importance.

The United States has had, of course, an over- rather than an under-active balance of payments ever since the war. During the 'twenties her vast new foreign investments tended to curtail the flow of gold to that country. After the crash of 1929 the American balance was kept in equilibrium chiefly by the withdrawal of foreign short-term capital, and after the depreciation of the dollar by a flight of American money. Until about the end of 1933, short-term capital exports were sufficiently large to offset imports of long-term capital; but during 1934, with the repatriation of American capital and an influx of foreign money to purchase American and foreign securities in New York, the United States became an importer of both long- and short-term capital. Moreover, the stimulus to American exports which had been provided by the reduction of the gold value of the dollar resulted in the balance of trade becoming much more active than in 1933. Temporary equilibrium was, therefore, preserved only

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by heavy imports of gold. In 1935 the stimulus to exports which resulted from depreciation was exhausted, and the export surplus fell to a more normal figure of \$234 millions, but there were large capital imports during the year estimated at \$442 millions of long-term capital and \$1,000 millions of short-term funds. A balance was, therefore, only effected by imports of gold valued at \$1,839 millions. Imports of gold of such magnitude as this cannot be expected to continue for more than a very few years. Imports of short-term capital—largely the result of the repatriation of American funds lodged abroad in 1933—may also be expected to diminish. There is, however, no indication that imports of long-term capital will diminish. They are the result, partly of the purchases of foreign dollar bonds by the nationals of debtor countries, and partly of investments in United States securities, chiefly by British investors. It is estimated that foreign investments in American stocks and bonds and other long-term holdings increased by \$765 millions in 1935, bringing the total of such investments to \$5,035 millions.¹

*Movement of Securities into and out of the United States**

(\$ millions)

	<i>Foreign stocks and bonds bought from foreigners</i>	<i>American stocks and bonds bought back from foreigners</i>	<i>Foreign stocks and bonds resold to foreigners</i>	<i>American stocks and bonds sold to foreigners</i>	<i>Balance</i>
1926 . . .	- 115	- 509	+ 286	+ 635	+ 297
1927 . . .	- 154	- 650	+ 395	+ 831	+ 422
1928 . . .	- 559	- 1,135	+ 449	+ 1,661	+ 416
1929 . . .	- 353	- 1,054	+ 474	+ 1,489	+ 556
1930 . . .	- 360	- 916	+ 806	+ 1,035	+ 566
1931 . . .	- 347	- 495	+ 659	+ 589	+ 406
1932 . . .	- 225	- 305	+ 385	+ 300	+ 155
1933 . . .	- 685	- 580	+ 565	+ 760	+ 60
1934 . . .	- 405	- 480	+ 510	+ 480	+ 105
1935 . . .	- 475	- 970	+ 425	+ 1,305	+ 285

* *Balance of International Payments of the United States, 1935*, United States Department of Commerce, Trade Information Bulletin, No. 833 (Washington, 1936).

This influx of foreign funds, which appears to have continued on an even larger scale throughout 1936, is giving American authorities serious concern. The Federal Reserve Board estimated that the

¹ Cf. *The New York Times*, 5 June 1936.

amount of foreign funds in the United States in November 1936 was \$7,000 millions, of which \$5,500 millions was invested in securities, and President Roosevelt has instructed the Board and the Treasury to attempt to draft legislation which will enable the Federal Reserve authorities to control imports of long- and short-term capital.¹

If, then, the balance of payments of the United States is to be in equilibrium, this can only be done either by an increase in foreign lending by that country, or by maintaining a less active, or even a passive balance of merchandise trade, or by both. Recent reports from Washington do not encourage the belief that equilibrium will be restored by a decline in American exports.² An increase in imports is possible, but not probable, and the same may be said of a resumption of foreign lending. It is not, therefore, unreasonable to expect that the net income which the United States receives from its foreign investments may fall still farther. It may, indeed, even become negative, i.e. larger interest payments may be made to foreigners on account of their investments in the United States than are received from American investments abroad, before a more stable balance of payments position is reached.

Up to the present both British and American policy has tended to favour exporters and home producers of goods which compete with imports, at the expense of *rentiers*. In both cases, the debtors have been prevented from making interest payments in goods. But Great Britain has now an increasing net outflow of long-term capital, while the United States has an increasing net inflow. If long-term international lending is resumed on the pre-depression scale, a temporary equilibrium will have to be reached which is more favourable to those who have invested capital abroad.

¹ Cf. *The Times*, 14 Nov. 1936.

² See above, Chapter XI, p. 197.

APPENDIXES

APPENDIX I

SOME NOTES ON THE SOURCES AND ACCURACY OF STATISTICS OF THE BRITISH BALANCE OF INTERNATIONAL PAYMENTS

We have given in Chapter X¹ some estimates of the balance of payments of Great Britain in recent years; these are reproduced, in part, on the next page. The sources from which the statistics have been obtained differ widely in accuracy and the following notes are intended to give some idea of the methods used, and the probable correctness of the final result.

'Current Account'.

All the figures under this head are taken from the estimates of the Board of Trade without alteration.² A balance of payments on current account generally refers to the cash received into or remitted out of the country in respect of items which imply recurrent income or expenditure. In some cases, however, balances are compiled which include the whole of the sums due under these headings, even though, in some instances, cash payment may be deferred, or in partial or complete default. This method of compiling a balance of 'amounts due' rather than 'actually received' gives a better picture of a country's position as a debtor or creditor on current account. For example, when a country is in complete default on its interest payments because of exchange transfer difficulties, a balance of payments compiled on a pure cash basis would give little indication of the country's financial position *vis-à-vis* the rest of the world unless it were supplemented by a statement which included sums due as well as those actually remitted. On the other hand, if it is desired to compile a balance of transactions which give rise to purchases or sales of foreign exchange, then the cash basis is the one which should be adopted.

In practice, the Board of Trade has never distinguished between the two methods, nor is it clear from its annual estimates which method it has adopted. For example, it has included the whole value of British exports of merchandise in its figures for 1933 and 1934, despite the fact that considerable arrears accumulated in these years in respect of unpaid exports, the chief sufferers being exporters to Germany, Italy, Spain, Roumania, and South American countries. Obviously, from a cash point of view, the amount of these arrears should have been deducted from the export figures, and this omission may have led to an appreciable error. Most of the other items in the Board of Trade's estimates appear to have been compiled on a cash basis.

1. *Balance of merchandise trade.* This is usually the most accurate of the items in the balance. It is calculated as the difference between imports of merchandise and silver bullion and coin and the corresponding exports.

¹ See pp. 139-40.

² Cf. *The Board of Trade Journal*, 20 Feb. 1936.

*Balance of International Payments of the United Kingdom,
1929-34^a*

(\$ millions)

	1929	1930	1931	1932	1933	1934
<i>Current Account^b</i>						
1. Balance of merchandise trade ^c	-381	-386	-408	-287	-263	-294
2. Government transactions	+ 24	+ 19	+ 14	- 24	- 2	+ 7
3. Shipping services	+130	+105	+ 80	+ 70	+ 65	+ 70
4. Income from long-term overseas investments	+250	+220	+170	+150	+160	+175
5. Interest on short-term investments, commissions, &c.	+ 65	+ 55	+ 30	+ 25	+ 30	+ 30
6. Other services	+ 15	+ 15	+ 10	+ 15	+ 10	+ 10
7. Balance on current account	+103	+ 28	-104	- 51	0	- 2
<i>Capital Account</i>						
8. Subscription to new issues for overseas borrowers ^d	- 96	- 98	- 41	- 37	- 83	- 63
9. Capital repayments ^d	+ 49	+ 39	+ 27	+ 48	+ 67	+ 42
10. Changes in other long-term investments abroad ^d	- ?	0	+ 10	+ 5	+ 5	- 20
11. Changes in London's short-term liabilities to foreigners ^e	- 52	- 16	-200	+ 67	+133	+ 15
12. Changes in the amount of acceptances held in the United Kingdom for account of foreigners ^f	+ 25	+ 15	+ 35	+ ?	- ?	- ?
13. Bank and Treasury advances, 1931 ^g	..	..	+ 74	-123	..	..
14. Balance of 'known' capital items.	- 74	- 60	- 95	- 40	+122	- 26
15. Movements of gold coin and bullion ^h	+ 15	- 5	+ 35	- 14 ⁱ	-195	-134
16. Estimated hoarding of gold in London for account of foreigners ^h	..	..	..	+ 3	+ 65	+ 79
17. Apparent sales of sterling for gold ^j	+ 15	- 5	+ 35	- 11	-130	- 55
18. Balance of gold and capital items	- 59	- 65	- 60	- 51	- 8	- 81
19. Errors and omissions	- 44	+ 37	+164	+102	+ 8	+ 83
20. Balance on capital account	-103	- 28	+104	+ 51	0	+ 2

^a A detailed discussion of the sources and accuracy of the statistics is given in the text.

^b Board of Trade estimates.

^c Includes silver bullion and coin.

^d Sir Robert Kindersley's estimates.

