

THE FIGHT FOR
FINANCIAL
SUPREMACY

BY

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"THE BANK FOR INTERNATIONAL SETTLEMENTS", ETC.

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PREFACE TO THE SECOND EDITION

SINCE this book was written four months ago, we have witnessed some important developments which are calculated to confirm the author's main thesis as to London's superiority as a world banking centre. During November and December, 1930, there was a serious run on American and French banks, of which even some leading banks did not remain altogether unaffected. A number of small and medium-sized banks failed, while the big banks had to take drastic measures to be prepared for any emergency. In Great Britain, on the other hand, there was no indication of any disquietude on the part of the public. Although exchange position, budgetary outlook, economic conditions, and political situation were much worse in Great Britain than in France or the United States, and the Bank of England's gold reserve compared unfavourably with that of the Bank of France or the Federal Reserve banks, the British public trusted its banks implicitly, and there were no withdrawals of deposits noticeable.

The banking difficulties in France and the United States have had important repercussions on the international banking position of both Paris and New York. Anticipating an accentuation of the crisis, French and American banks called in credits ruthlessly from their foreign customers, placing thereby some of them in a

rather embarrassing position. For instance, but for the eleventh-hour intervention of British banking interests, the withdrawal of American credits might have provoked a banking crisis of first-rate magnitude in Brazil. This and similar experiences are not easily forgotten, and it is reasonable to assume that the debtors affected will in future give preference to the centre which, in spite of its depleted external resources, provides the best safeguard for internal stability.

Another important change that has taken place during the last few months is a rapprochement between the British and French authorities. It is true that the conversations between representatives of the two Treasuries held during January and February have failed to result in any definite agreement; but the fact that the Bank of France reduced its Bank Rate to 2 per cent early in January, and that some days later it decided to remove the embargo on gold of standard fineness, seems to indicate a favourable change in the attitude of Paris towards co-operation. Chapter X., dealing with the French gold imports, has been brought up to date, in accordance with this change; apart from this, the book contains no alterations.

Although it would be premature to rejoice about the progress of co-operation, the signs indicating a better spirit ought to be welcomed. It is hoped that, even though the fight for financial supremacy will continue, it will be fought in future with more consideration for general interests than has been shown in the past.

P. E.

PREFACE

WILL London retain her supremacy as the World's banking centre? The present book is an attempt to answer this highly controversial question. To that end, it compares the strong and weak points of the financial markets of London, New York, and Paris, and gives an account of the endeavours of the last two to capture the lead in the field of International Finance. It arrives at the conclusion that, notwithstanding the spectacular progress made by both New York and Paris—thanks to exceptional circumstances—London will be able to hold her own in the long run.

Admittedly, the two rival centres have succeeded in equalling London and even in leaving her behind in more than one respect. The immense wealth accumulated by the United States since 1914 secures her an incontestable advantage over Great Britain, while the position of Paris compares favourably with that of London in respect of her gold reserve and liquid balances abroad. It will be seen, however, that these are not the only factors which count. London has retained the pre-war superiority of her technical organisation, her advantageous geographical position, and the traditions, experience, and international mentality of her banking community. Thanks to these assets, time favours London, for the chances are that

the abnormal advantages secured by her rivals will be gradually levelled down.

The author has endeavoured to examine critically but impartially the causes, methods, consequences, and prospects of the fight for international financial supremacy. In criticising one or another of the rival centres, it is not as if he would contest their right to attempt to supersede London. Although for the United States and France the possession of a leading banking centre is a mere luxury, while for Great Britain, with her peculiar economic structure, it is a necessity, the legitimacy of the ambitions of New York and Paris to assume leadership is beyond question. The author's criticism is not directed against their endeavours to provide better international financial facilities than London; so long as competition is of such nature it is beneficial to all parties, for it compels London to keep pace with their progress. If, however, competition departs from the constructive field it becomes detrimental not only to the centre against which it is directed but to general interests. It jeopardises international monetary stability and tends to delay the restoration of normal financial conditions.

The author's aim in drawing attention to the struggle for supremacy is to emphasise the need for closer co-operation. To ignore the very existence of the fight is an ostrich-like policy. It is desirable that public opinion should realise its disadvantages, and that pressure should be brought to bear to compel co-operation, in the place of competition, between the authorities concerned.

Although the book is concerned with the fight between the three principal centres, the author considered it relevant to add two Appendices dealing with

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the position and prospects of the secondary financial centres. Part of the material of these appendices was published in *The Economist*, while part of Chapter X. appeared in the September, 1930, issue of *The Economic Journal*, and parts of various small chapters have been published in *The Financial News* and *The Banker*. The author wishes to thank the Editors of these publications for their permission to reproduce his articles, and his friends in the banking and diplomatic world who supplied him with information. He also owes a debt of gratitude to Mr. Geoffrey Eley for his valuable criticisms and suggestions, and to Mr. L. P. Thompson for his help in the revision of the proofs. Owing to the highly controversial nature of part of the material, it is only fair to emphasise, however, that the author is solely responsible for the opinions expressed in this book.

P. E.

20 BISHOPSGATE, E.C.2
November, 1930

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CHAPTER I

INTRODUCTORY

THOSE who take the Press interviews and after-dinner speeches of statesmen and financiers at their face-value may be inclined to believe that the financial authorities of various countries are working in harmony for the common good, and that ideal conditions of peace and goodwill reign in the domain of international finance. It is impossible to open a newspaper without reading some optimistic remarks about the progress of international financial co-operation, whether through the medium of the Financial Section of the League, or of the alliance of central banks, or of the Bank for International Settlements. And yet, the careful observer cannot help noticing from time to time indications of conflicting undercurrents beneath the smooth surface. The exchange of compliments and the niceties of financial diplomacy are a screen to conceal the fact that we are in the middle of a silent but determined struggle for international financial supremacy. The authorities and banking interests of the three leading financial centres—London, New York, and Paris—are making a hard fight behind the scenes for this leadership. The conflict manifests itself now and again in the form of a clash at an international conference on some financial question; or in an

apparently inexplicable withdrawal of gold from one or another centre; or in the failure of some international loan negotiation; or in a stormy board meeting of the Bank for International Settlements.

The man in the street does not realise that the apparently isolated events are part of one persistent struggle between opposing forces, like battles in a prolonged campaign. He is unaware of the immense interests at stake, or of the supreme efforts which are being concentrated on the fight by the parties in this international financial triangle. It is by no means obvious to the uninitiated that leading bankers or banking groups, in their efforts to serve their own interests against their foreign rivals, serve at the same time—consciously or unconsciously—the cause of their centre against the rival centres, or that Governments and central banks, in deciding upon their monetary policy, pursue the same end. Few people know that there has developed since the war a system of financial diplomacy, the importance of which is increasing steadily. There is intense activity behind the closed doors of Treasuries and central banks; each party is anxious to ascertain and forestall the opponent's next move; unknown to the general public, financial battles are won and lost. Indeed, financial diplomacy works with an almost complete absence of publicity; only a few initiates are in a position to follow its work. The Press does remarkably little to dispel this atmosphere of secrecy that surrounds the fight for financial supremacy. While an international sports event occupies columnus in newspapers, highly important financial events, negotiations, agreements—each one a landmark in the struggle for financial supremacy—pass almost unnoticed.

It is time that public opinion took an intelligent interest in these developments, which play a prominent part in shaping the monetary policy of nations, and which, through their repercussions on political developments, affect the course of History. In these days economic and financial considerations tend more and more to influence sympathies and antipathies in foreign policy. If, as is to be feared, nations cluster once more into political alliances as before the war, considerations of financial interest will play at least as important a part as those of a purely political nature.

From an international point of view, the importance of the financial factor has increased considerably since the war. Before the war, the increase of material wealth and of financial resources kept pace with each other. The war has destroyed considerable material wealth, while inflation during and after the war has destroyed a much more considerable amount of financial resources. In countries which suffered inflation there is a disparity between real wealth and financial resources which makes them dependent upon foreign assistance, not only for the development of their unexplored wealth, but even for meeting their requirements of working capital. Before the war, there was progress towards a more equal distribution of financial resources between the various nations; this process suffered a marked setback as a result of the war. While, in pre-war days, a comparatively moderate discrepancy between the yield of capital in various countries was sufficient to bring about a movement of funds, at present a much wider margin is necessary to draw capital across frontiers. There are to-day a hundred would-be borrowers for each lender.

While, before the war, there was no pressing need for a rapid expansion of production, since the war, it has become more important and urgent than ever to create additional real wealth. The present apparent over-production—which is merely a temporary lack of equilibrium—does not alter this fact, if we take the long view. The nations have become heavily indebted, and the standard of living of the working classes has increased in almost every country.

In industrial countries trade unionism has enforced high wages, and the increased political influence of Socialism has led to an expenditure on social welfare that has been far beyond the means of the impoverished nations. Even in agricultural countries agrarian reforms have raised the standard of living of land labourers. We have become accustomed to spending more than we earn. In this situation there are two alternative ways of avoiding bankruptcy: either to reduce the standard of living, or to make a proportionate increase in the production of real wealth. The former is politically impossible in democratic countries where universal suffrage prevails. The latter is only financially possible in countries which possess adequate financial resources, or which succeed in raising funds abroad. The next decade or two will witness, therefore, a scramble for funds on the part of countries anxious to develop their resources with the aid of foreign capital.