^e Estimates for 1929 and 1930 are based on those given to the Macmillan Committee, for later years the estimates are our own modified by those of the Bank for International Settlements.

^f From figures supplied to the Macmillan Committee.

^g These are our own estimates.

^h Published figures of exports and imports.

ⁱ Less approximately £1 millions saved from the S.S. *Egypt*.

^j A 'plus' sign indicates an export of gold, i.e. a purchase of foreign currency.

In the case of Great Britain there is always a surplus of imports, and this is indicated by a minus sign in the foregoing table. The value of the merchandise which actually passes through the customs in a calendar year may not, however, correspond exactly to the cash payments made between countries on account of merchandise trade during the same period. The information is not available to enable such calculations to be made, but the error involved over a period of years must usually be very small. As has already been mentioned, however, a considerable error may arise if exports are not paid for within the normal period of a few weeks or months. Unfortunately, we cannot calculate the extent to which British exporters have not received payment in recent years, but the amounts involved are considerable, and this item is, therefore, underestimated in the years 1933 and 1934.

2. *Government transactions.* The principal items under this heading are receipts and payments on account of inter-governmental debts and the charges which the Indian Government must meet in London. Also of importance are the receipts and payments made on account of the external activities of various government departments. Finally, payments on account of war debts, &c., which would more properly appear in the 'capital account', are also included.

3. *Shipping services.* Information regarding the proportion of British trade which is carried in British ships is not available for the years under review.¹ Since the value of imports used in the calculation of the 'balance of merchandise trade' (item 1) includes freight charges from the overseas countries from which the goods came, the extent to which sterling was sold to pay for the imports is overestimated by the amount of the freight which was due to British shipowners. In the case of exports, freight charges to their overseas destination are not included, and the claims of British residents on the rest of the world are underestimated by the amount of the freight due to British ships. Even approximate estimates of the correction which should be made to item 1 on this account cannot be made. The Board of Trade, therefore, estimates the net income earned by British ships in another way.

They attempt to assess the gross earnings of British shipping and to deduct therefrom the amounts paid by British residents for the services of foreign ships and the expenses of British ships in foreign ports; to this is added the expenditure of foreign ships in British ports, and the total is the net income received by Great Britain on account of shipping services. These estimates are based upon the known figures of passengers travelling to and from the United Kingdom and of British and foreign tonnage entered and cleared from United Kingdom ports. Allowance is made for changes in passenger fares and freight rates and for sales of bunker fuel. This does not, however, take account of all the factors to be considered. The final figure given by the Board of Trade may usually be regarded as a conservative estimate.

¹ This information will be available in future. *B.O.T.J.*, 20 Feb. 1936, p. 259.

4. *Income from long-term overseas investments.* This item 'includes all income from overseas investments, whether of a joint-stock or private character, and the figures given allow for the deduction of income paid to overseas residents in respect of their investments in the United Kingdom; further, they do not include receipts and payments between Governments in respect of War Debts settlements, which have already been taken into account'.¹

These estimates are based in part on those of Sir Robert Kindersley; but they are intended to include sums put to reserve and other expenses which he does not consider, and to allow for the sums paid abroad to persons who have invested money in the United Kingdom. The two sets of estimates are given below for comparison. The income from British overseas investments in shipping are included in Sir Robert Kindersley's estimates, but, presumably, they appear under 'shipping services' in the Board of Trade's figures.

United Kingdom: Income from Overseas Investments
(£ millions)

	<i>Sir Robert Kindersley's estimates of interest and dividends paid to British residents in respect of their long-term investments abroad^a</i>	<i>The Board of Trade's estimates of the net national income from overseas investments</i>
1929	230·9	250
1930	209·0	220
1931	168·7	170
1932	156·4	150
1933	149·7	160
1934	159·2	175
1935 ^b	167·9	185

^a Cf. *Economic Journal*, Dec. 1936, p. 659.

^b Provisional estimates.

It will be noted that the Board of Trade's estimates tend to give a higher figure than those of Sir Robert Kindersley. The Board, in other words, estimates that the amounts put to reserve, &c., by British companies operating abroad usually exceed the interest payments which have to be made to overseas owners of long-term investments in Great Britain. In 1931 and 1932, however, it was apparently assumed that the amounts put to reserve were very small. The Board's estimates are probably reasonably accurate.

5. *Interest on short-term investments, commissions, &c.* Under this heading are included 'charges in respect of acceptance credits, discount on foreign bills, bank interest (i.e. short interest and commissions), commissions and other charges on new issues paid by overseas borrowers, merchanting commissions on overseas produce, brokers' commissions, insur-

¹ *B.O.T.J.*, 20 Feb. 1936, p. 260.

ance remittances from abroad and earnings on exchange transactions'.¹ Deductions are made on account of payments by British residents to foreigners for similar services. This item can, unfortunately, be regarded as little more than a guess.

6. *Other services.* Under this heading are included such items as the expenditure of British tourists abroad and of foreign tourists in the United Kingdom (only approximate data are available, and even this was lacking before 1932),² payments and receipts in respect of motion picture royalties, sales and purchases of second-hand ships, emigrants' remittances, the savings of returning migrants, the expenditure of foreign governments on their diplomatic and consular services in Great Britain, the profits of British speculators on Wall Street, &c.³ The final figure given in the Board of Trade's estimates is merely conventional.

7. *Balance on current account.* The sum of all the items discussed above shows the extent to which sterling is due to or owed by foreigners as the result of the year's transactions. Normally, this item is positive, i.e. foreigners owe to Britain a sterling balance, but the decline of British exports both visible and invisible during the depression caused the balance to become negative in several of the years under review. When the balance is positive, it is offset by imports of gold or exports of capital and vice versa. Such transactions are shown in the capital account; their magnitude must be such that they exactly equal in sum the balance on current account.⁴

'Capital Account'

Various attempts have been made to amplify the estimates of the balance of payments which are made annually by the Board of Trade. The Board's figures refer entirely to the current items in the balance of payments; they do not attempt to include the capital items. The data on which an analysis of these items may be based are very incomplete for two main reasons. First, the highly complex natures of the London money and capital markets, though increasing the efficiency with which international transactions may be carried on, renders very difficult the compilation of accurate figures of the total magnitude of such transactions. By reason both of their multiplicity and of the large number of different ways in which capital movements which have an identical effect on the balance of payments may be carried out in practice, the preparation of comprehensive statistics is impossible. In the second place, it is natural that individual firms in the City should desire to keep their business secret, and they are therefore unwilling to disclose the relevant figures to any but official bodies, and even then certain conditions as to their use are agreed upon between the parties. The veil was partly removed by the Macmillan Committee and, as the result of the findings of that Committee,

¹ *B.O.T.J.*, 20 Feb. 1936, p. 261.

² *Ibid.*, 20 Feb. 1936, p. 262.

³ *Ibid.*, 21 Feb. 1935, p. 275.

⁴ See above, Chapter V, *passim*.

the Bank of England now collects considerable information about foreign short-term funds in London from a large number of bankers and acceptance houses. This information is not published, however, and the size of foreign short-term balances in London remains secret. A further complicating factor in recent years has been the Exchange Equalization Account. The operations of the Account have never been disclosed and, although attempts have been made from time to time to estimate the distribution of the assets of the Account, such estimates are unreliable and have therefore been ignored in compiling the balance of payments.

8. *Subscription to new issues for overseas borrowers.*¹ This excludes the amounts, if any, subscribed by residents of other countries. It also excludes conversion operations, 'but not new issues, the proceeds of which are used wholly or in part to effect redemption of existing loans'. New

New Capital raised in London by Overseas Borrowers
(£ millions)

	<i>The Midland Bank</i> ^a	<i>The Economist</i> ^b	<i>Sir Robert Kindersley</i> ^c
1920 . . .	59.7	..	..
1921 . . .	155.7	..	..
1922 . . .	135.2	130.1	..
1923 . . .	136.2	137.5	..
1924 . . .	134.2	124.7	..
1925 . . .	87.8	77.2	..
1926 . . .	112.4	101.6	..
1927 . . .	138.7	148.3	..
1928 . . .	143.4	105.5	..
1929 . . .	94.3	87.2	96
1930 . . .	108.8	97.1	98
1931 . . .	46.1	47.6	41
1932 . . .	29.2	25.8	37
1933 . . .	37.8	34.6	83
1934 . . .	43.4	31.4	63
1935 . . .	20.9	15.5	..

^a Cf. Dec.-Jan. numbers of *The Midland Bank Monthly Review*.

^b Cf. *The Economist*, 28 Dec. 1935, p. 1305, and the supplement, 'Commercial History and Review of 1935', 15 Feb. 1936, p. 69.

^c Cf. *The Economic Journal*, Dec. 1936, p. 659.

issues of this latter type were large in 1933 and 1934, which accounts for the relatively large size of the figures for these years. No deduction from the figures for new overseas issues has been made in respect of commissions, &c., paid to firms in the City and not remitted to the foreign borrower as part of the proceeds of his issue. No estimates of the amount of these commissions are available, since they are not shown separately in the Board of Trade's figures for the current account although they are included there ;

¹ Estimates of this item are those of Sir Robert Kindersley which are published in *The Economic Journal*, March 1929, June 1930, Sept. 1931, June 1932, June 1933, Sept. 1934, Sept. 1935, and Dec. 1936.

they have, therefore, been included twice in our estimates, which are inaccurate to this extent.

Mainly because they are compiled on a somewhat different basis, Sir Robert Kindersley's estimates differ from those made by the Midland Bank and *The Economist*. The foregoing table gives the estimates of these three authorities.

9. *Capital repayments.* This item also follows Sir Robert Kindersley's estimates. It represents the sinking fund and amortization receipts of British investors from overseas borrowers. The amount of debt which is written off in this way every year is, as one might expect, fairly constant. It diminished in 1931 during the crisis and rose sharply in 1933 when interest rates in London were favourable to refunding operations.

10. *Change in other long-term investments abroad.* Sir Robert Kindersley gives estimates, which he admits are not very accurate, of the extent to which British investors have lent capital abroad on long-term which is not represented by securities quoted on United Kingdom stock exchanges. The major part of such investment consists of foreign (chiefly American) securities, but mortgages and other sorts of investments are also included. The figures quoted in our estimates of the balance of payments show the change in the amount of this investment from year to year.

The following table gives Sir Robert Kindersley's estimates of the total of such investment at the end of each year:

*British Investments Overseas (excluding investment in securities quoted in the United Kingdom)**

	£ millions
1929 . . .	300
1930 . . .	300
1931 . . .	290
1932 . . .	285
1933 . . .	280.
1934 . . .	300

* 'No great accuracy is claimed for this figure, since it is intended to cover not only security investments, but also a large number of miscellaneous assets of companies and individuals to which in any case a nominal value can only be arbitrarily assigned.' (*Economic Journal*, Sept. 1935, p. 453.)

11. *Changes in London's short-term liabilities to foreigners.* The figures given under this item have been derived from the table on p. 340, and they must, unfortunately, be regarded as of very doubtful accuracy.

The figures for the years 1927 to 1930 are those furnished to the Macmillan Committee and published by it.¹ Those figures very considerably under-estimate the size of foreign short-term balances in London (they omit, for example, the balances held by foreign banks in London), and some authorities place the total in 1930 at as much as £700 millions. Since,

¹ Cmd. 3897 of 1931, p. 301.

London's Liabilities to Foreigners on Short-term
(£ millions)

	<i>Total at end of year</i>	<i>Change during year</i>
1927 . . .	419	..
1928 . . .	503	+84
1929 . . .	451	-52
1930 . . .	435	-16
1931 . . .	235	-200
1932 . . .	302	+67
1933 . . .	435	+133
1934 . . .	450	+15

for our present purpose, it is not the absolute size of these balances, but the change from year to year which is of interest, and since no authority has volunteered more accurate figures, we have had to use them.

It has been publicly stated by competent authorities that the extent of the withdrawal of London balances by foreigners during 1931 was about £200 millions, and the Bank for International Settlements estimates that the short-term liabilities of London at the end of 1933 were about the same as at the end of 1930, i.e. that the losses of 1931 had been completely retrieved.¹ It has been said that the officials of the Bank for International Settlements had access to the secret figures in the possession of the Bank of England when they made these estimates. This is not the case; but it is generally conceded that their estimates are exceedingly good guesses, and they have, therefore, been accepted.

It seems reasonable to assume that the net increase during 1932 was considerably smaller than in 1933 and we have therefore placed the total liabilities at the end of 1932 at £302 millions, or an increase of one third of the total increase between 1931 and 1933. Some estimates place the rise during 1932 at a much higher figure than this,² but it is difficult to see how the net increase over the year can have been on a much larger scale. The rise in foreign balances in London in 1932 must have been due to the increase in American balances, although this was partly offset by the withdrawal of balances by nationals of some other countries. In 1933 balances in London were built up by the flight from the dollar in the first quarter of the year (though a part of these balances were repatriated between October and December) and by the rise in the London balances of South Africa, Australia, India, and certain Scandinavian countries. £133 millions seems to be, if anything, an under-estimate of the increase in London's liabilities during this period, and it is possible that this figure should be slightly increased and that for 1932 correspondingly diminished. The

¹ Cf. *Midland Bank Monthly Review*, May-June, 1935.

² See, for example, Professor N. F. Hall, *The Exchange Equalisation Account* (London, Macmillan, 1935), p. 50. His estimates cover only the first part of the year, after which there was a considerable withdrawal.

Bank for International Settlements estimated that there was little change in the amount of London's external liabilities during 1934, i.e. that they remained between £400 and £450 millions. We have chosen the upper of these two figures, because there is some evidence that the sterling balances of various countries continued to increase during that year.

12. *Changes in the amount of acceptances held in the United Kingdom for the account of foreigners.* Against its short-term liabilities, London holds short-term foreign assets, and these must also be considered in computing the balance of payments. Published statistical data relating to these assets are very meagre; they consist, in fact, only of the figures given to the Macmillan Committee of the volume of acceptances on foreign account which were held by banks and acceptance houses in the years 1927 to 1931. These figures are given below:

*London: Acceptances on Foreign Account**

(£ '000)

	<i>By clearing banks and Scottish banks</i>	<i>By accepting houses</i>	<i>Total acceptances</i>
30 June 1927	31,445	91,504	122,949
31 Dec. 1927	31,678	107,954	139,632
30 June 1928	38,467	126,907	165,374
31 Dec. 1928	51,278	149,231	200,509
30 June 1929	51,615	150,883	202,498
31 Dec. 1929	39,978	135,699	175,677
30 June 1930	43,165	132,111	175,276
31 Dec. 1930	35,667	125,282	160,949
31 Jan. 1931	34,799	120,846	155,645
28 Feb. 1931	34,468	120,942	155,410
31 Mar. 1931	32,301	120,616	152,917

* Cmd. 3897 of 1931, p. 301.

The figures for 1931 relate only to the first quarter of the year. We have assumed that the rate at which the total volume of outstanding acceptances declined during this quarter was continued throughout the year, and that the total decline for the year was therefore £35 millions. We have made no attempt to estimate the changes in more recent years, but we have indicated the direction in which we believe the changes took place.

13. *Bank and Treasury advances, 1931.* During the summer of 1931, every effort was made to keep Great Britain on the gold standard. Some of these efforts took the form of short-term credits raised in Paris and New York. These amounted to £130 millions gold. About 30 per cent. of this amount was repaid during December 1931. At that time the dollar-sterling exchange rate was about \$3.374 per £, so that a payment of £39 millions gold involved an actual expenditure of about £56 millions sterling. The remainder of these credits were repaid during the first six months of 1932. The average dollar sterling rate during this period was \$3.599 per £, so

that the repayment of £91 millions gold required the transfer of about £123 millions sterling. Actually, therefore, the Bank and the Treasury borrowed £130 millions gold and repaid £179 millions sterling, a 'loss' of £49 millions. In fact, the actual loss was £30 millions because a part of the repayment was done by the sale of gold and foreign assets in the possession of the Bank on which an exchange 'profit' was made. From the point of view of the balance of payments, therefore, there was an inflow of £74 millions in 1931 and an outflow of £123 millions in 1932.

14. *Balance of 'known' capital items.* This item is, of course, merely the sum of items 8 to 13. There are two sorts of capital movements which have not been included in our estimates, because we consider the data to be too unreliable.

The first concerns the purchase and sale of long-term securities. In so far as these are securities which are not quoted in the United Kingdom, they have been included under 'other long-term investments abroad'; but we have nowhere made any allowance for the movements of quoted securities. It has been suggested that some idea of the magnitude of the sums involved might be gained from Sir Robert Kindersley's estimates. These may be conveniently arranged as in the two following tables:

Nominal Amount of British Overseas Investment in Quoted Securities

(£ millions)

	<i>Total at end of year</i>	<i>Change during year</i>
1929 . . .	3,438	..
1930 . . .	3,425	+13
1931 . . .	3,410	+15
1932 . . .	3,356	+54
1933 . . .	3,385	-29
1934 . . .	3,414	-29

Changes in Nominal Amount of British Overseas Investment in Quoted Securities

(£ millions)

	<i>British subscription to new overseas issues</i>	<i>Capital repayments</i>	<i>Other changes</i>	<i>Total</i>
1930 . . .	-98	+39	+72	+13
1931 . . .	-41	+27	+29	+15
1932 . . .	-37	+48	+43	+54
1933 . . .	-83	+67	-14	-29
1934 . . .	-63	+42	- 8	-29

The 'other changes' in the second table are due partly to changes in the methods of inquiry and the accuracy of the estimates and partly to the liquidation of unprofitable enterprises and purchases and sales of quoted

securities. These 'other changes' are greatest in 1930, and Sir Robert Kindersley believes that during this year there was a net sale of quoted securities to foreigners to the extent of about £35 millions.¹ He has made no later estimates of the changes due to this factor, and since we have no other data we have made no mention of it in our own estimates.