Thus, the restricted supply of capital available for lending abroad is faced by an increased demand, which places those who are able to lend in a monopolistic position. There is, indeed, ample scope for every financial centre to display constructive activity. Each of them can occupy itself to the limit of its capacity without encroaching upon its neighbour's territory.

And yet, instead of collaborating to arrive at a rational satisfaction of the world's financial requirements and at the same time to advance their identical interests, they compete fiercely one with another.

It is true that, to a certain extent, they have worked together. The successful stabilisation of currencies in a number of countries was largely the result of their co-operation. The leading banking houses of London, New York, and Paris often join forces to carry out big international transactions. Innumerable new financial links have been forged since the war between the three markets. International banking groups have been formed to participate in the capital of foreign banks, investment trusts, holding companies, and finance companies of every description. Nevertheless, as often as not, the spirit of rivalry prevails over that of co-operation. This, in itself, is not necessarily evil; so long as it is of a constructive nature it can only meet with approval. Occasionally, however, it goes beyond the limits of sound competition and is directly damaging to financial equilibrium.

Before the war, London was incontestably the world's financial centre. Since the war, however, both New York and Paris have set to themselves the task of acquiring this much-coveted position. New York's endeavour was the result of the accumulation of surplus resources, which had to be reinvested abroad. In Paris the desire to attain supremacy was a natural reaction after the humiliating experiences during the years when French currency was at the mercy of international finance.

The period between the Armistice and the stabilisation of the franc was characterised by a duel between

the pound and the dollar. American financial circles hoped to replace the pound by the dollar as the principal international means of payment—a perfectly legitimate ambition, fostered by the immense financial strength acquired by the United States during the war. Great Britain was heavily handicapped in this race, but it must be admitted that the United States proved to be a chivalrous opponent. Official circles in Washington and banking circles in New York realised that international monetary stability was more important for the United States than the victory of the dollar over the pound. Thus, far from putting obstacles in the way of Britain's efforts to restore the stability and prestige of sterling, American interests provided most valuable assistance. Though there was a certain amount of rivalry between British and American banks for international loans and acceptances, it did not exceed the limits of healthy competition. The authorities of both countries established close co-operation, which was largely responsible for the success of Great Britain in restoring the gold standard in 1925. There was a lull in the fight for supremacy between London and New York from 1927 to 1929 while the Wall Street boom changed New York from a lending into a borrowing centre. Subsequently, the slump of 1929-1930 has necessitated the concentration of all American resources upon domestic affairs, and the "armistice" has been prolonged. The struggle may be resumed, however, after conditions have settled down to a normal level.

It was not until 1927 that Paris entered this international contest. After a period of inflation and violent fluctuation of the franc, stability was achieved towards the end of 1926. The remarkable financial re-

covery that accompanied the *de facto* stabilisation of the franc enabled the French authorities to make themselves felt in the field of international finance in the spring of 1927, when they attracted attention to their restored strength by large gold purchases. Ever since, Paris has been making great efforts to attain financial supremacy. At first, the fight did not exceed the proportions of a duel with London for the lead in Europe. As a result of the preoccupation of New York with domestic affairs during the Wall Street boom and the subsequent slump, Paris has attempted the task of competing with both London and New York for world supremacy, and the fight has become three-cornered. She has proved to be a less considerate rival of London than was New York. While showing an occasional willingness to co-operate, she proved, on the whole, to be a hard opponent. Indeed, she has often been criticised as having placed financial supremacy above the aim of that of international monetary stability.

The apparently uncompromising attitude of France is easily understood if we consider that she had to restore her financial stability without external assistance. While support was generously given to Central Europe, it was almost entirely withheld from France when she was fighting her "financial battle of the Marne". In the circumstances, it is not surprising that she should disregard international considerations when they appear to conflict with her immediate interests. But to explain is not necessarily to excuse. After all, it was not altogether without reason that support was withheld from France during 1922-1926, as will be shown in a later chapter. Nor, from the French standpoint, was the lack of assistance wholly to be regretted. The success of

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her effort to restore stability has resulted in very substantial moral and material advantages which she would have missed if the franc had been stabilised with external aid. In any case, it is not to her interest to adopt a financial policy that disregards international considerations. Although such a policy may secure temporary advantages, in the long run they could not fail to be outweighed by the benefits obtainable through co-operation.