Secondly, we have made no estimate of the Bank of England's or the Exchange Equalization Account's dealings in foreign exchange. It is assumed that the Bank's holdings of non-sterling securities are included under 'other securities' in the Issue Department, and these are shown below:

Bank of England: 'Other Securities' in the Issue Department. Amount on the last Wednesday of each quarter

		(£ millions)		
1929	March . . .	9.0	Sept.	9.7
	June	9.1	Dec.	5.1
	Sept.	8.4	1933 March . . .	10.5
	Dec.	10.8	June	1.5
1930	March	11.5	Sept.	2.4
	June	11.6	Dec.	2.3
	Sept.	11.6	1934 March . . .	0.1
	Dec.	11.5	June	1.6
1931	March	13.5	Sept.	0.9
	June	12.7	Dec.	1.0
	Sept.	24.5	1935 March . . .	0.2
	Dec.	17.2	June	0.3
1932	March	19.3	Sept.	1.1
	June	50.6	Dec.	1.4

It will be seen that the fluctuations on this account are most important during 1931 and the first six months of 1932. They become almost negligible after the establishment of the Exchange Equalization Account. We have not thought it desirable to attempt to include these figures in our estimates of the balance of payments, because we know of no way in which it can be determined whether increases or decreases in this item represent actual purchases from or sales to foreigners or merely transfers of foreign assets from the Bank of England to some other British holder and vice versa. The decline of £40 millions during the third quarter of 1932 represents, for example, not a sale of foreign securities from the point of view of the balance of payments, but merely a transfer of assets from the Bank to the Exchange Equalization Account.

That Account publishes no record of its dealings, and any estimates made of them must be based on assumptions which are very risky indeed. The most complete of such estimates are those made by Mr. F. W. Paish, and they are given in part in the table on the next page. The non-sterling assets of the Account consist, it is generally admitted, only of gold in London or of ear-marked gold abroad, and changes in Mr. Paish's figures

¹ *Economic Journal*, June 1932, p. 195.

should show the extent to which sterling was bought or sold by the Account. We cannot accept these figures, however, because the assumptions on which their author has based his estimate do not appear to us to be justified.¹

Exchange Equalization Account: Non-sterling Assets in Actual Possession of the Account at the End of the Month^a

		Francs, milliards			Francs, milliards
1932	July	5.97	1934	March	9.63
	Sept.	0.34		June	8.99
	Dec.	2.83		Sept.	5.76
1933	March	4.96		Dec.	2.46
	June	6.75	1935	March	3.34
	Sept.	3.68		June	6.77
	Dec.	10.66		Sept.	8.60 ^b
				Dec.	10.81

^a *Economica*, Feb. 1935, p. 70, and Feb. 1936, p. 82.

^b On another assumption, he also gives an alternative estimate of francs 7.55 milliards for this date.

15. *Movements of gold coin and bullion.* The Board of Trade's returns of the amount of gold coin and bullion imported and exported include sovereigns at their face value and other coins and bullion at their market value. We have, therefore, for 1932, 1933, and 1934, revalued the sovereigns at their market value in order to obtain the net movement of gold in terms of sterling. From the net imports calculated by this method for the year 1932, a deduction of £1 million has been made in respect of gold salvaged from the S.S. *Egypt*, which did not involve a purchase of foreign currency.

16. *Hoarding in London for account of foreigners.* It is known that a large part of the gold imported into Great Britain in recent years has been sent by foreigners, who have merely held it in London. The import of such gold does not involve a sale of sterling, and it should, therefore, be deducted from the imports shown in the Board of Trade returns. We have made the quite arbitrary assumption that sixty per cent. of those net imports of gold into London which were not absorbed by the Bank of England have been hoarded for the account of foreigners. The result of this calculation is shown in the table on the opposite page.

Our arbitrary assumptions of the proportion of the gold imports which were hoarded by foreigners may be justified by the result. During the four years, 1932 to 1935, the net increase in supplies of gold in the United Kingdom outside the Bank of England was £301 millions valued at the average market prices ruling at the time that the import was made. If £191 millions of this was 'hoarded', the remainder must have been in the possession of the Exchange Equalization Account at the end of 1935. Valued at 140 shillings an ounce, this would have amounted to about £120

¹ In this we are supported by other observers. Cf. *The Economist*, 10 March 1934, p. 520; 16 Feb. 1935, p. 368; 23 Feb. 1935, p. 420.

millions. This figure coincides very nearly with independent estimates of the amount of gold in the hands of the Account at the beginning of 1936 and our figures may therefore be accepted as correct for the period as a whole. For individual years, however, our estimates may be very far wrong. If we assume that hoarding took place on the largest scale when the price of gold was highest, they seem to be fairly consistent. There is, unfortunately, no other means of checking them.

United Kingdom: Gold Movements
(£ millions sterling)

<i>Quarterly increase (+) or decrease (-) in amount of gold in:</i>				
	<i>The United Kingdom</i>	<i>The Bank of England</i>	<i>The U.K. outside the Bank</i>	<i>Hoards for account of foreigners</i>
1932				
I . . .	- 8.3	+ 0.1	- 8.4	
II . . .	+20.1	+16.5	+ 3.6	
III . . .	+ 7.6	+ 8.3	- 0.7	
IV . . .	- 4.6	-14.2	+ 9.6	
			+ 4.1	+ 2.5
1933				
I . . .	+13.3	+48.6	-35.3	
II . . .	+67.7	+34.8	+32.9	
III . . .	+47.6	+ 3.9	+43.7	
IV . . .	+66.8	+ 0.5	+66.3	
			+107.6	+64.6
1934				
I . . .	+70.8	+ 0.5	+70.3	
II . . .	+23.0	+ 0.6	+22.4	
III . . .	+15.2	+ 0.7	+14.5	
IV . . .	+24.5	+ 0.7	+23.8	
			+131.0	+78.6
1935				
I . . .	+ 4.4	+ 0.5	+ 3.9	
II . . .	+59.8	+ 0.3	+59.5	
III . . .	+ 2.7	+ 1.3	+ 1.4	
IV . . .	+ 3.7	+10.0	- 6.3	
			+ 58.5	+35.1
			+301.2	+190.7

It has been suggested that some error may have arisen from the assumption that all the gold which entered the Bank of England came from abroad and that none was withdrawn from private hoards within Great Britain. It is certain that some jewellery and a considerable number of sovereigns have been melted down since 1931; but the error involved may be partly offset by the fact that no allowance has been made for the consumption of gold by industry.

19. *Errors and omissions.* This item is merely the difference between the sum of all the 'known' items of gold and capital movements and the

'balance on capital account'. The latter, it will be remembered, is always equal in value but opposite in sign to the 'balance on current account'. The 'errors and omissions' are largest in 1931 and 1932. It has been suggested, and, we believe, with some justice, that the error in 1931 consists for the most part in an under-estimation of the extent to which British investors repatriated the capital which they had lent abroad in previous years. In 1932, it is possible that the largest part of the errors and omissions item is the result of too low an estimate of the withdrawal of short-term funds from London. It should also be remembered that we believe the 1931 estimate of item 12 ('acceptances for account of foreigners') to be very conservative and that no estimate of this item is available for 1932.

The estimates which we have presented here must be regarded as merely tentative. They are an attempt to show what can be done with the meagre information available. More accurate data regarding the capital items is in the possession of the Bank of England. When that is made public much better estimates of Great Britain's trading position *vis-à-vis* the rest of the world will be possible.

APPENDIX II

THE TERMS OF INVESTMENT CONTRACTS

ONCE it has been decided that an international investment shall be made, the ingenuity of legal draftsmen is devoted to the task of making that investment as secure for the investor as possible. Where the investment is a loan, and therefore fortified by definite promises by the borrower regarding the payment of interest and the repayment of principal, considerable scope is offered for devising safeguards designed to ensure that those promises shall be kept, and that if they are not kept the lenders shall ultimately recover what is due to them. If the loan is offered for public subscription, these safeguards figure prominently in the prospectus and form part of the inducement on the faith of which investors part with their money. It is therefore worth while to examine the nature of these safeguards and the limits of their efficacy.

To what extent does the security of a foreign loan depend on the provisions of the loan contract?

Those who frame a foreign loan contract are primarily concerned to minimize two different risks: the risk that money obligations will not be met, and the risk that these money obligations will have depreciated in value when the time for payment arrives. It is convenient to examine the second of these risks first.

The loan must be expressed in money, and the possibilities of its depreciation are two:

- (a) that the money in which it is expressed may be worth less in terms of the lender's currency at the time when payment is made than it was when the loan was advanced, and
- (b) that the lender's currency may itself have depreciated in terms of other currencies or in terms of goods or in terms of gold.

The intention of a contract of loan is that ultimately the borrower shall pay back what he borrowed and the lender shall recover what he lent. If, while the loan is outstanding, the monetary unit in which it is expressed depreciates, the parties' intention may be defeated. But there are two quite distinct senses in which it may be defeated, one of which is peculiar to foreign loans, whilst the other applies equally to domestic loans.

It is a peculiarity of foreign loans that borrower and lender probably keep their books in different currencies. Each keeps them in his own. If the relation between those currencies changes, the original intention of the parties cannot possibly be wholly fulfilled. Unless the borrower repays more (or less) than he borrowed, the lender must receive less (or more) than he lent. Nothing which is written into the loan contract can do justice to both sides. The most which can be done is to determine on which side the loss shall fall or the profit shall be made.

The loss or profit which is here discussed is an ascertainable sum in

money. If the loan is expressed in the debtor's currency and the debtor's currency depreciates, the sum which the lender is entitled to claim will be insufficient to buy as much of his own currency as went to the making of the loan. If in the same circumstances the loan is expressed in the creditor's currency, the debtor must spend more of his depreciated currency than he originally received in order to buy the currency with which to pay the debt.

If a lender asks no more than to be protected against such money loss, it is sufficient for him to insist on the loan being expressed in his own currency, and this was in fact the British pre-war practice. A promise to pay sterling was sufficient.

There is, however, another sense in which payment in a depreciated currency may be held to involve loss. The depreciated currency may have—and probably has—less purchasing power. Its 'real' value may be—and probably is—less. This loss of 'real' value may be measured in terms of other currencies or of gold or (theoretically at least) of goods. And the possibility of such loss of real value has led lenders to fortify loan contracts still further by adding safeguards against the depreciation of their own currencies also. Such measures have been most fully worked out in 'international' loans, that is, loans subscribed in several creditor countries, but it is clear that the risk so far as it exists applies to all loans alike.

Now the 'reality' of this kind of loss in certain cases is undeniable. During the inflation in Germany the relation of money to goods changed so rapidly that borrowers were enabled to pay off large loans by payments whose real value was trifling. On the other hand, the depreciation of sterling after the suspension of convertibility in 1931 was not accompanied by any corresponding drop in its internal purchasing power. Its depreciation in terms of gold and of currencies linked to gold was apparent and ascertainable, but this formed no reliable index even of its average external purchasing power in view of the number of currencies which moved with it. Similarly, the relative appreciation of currency experienced by a borrower in a country whose currency rises in value relatively to others by no means measures the increase in its purchasing power.

If changes in purchasing power were constant over all commodities and in all countries, and if these changes were capable of exact and instantaneous measurement, it would be possible to measure and provide for changes of 'real' value such as have been discussed. The extreme remoteness of the time when such conditions could be expected to be realized indicates how difficult and how inexact must be efforts made to-day to meet them. This, however, has not deterred lenders from devising provisions to ensure that however much currencies depreciate, lenders at least shall receive the same 'real' value in money as if the depreciation had not taken place. Where neither the borrower's nor the lender's own currency is considered sufficiently stable, loans have been expressed to be payable in the currency of some third country or, at the option of the lender, in more than one currency at a fixed rate of exchange. This device is adequate so

long as the sponsors of the loan are successful in selecting the currency or currencies on which to 'put their money'. The history of the last seven years has provided little opportunity for guessing right; and wrong guesses sometimes have an unlooked-for effect. Between 1925 and 1930 sterling and U.S. dollars were selected as the currencies for various loans issued in Germany and elsewhere; and for some years prior to 1936 Swiss and Dutch holders had the privilege of selecting in which of these two depreciated currencies they would receive payment. Thus whilst both debtor and creditor were (nominally or actually) in their original positions, the calculation of the sum payable was made by reference to a standard which had changed, presenting an unexpected profit to the borrower and an unexpected loss to the lender with every payment made.

A wider protection may be given by fortifying the currency selected by the addition of a so-called 'gold' or 'valuta' clause. These are attempts not merely to define the currency but to fix its value. A new standard must be invoked whereby the standard itself may be measured; and this standard is found either in gold or in some other currency.

The best-known form of gold clause is that which has for many years figured in American loan contracts both internal and external, and which defines the currency of payment as 'gold dollars of the standard of weight and fineness existing on' a specified date. The expression '*franc or*' in pre-war French loan contracts affords a similar example.

Both the 'gold dollar' and the '*franc or*' have been the subject of litigation in their countries of origin as well as in other lands. Both France and the United States when devaluing their currencies have sought to relieve their citizens of contractual obligations to pay more in discharge of a money debt than its nominal amount in the currency which is actually 'current'. Both have sought to some extent to retain the right to demand from foreigners payment according to the letter of the bond. Borrowers, on the other hand, have shown great reluctance to pay the equivalent of a no longer existent currency in satisfaction of a debt. It would not be appropriate here to summarize either the legislation or the judicial decisions on this complex subject. It is sufficient to point out that a promise to pay a debt in a currency of a certain value cannot mean more than a promise to pay a sum in the currency which is legally in force in the country indicated at the time when payment is made, the amount payable being adjusted if the currency has been devalued. Contracts of this kind have been somewhat roughly handled both by courts and legislatures, but where they have been upheld, this is the meaning which has been attributed to them, the amount payable being computed by reference to the current value of the gold content of the original currency.

It is noteworthy that this meaning has also been attached to such contracts, even though the currency concerned had not been officially devalued, though it had depreciated on the foreign market owing to the suspension of its convertibility.

Essentially, therefore, clauses providing for payment in a specified and

valued currency do not differ from the simpler form of gold clause exemplified in the German 'gold mark' mortgage bonds. Here the promise is to pay a certain sum in German legal currency, the sum payable being a sum sufficient at the date of payment to buy a specified quantity of fine gold. Such a clause, when used to fortify a promise to pay in the debtor's currency, protects the lender against depreciation up to the date on which the sum payable is ascertained; but if transfer facilities are not then immediately available, any further risk falls on the lender. When added to an obligation expressed in the creditor's currency it protects the creditor against depreciation of his own currency more effectively than the more common type of clause, but it is less convenient, since the sum payable cannot be ascertained until the date of payment arrives. In the United States of America bonds must secure the payment of a definite sum if they are to be negotiable; and negotiability is necessary to a bearer bond.

Valuta clauses define the amount payable by reference to its value in terms of other currencies. They are more common in short-term than in long-term obligations—except in so far as a provision that a bond shall be payable in alternative currencies at fixed rates may be regarded as a valuta clause. All the foregoing observations regarding the simpler form of gold clause apply equally to valuta clauses.

It is to be observed that gold and valuta clauses, as well as 'double currency' bonds and similar devices, aim not at meeting some disparity between the two currencies concerned but at maintaining the value of one of them by reference to some external standard. Suppose, for example, a loan contracted between a Danish borrower and an English lender whilst both currencies were on gold. Both currencies depreciate, the relation between them remaining unchanged. An effective gold clause will ensure that on every payment the lender shall make a money profit and the borrower shall suffer a money loss.

It would be inappropriate here to discuss the legitimacy of these attempts to secure repayment in currency of a certain value beyond pointing out how uncertain and inexact this measure of value may be. Two important conclusions emerge, however, relative to the efficacy of loan contracts.

First, it is to be noted that none of the devices which have been discussed provide any safeguard against the danger of transfer restriction. It has been a feature of recent experience that, if a country's currency becomes depreciated, the government is unlikely to allow it at once to find its own level. It may suspend not only the convertibility of the currency but also the free purchase of foreign exchange. Foreign exchange then becomes a resource of the state to be collected, preserved, and applied where it is most needed, irrespective of the effect of such control on the fulfilment of private contracts. The foreign lender cannot obtain payment in his own currency, however willing and able his debtor may be to pay. Sometimes, he cannot even accept payment in the debtor's currency and spend the money freely in the debtor country. His gold clauses and valuta clauses are, at least for the moment, entirely useless.

The extreme example of such a policy is seen in Germany to-day. This country's currency is kept on gold by a strict control of the exchanges, although all her principal creditors have undergone heavy currency depreciation. Hence, German borrowers would, in many cases, be glad to repay their foreign loans at par, in order to realize and book the profit due to the depreciation of their creditor's currencies. Their creditors, on the other hand, would be quite willing to receive payment even at a certain loss, yet these complementary desires cannot be satisfied directly, because the German Government controls the exchanges and permits repayment only in so far as it is prepared to allot foreign exchange for that purpose or in so far as it is able to make arrangements with creditor and debtor which it regards as satisfactory.

Secondly, it must be recognized that none of these devices can do more than determine how certain losses are to be measured and by whom they are to be borne. They cannot eliminate the losses themselves nor, in extreme cases, make them supportable by either party. The fundamental fact is that long-term lending assumes long-term stability of currency, just as foreign lending assumes stability of exchange. If either assumption becomes sufficiently doubtful to be a material factor in the decision, lending between responsible parties becomes impracticable.

The other concern of the sponsors of the loan is to secure, so far as may be, that sums due shall be paid. If loss due to currency depreciation falls on the debtor, the chance of his default is increased and the importance of security becomes greater. Here again, however, the limitations of contractual provisions should be noted. No 'security' can do more than secure that the debtor shall pay as much as he can. It may confer precedence over other creditors. It may eliminate the chance of fraud. But it cannot guarantee solvency.

The principal causes of default are three—insolvency, transfer restriction, and unwillingness to pay. The first means that the debtor's resources are insufficient to meet the loan. This may be due to incompetence, to an excessive burden of debt, or to unfavourable trade conditions. The first two may be cured by reorganization with or without a scaling down of debt; but nothing can be done about the third so long as these unfavourable conditions remain. Transfer restrictions are entirely an affair of the central government and affect all the debtors—in theory though not in practice—equally. Unwillingness to pay, unaccompanied by either of the other two causes, can be overcome by legal enforcement of 'security' so far as such steps are possible. It is material to observe that unwillingness to pay seldom occurs in isolation from the other two causes of default; and that sovereign states are subject to legal process only with their own consent both in their own and in other courts.

It is well to consider the various kinds of security in connexion with these three causes of default, since security is of no importance except in the event of default. Security usually consists in the hypothecation of assets or revenues or both; and the hypothecation may be of varying

degrees of efficacy according to the nature of the borrower, the nature of the assets, and the state of the law in the borrower's country.

The security offered by sovereign states has certain peculiarities which need separate consideration. It usually consists in the so-called charging of certain revenues. This is in fact an undertaking by the government concerned to ear-mark certain revenues for certain purposes. It is not a legally enforceable undertaking; still less can representatives of the borrowers by any process of law collect such revenues for themselves. The state is sovereign and cannot irrevocably bind itself or legally pledge its revenue-collecting powers. This fact is in practice of less importance than the fact that a sovereign state is a borrower different in kind from a private corporation. Its assets are negligible in relation to its revenues. Its revenues for the most part do not arise from its assets. Its revenues are elastic. It is difficult to know what they are and impossible to know what they might be. Its obligations are also elastic, and the order in which they are satisfied is determined by considerations different in kind from those which determine or compel the choice of an embarrassed private debtor. Nothing will prevent a government from raiding 'pledged' revenues if its own domestic necessities are sufficiently imperious. The best security for the payment of a foreign loan consists in the continuance of sound finance and a reasonable degree of prosperity in the borrowing state.

It would be wrong, however, to suggest that the security of such loans is unimportant. In the event of disaster it will probably have little effect in determining how much of the national revenue or of the national supply of foreign exchange will be devoted to meeting external debt obligations, but it may be of great importance in determining the treatment of the various loans *inter se*.

Provisions which tend to avert default rather than to provide for it may also be of value to borrowers as well as lenders. Provisions limiting or imposing conditions on future borrowing are of this kind. It is seldom practical to impose such limitations on sovereign states.

An intermediate case between public and private borrowings is afforded by loans raised by public institutions such as the Roumanian Monopolies Institute. A separate corporation is created by law to collect a revenue, exploit a monopoly, or administer an asset. The corporation raises the loan with or without the guarantee of the government. It is subject to the law and its revenues can only be diverted from it by an exercise of the sovereign power of a more high-handed and definite character than is usually involved in the diversion to other uses of revenues 'pledged' by a state but still administered by it. It is probably impracticable for the lenders in case of default to 'enforce their security' either by selling it or by themselves administering it—but it is only in the rarest instances that such rights have any value even where the borrower is a private corporation. The value of the security given by such an institution depends largely on the extent to which the continuance of such revenues is assured and the extent to which they are collected in foreign exchange.

Private corporations can mortgage their assets to secure foreign as well as private loans. The legal rights which usually belong to a mortgage in the event of default—the power to sell, the power to manage, the power to foreclose—are seldom of direct value to lenders. Things must be had indeed if the trustee for a body of bondholders can turn a commercial undertaking in a foreign country to better account than its own proprietors, and the sale of such an undertaking, even if a buyer can be found, has all the difficulties which attend similar operations at home, and in a greater degree. It is rare that a purchaser for a large and unsuccessful undertaking can be found otherwise than in its own former proprietors. None the less, the mortgaging of assets gives to the lenders a measure of negative control and a basis for effective intervention if default should occur. No such security, however, gives any protection against phenomena such as have distinguished recent defaults, namely, changes in the conditions of trade which render whole industries unproductive and compel the debtor state to 'ration' foreign exchange.

An examination of recent history suggests that debtors who earn their revenues in foreign exchange are not only more appropriate but also safer borrowers. Their revenue being earned in foreign currency is protected from some of the effects of currency depreciation. Unless complete transfer control is instituted they have their own resources for paying their foreign currency obligations. And even if control is instituted, they are favourably placed and their importance as 'devisen earning' members of the embarrassed state will certainly create a national interest in their prosperity, even if this does not express itself in giving them, for the purpose of meeting their foreign debts, an undue share of the devisen which they earn.

These advantages, however, though they may make such borrowers preferable to others still worse placed, cannot make them desirable. If the risk of transfer restriction is sufficiently real to need safeguarding, experience suggests that only two safeguards are effective—the pledge of vitally important assets situated outside the debtor country and (to a lesser extent) the pledge of revenues earned outside the country from a vitally important activity.

An example of the former is afforded by a mortgage on ocean-going ships. Shipping services are part of a country's exports. No country is likely to suspend its own shipping services voluntarily. No country can do so without sacrificing their value. Yet so long as these services are operated the ships are subject to seizure in every foreign port and unlike most kinds of security are for the most part saleable, if not profitably saleable, for foreign currency. The loans of the Nord Deutsche Lloyd are unlikely to fall into default whilst the ships mortgaged to secure them ply to foreign ports.

An example of the pledge of revenues is afforded by the German Potash Loan. Indeed, this loan, the first large loan to Germany after the inflation, affords so good an example of the various problems dealt with in

this Appendix that it deserves somewhat detailed consideration. The new Reichsmark was regarded with distrust and the loan was made payable in either of two trustworthy gold currencies—sterling and U.S. dollars—at a fixed rate of exchange. The bondholder might choose whichever he pleased. He was secured by an enormous mortgage registered upon every potash mine in Germany. Finally, the debtor undertook that his foreign receipts should pass through a foreign bank, which was authorized to take the monthly service from this constantly running stream before it reached the debtor.

The lenders' foresight was not wholly justified by events. They attempted to secure themselves against the possibility that the Reichsmark would depreciate; in fact, they have protected themselves against the measures used to keep German currency over-valued. The bondholders, if they were treated like other German bondholders, would be receiving 4 per cent. or 3 per cent. Funding Bonds instead of cash by way of interest; and their mortgage would be useless, since they would be unable to enforce it, or to do anything with the mortgaged properties even if they could enforce their rights. Yet, in fact, this loan is still fully serviced. Though most of the German government's own obligations are in default, the Potash Syndicate still pays its 7 per cent. because the framers of the loan secured it on the one asset whose value could not wholly depreciate: the proceeds of a world-wide trade in an essential commodity.

One touch of irony completes the picture; the service of the Potash Loan has been threatened from an unexpected quarter, namely, by the unlooked-for intervention of the governments of certain countries who, by establishing clearings with Germany, seize potash proceeds to pay German debts to their own nationals, and thus break down the private clearing-in-embryo established by the parties to the loan ten years before.

A parallel case is furnished by the Union Company of Oslo, the largest producer of newsprint and mechanical pulp in Norway, which in August 1934 placed privately in London £1,150,000 5½ per cent. First Mortgage Debentures. According to *The Times*,¹ the debentures are secured by a first charge on the proceeds of the company's exports, the buyers of the company's products receiving irrevocable instructions to pay to a bank in London the entire proceeds of the exports, and the bank retaining in sterling out of the proceeds in every month one-twelfth of the amount required for the debenture service.

The 'security' offered by arrangements such as this is inferior to that provided by the pledge of assets which are situated or which, like ships, sometimes go abroad, in that security of the latter class cannot be impaired by any act of the debtor or his government. Where commodities or the proceeds of sale arising from them are earmarked for creditors, the debtors' government can insist upon such assets being sold or their proceeds being remitted through other channels, and in certain cases this has taken place. Experience seems to show, however, that the task of

¹ 15th August 1934.

upsetting such arrangements is harder, more invidious, and less safe than that involved in setting aside the more imposing securities offered by governments themselves.

Fixed-interest-bearing securities give no latitude to the borrower in times of depression, and it would undoubtedly increase the safety factor in international investment if more of this investment could take the form of investment in 'equities'.

Foreign commercial undertakings can, of course, make share issues. Even if the foreign borrower is a commercial undertaking, however, share issues are less well received than issues made by domestic commercial borrowers of similar standing owing to the difficulty of control and the additional risks which foreign borrowing involves. For government borrowers, any issue on an equity basis is impracticable. Theoretically, it is conceivable that service payments on an issue might be varied according to some index of the internal and external prosperity of the country concerned, but any such indices are at present far too inexact to be used for such a purpose, nor would it be possible to set up adequate machinery for determining questions of doubt. The experience of the Reparations Commission in determining Germany's 'ability to pay' provided a useful but not very encouraging example of what can and cannot be done in this direction.

Public utilities managing specified undertakings such as docks have, however, a more exact and reliable index of their prosperity and might issue obligations carrying variable rights. A more serious practical objection to any such scheme is that it would probably not appeal to the investor. The possibility of an automatic reduction in interest or sinking fund would depress the value of the bond and the value of the security, and its rights in times of prosperity would have to be very heavily weighted in its favour in order to counter-balance this disadvantage. However desirable it might be in the interests of the world at large that some machinery should be provided for the automatic adjustment of debt burdens in times of international depression, there is little doubt that individual borrowers will raise their money more cheaply by issuing obligations with fixed rights in accordance with their present practice.

The extent to which investors are willing that the fruits of their investment should vary with the prosperity of the undertaking concerned is proportionate to the investor's knowledge of and interest in that undertaking and to the extent to which he is able and willing to participate in its control. It would appear, therefore, to be inevitable that the field of foreign equity investment should be principally confined to those direct investments which are referred to elsewhere in this book or to speculation in foreign equities through the medium of the Stock Exchange when circumstances make such action seem attractive either because of a hope of market appreciation or a fear of domestic currency depreciation.

APPENDIX III

BRITISH OVERSEAS INVESTMENT IN 1928 AND ITS SUBSEQUENT HISTORY

THE object of this Appendix is to analyse the new capital issues for overseas borrowers in London in 1928, and to trace their subsequent history down to the beginning of 1935. Investment, even investment overseas, is of many different kinds and encounters many different fates, and the experience of even one typical and active post-war year should be of significance.

The method adopted has been to go through the weekly list of 'New Issues' in the *Economist* and to collect together all issues by governments, public bodies and business concerns in overseas countries and by all British companies (except investment trusts) whose main income appears to be derived from operations abroad. This list covers only new issues offered to the public or to shareholders; thus it excludes refunding operations and issues placed privately. Investment trusts are excluded in order to prevent reduplication. The resulting total does not include *all* new overseas investment during the year; but it does cover the larger and more important part of it.

The issues have been analysed and arranged in groups on the basis of the classifications in the Stock Exchange Official Intelligence. Each issue has

Classes of Overseas Investment, 1928

	<i>Cash subscribed</i>	
	<i>£ millions</i>	<i>Per cent. of total</i>
Public loans ^a	70·3	62
Utilities and services ^b	13·9	12
Commodities ^c	18·2	16
General enterprise ^d	11·4	10
TOTAL	113·9	100

- ^a Empire and foreign governments and corporations.
- ^b Banking, transport, electricity, gas, water.
- ^c Mining, oil, rubber, tea, and coffee.
- ^d Commercial, industrial, land, miscellaneous.

been revalued in terms of the prices ruling at the beginning of January 1935. If the issues were those of governmental bodies and of large concerns, and had maintained their identity, this has proved a simple matter. If a concern had been reconstructed, the value taken has been that of the 'successor' securities corresponding to the original issue. If loan capital was repaid in cash before January 1935, the value of the issue has been taken as the amount of the cash payment. If a company had been wound up, anything recovered by the holders of the issue has been credited under

'value'; if there is no evidence in the Stock Exchange Intelligence of anything having been recovered the value of the issue has been taken as 'nil'. Issues that are not quoted in either of the Stock Exchange Lists have been given an estimated value based on the record and latest dividends (if any) of the company—not a very satisfactory method, but the only one which enables us to fill in the details of the picture without an unreasonable expenditure of time and effort.

The investments whose history we have to follow may be classified under four main heads, as in the table on the previous page. This total includes all the issues which fall within the definition given above.¹

The next stage must be to analyse each category of lending in detail, and at the same time to show the position reached at the beginning of 1935.

Public Loans.

The position in regard to loans to governments and public authorities overseas may be set out as follows:

Public Loans, 1928

	<i>No. of issuers</i>	<i>No. of issues</i>	<i>Nominal</i>	<i>Cash</i>	<i>Value Jan. 1935</i>	<i>Value as per cent. of cash</i>
				(£ '000)		
Empire governments	10	11	41,840	40,223	47,728	119
Empire corporations .	6	8	6,682	6,528	7,602	116
Total Empire .	16	19	48,522	46,751	55,330	118
Foreign governments	8	11	20,624	19,234	5,980	31
Foreign corporations	4	4	4,575	4,332	1,537	35
Total foreign .	12	15	25,199	23,566	7,518	32
TOTAL	28	34	73,721	70,317	62,848	89

More than half the borrowings of Empire governments were destined for Australia and New Zealand; of the rest, the most substantial item is a loan to the Government of India; the remainder was divided between Kenya, Southern Rhodesia, Tanganyika, Newfoundland, and Fiji. All the loans had appreciated by January 1935, thanks to the fall in gilt-edged rates and to the improved position of primary producers. All the borrowings by Empire corporations were by cities in Australia and New Zealand, with the solitary exception of a loan (cash subscribed £1,261,668) floated on behalf of the City of East London, and the market value of these had also risen. Perhaps it is not always realized that over a quarter of the

¹ The only exceptions are an issue by the city of Dublin (cash subscribed, £768,000), and three minor company issues whose origins and history are obscure.

British capital sent overseas in 1928 was borrowed by public authorities in Australia and New Zealand, which together have only a little over seven million inhabitants, and that in 1928 alone new borrowings amounted to approximately £4 per head. When one considers the fall in the prices of wheat and wool during the depression, the efforts of these two countries in the face of economic crisis represent a remarkable achievement.

But the story is a less happy one when we come to loans to foreign countries. A third of the borrowings by foreign governments went to the Brazilian States, another third to Greece, and the remainder was divided between Chile, Peru, Bulgaria and the Free State of Hamburg. One Brazilian and three German borrowers account for the item 'foreign corporations'. Government and corporation loans alike had depreciated to one-third of their original cost by January 1935; foreign corporations loans had fallen slightly less than those of governments only because one of the three German borrowers happened to be Saarbrücken.¹

Utilities and Services.

The position under this head is as follows:

Issues on Behalf of Utilities and Services Overseas, 1928

	<i>No. of issuers</i>	<i>No. of issues</i>	<i>Nominal</i>	<i>Cash</i>	<i>Value Jan. 1935</i>	<i>Value as per cent. of cash</i>
				(£'000)		
Banks	5	5	3,183	4,181	2,412	58
Electricity	6	7	6,520	6,095	4,810	76
Others*	5	5	3,671	3,669	1,557	42
TOTAL	16	17	13,374	13,945	8,579	62

* 3 railway, 1 gas, 1 waterworks.

As regards banks, two Australian banks offered ordinary shares which had depreciated slightly by January 1935; a South African bank offered ordinary shares which had appreciated by some 50 per cent., a London banking institution established to do business on the continent offered ordinary shares which had lost two-thirds of their value, and a Brazilian bank offered sterling bonds which had lost four-fifths of their value. This is very similar to the history of the public loans discussed above.

The history of the electric lighting and power concerns is at first sight a little more pleasant. But nearly half the cash subscribed was in the form of two debenture issues of a Hungarian concern; one issue is guaranteed under the Trade Facilities Act; its price in January 1935 was 107; the other is not; its price was 26, so that the Trade Facilities Act is to some extent responsible for the apparent success of this category. Other bond and debenture issues were those of a German concern (heavily depreciated),

¹ Which was still under League control in January 1935.

a Canadian concern (appreciated), a Belgian concern (doubled in value, a remarkable achievement for a fixed interest issue, but the fall in interest rates and a gold clause made it possible), and a Japanese concern (slightly depreciated). The only issue of shares (Indian) was a small one, but it had trebled in value.

The third category is an omnibus item; the two large railways were Argentine and the waterworks Brazilian. Only one smallish issue (gas, connected with Australia) had maintained its value.

Most of the losses on 'public loans' and 'utilities and services' can be traced to South America and Central and Eastern Europe.

Commodities.

The position is as follows:

Issues for Commodity Production Overseas, 1928

	No. of issuers	No. of issues	Nominal	Cash	Value Jan. 1935	Value as per cent. of cash
				(£'000)		
Tin mining . . .	19	20	2,648	3,634	1,757	48
Gold mining . . .	7	7	1,100	1,907	3,186	167
Copper mining . . .	4	4	1,050	1,087	1,470	135
Other mining . . .	8	9	2,686	3,080	2,828	92
Total mining . . .	38	40	7,484	9,708	9,241	95
Oil	4	4	5,543	5,623	4,244	75
Rubber	10	11	1,881	2,665	1,708	64
Tea and coffee . . .	7	8	145	252	207	82
Total, other com- modities	21	23	7,569	8,540	6,159	72
TOTAL	59	63	15,053	18,249	15,400	84

Gold-mining calls for no comment; the copper issues were mainly associated with developments in Rhodesia. The oil figures are slightly deceptive as they include a £4 millions debenture issue by one concern, which was repaid in 1934. 'Tea and coffee' were relatively successful.

But the most interesting figures are those dealing with the Malayan products—tin and rubber. The prices of these moved as follows:

	Tin, Standard cash, £ per ton	Rubber, Plantation sheet, pence per lb.
1925 . . .	261 $\frac{1}{2}$	34 $\frac{1}{2}$
1929 . . .	203 $\frac{1}{2}$	10 $\frac{1}{2}$
1930 . . .	142 $\frac{1}{2}$	5 $\frac{1}{2}$ *
1931 . . .	118 $\frac{1}{2}$	3 $\frac{1}{2}$
1932 . . .	136 $\frac{1}{2}$	2 $\frac{1}{2}$
1933 . . .	194 $\frac{1}{2}$	3 $\frac{1}{2}$
1934 . . .	230	6 $\frac{1}{2}$

Thus, tin, after a heavy fall, rose to above the 1929 level, in 1934, whereas rubber, though it had risen from the depths of 1932, still remained very low judged by pre-depression figures. But investment in rubber has been successful compared with investment in tin, and both were better than investment in South American and Central European bonds. On the whole, investment in commodity production proved satisfactory, even if allowance is made for the fact that the figures are distorted by the enhanced profitability of gold mining.

Certainly investment in commodities was more successful, as we shall see, than investment in many types of commercial and industrial activity. In this connexion, the various restriction schemes must not be forgotten, and it is worth mentioning that tin, rubber, and tea issues for the most part were small issues to shareholders only.

General Enterprise.

The position may be set out as follows:

Issues for General Enterprise Overseas, 1928

	<i>No. of issuers</i>	<i>No. of issues</i>	<i>Nominal</i>	<i>Cash</i>	<i>Value Jan. 1935</i>	<i>Value as per cent. of cash</i>
Financial trusts, land, property	8	14	2,513	£ '000 2,645	1,269	48
Commercial and in- dustrial	18	26	5,002	6,137	4,197	68
'Foreign rights'	17	20	2,675	2,595	60	2
TOTAL	43	60	10,190	11,377	5,526	49

A word of explanation is needed concerning this category, which includes many different sorts of issues. 'Financial trusts, land, and property' covers all the companies under that head in the Official Intelligence, and the classification has been strictly adhered to, but it must be remembered that the border-line between mining or tea or rubber production, on the one hand, and the possession of estates in tropical countries, on the other, may be rather an arbitrary one, so that this item is not as clearly defined as some of the others. The other two items consist of concerns classified under the Intelligence heading 'Commercial and Industrial',¹ but they have been divided into two in order to isolate companies formed to exploit certain patents, &c., overseas; the reasons for this will be explained below. It must be added that the process of revaluing the issues in this category is far more a matter of guesswork than in the other categories; consequently the figures must be taken as very approximate.

The figures for 'financial trusts, land, and property' are somewhat deceptive. If the capital raised by one unfortunate concern interested in

¹ And also two concerns, one officially classified under 'Breweries and Distilleries' and the other under 'Iron, Coal, Steel', which fit in most appropriately here.

timber trading in Germany were excluded, the figure in the last column would be raised from 48 to 75 per cent. The remaining concerns were mainly property-owning companies. The properties varied considerably in character: they included mining rights over certain areas, plantations, and urban real estate. No generalizations can be applied to the category as a whole.

'Commercial and industrial' is an even more indeterminate category. The more normal concerns (those formed to exploit 'foreign rights' of British gramophone companies, &c., are treated separately) had, as a class, depreciated by about one third (or perhaps even more) by January 1935. They were of the most diverse character. Companies interested in wood-pulp were unfortunate, as were also a number of concerns of rather a speculative kind. The older, established companies showed better results. Conditions in Germany, Central Europe, and South America do not seem to have been an important cause of the fall in value of these issues.

Of the twenty issues by companies formed to exploit 'foreign rights', ten represented foreign rights in gramophones, four foreign rights in snapshot photography, and the remainder include Ner-Sag (Overseas), Blue Bird Petrol (Foreign), and Continental Waste Food Products. The careers of these concerns—though interesting—are irrelevant here. Almost all of them have been liquidated. It must be pointed out, however, that their 'value' in 1935 may have been understated, as no serious attempt has been made to discover what, if anything, shareholders received when the concerns were wound up. But even if liberal allowance is made for this possibility, the story is unfortunately only too clear, and the principal cause of this sad result was certainly the condition of the London new issue market in 1928.

The only question which really arises is whether we are entitled to include such concerns under 'overseas investment'. It is doubtful, of course, how far any substantial proportion of the capital raised ever found its way overseas; most of it probably went straight to the parent companies. On the other hand, according to the strict letter of their prospectuses, the intention of the promoters of these concerns is clear and unambiguous, and we are hardly entitled to count these concerns as 'home investment' on the ground that subsequent history leads us to suspect that only a small part of this capital did ultimately find its way abroad. One must call them 'overseas investment', and very unfortunate overseas investment at that.

Conclusions.

To draw the picture together, we may summarize the foregoing tables. The story of British overseas lending in 1928 may be roughly described in a few sentences as follows. Two-fifths of the total went to state and local authorities in Australia and New Zealand, and other parts of the Empire, and proved exceedingly successful. Another fifth went to authorities in South America and in Central and Eastern Europe—with most

unfortunate results. Rather less than a fifth went to companies producing commodities—to Malaya, for the production of rubber, tin, and tea; to Rhodesia, for the production of copper; to Africa and Australia, for the production of gold; to Burma and South America, for the production of oil. These investments have varied a good deal in character, but considering the nature of the economic depression, cannot be considered unsatisfactory. Finally, the balance is made up by investment in utilities and services (which, in general, were successful or not according to their geographical situation) in property-owning companies and in general enterprise, which on the whole was moderately fortunate although some of it was very bad indeed.

Summary: British Overseas Lending, 1928

	<i>No. of issuers</i>	<i>No. of issues</i>	<i>Nominal</i>	<i>Cash</i>	<i>Value Jan. 1935</i>	<i>Value as per cent. of cash</i>
			<i>£ millions</i>			
Public loans	28	34	73·7	70·3	62·8	89
Utilities and services	16	17	13·4	13·9	8·6	62
Commodities	59	63	16·1	18·2	15·4	84
General enterprise	43	60	10·2	11·4	5·5	49
TOTAL	146	174	112·4	113·9	92·3	81

When we examine the details, it is clear that the fortunes of the new issues made in 1928 varied greatly. The most unsuccessful were those on behalf of borrowers in Latin America and Central and Eastern Europe. Smaller in amount, but equally unfortunate, were those dubious issues by firms which desired to exploit 'foreign rights'. The proof of this generalization is simple. Eliminate from the total of new issues all loans to foreign governments and municipalities, all utilities and services situated in South America or Central and Eastern Europe, and all concerns in the 'foreign rights' category. The result is:

Cash subscribed (£'000)	.	.	79,588
Value Jan. 1935 (£'000)	.	.	81,132
Value as per cent. of cash	.	.	102

The last figure would be 81 per cent. if all overseas investment were included. The favourable result is due in the main to the rise in value of Empire government and corporation securities; nevertheless, when we bear in mind the economic history of the world in the years since 1928, the resulting picture is a satisfactory one.

Even in cases in which losses have been heavy, extenuating circumstances may be urged. The Greek and Bulgarian loans, for example, were reconstruction loans floated under the auspices of the League of Nations, and they did serve their purpose, which was to reconstruct countries suffering from the war. The problem of reconstruction lending may have been faced wrongly—but it had to be faced. British investors may have

lent too much to Germany and probably did to Brazil; but Brazil with her enormous natural resources and Germany with her enormous technical resources must both have appeared to be countries to whom it would not be unreasonable to lend, and no unbiased judge would suggest that either of those countries is entirely responsible for its own difficulties.

But the complete collapse of the concerns classified under 'foreign rights'—and the none too prosperous fortunes of the 'commercial and industrial' concerns generally—cannot be treated so lightly, even though the sums involved are much smaller. After all, the world probably enjoys an excess and not a deficiency of commodity production,¹ and—on *a priori* grounds at least—one would expect the most profitable new developments to lie in the direction of popular luxuries such as gramophone records and the rest. It is easy to dismiss the investor who put his money into snapshot machines as a fool who got what he deserved—but his instinct was right. The world was likely to want more snapshot machines and gramophones rather than more rubber or tin—and yet rubber and tin have proved much the more successful investment. The only conclusion that can be fairly drawn is that the machinery for financing new inventions was deficient, while that for financing new mines or new plantations was not. By now it has probably improved—and in any case, as far as 'foreign rights' are concerned, the defect is one of home investment machinery alone, and had nothing to do with overseas operations. It may be added that 1928 was an exceptional year in regard to both the number and quality of issues of this sort.

What conclusions can we draw? They are prosaic ones. British overseas investment in 1928 was not as unfortunate as some of the more extreme pessimists would have us believe. Some of the losses were a secondary result of the war; others of too optimistic estimates of the pace at which a country rich in natural resources (Brazil) could develop itself. The failures under the head 'commercial and industrial' are accounted for largely by a boom in which company promoters appealed to the imaginative instinct of the public, an instinct as old as the South Sea Bubble.

¹ *The Economist* of 30th November, 1929, told me in three successive paragraphs that there was too much tin in the world, too much tea, and too much oil; and of course I knew already that there was too much coal, too much rubber, and too many ships.' (D. H. Robertson in *The International Gold Problem*, p. 23.)

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