It is perfectly legitimate for a great nation to endeavour to strengthen her position in the field of international finance. As French savings continue to increase rapidly, and the trade balance (including invisible items) is steadily favourable, it is only natural that Paris should rise to a position of importance as an international financier. But this end can equally well be attained by co-operation. Perhaps her expansion would not be quite as spectacular, but it would be achieved without antagonising other interests, and, in the long run, would prove more beneficial.

In the following chapters an attempt is made to give an account of the course of the fight for international financial supremacy, and to forecast the chances of the three principal contestants. A comparison is made between their pre-war and post-war situations. It will be seen that, notwithstanding the considerable changes that have taken place since 1914 in relative strength, organisation, etc., London has resumed the lead which she had to relinquish for a time, and she has an excellent chance of remaining the world's principal banking centre. New York and Paris will fulfil important functions in the domain of international finance, but are unlikely to capture the lead from London. There is a fair scope for them both to expand without en-

croaching on London's position. The conclusion is reached that the latter has certain fundamental advantages which will, in the long run, prevail over the superiority of New York's inherent financial strength, or of Paris's liquid resources.

CHAPTER II

CONDITIONS OF INTERNATIONAL FINANCIAL SUPREMACY

BEFORE attempting to examine the relative situation of the three leading centres before and after the war, it is necessary to examine the conditions under which a centre can attain international financial supremacy, and the advantages attached to such a position. The comparison of the financial power of two centres is by no means a simple task. While it is easy to measure naval power by a comparison of tonnages, there is no statistical basis for gauging financial strength. Such factors as experience, tradition, reputation, mentality, are absolutely incapable of measurement. Thus, it is not surprising to see three centres at the same time claiming to have attained supremacy; one of them on the basis of its unequalled technical equipment; the second on the basis of the magnitude of its capital resources; and the third on account of the magnitude of its liquid external reserves.

The question we have to consider is the relative importance of these assets in determining the present position and future prospects of a financial centre. Evidently, the importance of a financial centre is not dependent upon any one single factor, but upon a set of factors which, to a great extent, are interrelated.

There are, first of all, a number of circumstances of a more or less permanent nature which determine in advance whether a centre can ever attempt to attain financial supremacy. It is impossible to imagine a centre remote from countries that matter from a financial point of view ever attempting to take the lead. Possibly, in the course of time, means of communication will improve sufficiently to reduce the importance of distance. But, for the present, remote centres are disqualified from attaining financial supremacy. It goes also without saying that a city cannot rise to financial prominence unless it is, at the same time, a commercial centre of importance. Nor can it attain supremacy unless it is situated in a comparatively large and wealthy country.

In addition to these general considerations, there are a number of special factors which play an important part in deciding how far it is possible to establish a financial centre in a given city. The most important of these are:

- (1) Ample capital resources available for lending abroad.
- (2) An adequate banking organisation.
- (3) Freedom of the financial market.
- (4) An investing public willing to acquire and keep foreign securities.
- (5) A stable currency.
- (6) A good money market.
- (7) A good foreign exchange market.

1. Capital resources for lending abroad may either be owned by the lending nation or held in deposit on account of foreign owners. The lender nation's own capital resources again may either be part of the per-

manent national wealth, or part of the current national income. Again, the borrowed or deposited resources may be either permanent investments by foreigners, or liquid resources temporarily employed in the centre in question.

Almost every nation has a certain proportion of its wealth invested abroad, either because, in the past, it possessed export surpluses, or because its citizens consider it advisable or desirable to keep part of their capital abroad. Thus, every nation is, at the same time, a debtor and a creditor. A nation which has a large amount of foreign investments is bound to take an active part in international finance. It has not only to reinvest funds as they are reimbursed by foreign debtors, but also to shift its existing foreign investments as occasion demands. This involves international banking operations which keep its market occupied independently of any fresh business, and thus provide the foundations of an international financial centre.

In addition to its existing foreign investments, a nation may also have current balances available for reinvestment abroad. If a country exports more than it imports (including invisible items and bullion) the balance automatically remains abroad (not necessarily in the countries from which the surpluses arise) in a liquid form. A foreign loan may represent either the reinvestment of capital returned from abroad or the consolidation of these liquid claims into a long-term investment. A steady export surplus is a good basis for the development of an international market. It makes possible a flow of foreign issues, which helps towards the development of the banking centre, and it results in the creation of an external reserve which enable a country to tide over the seven lean years.

If a period of adverse trade balances becomes too prolonged, the international significance of the financial centre and the financial supremacy of the country is bound to suffer. An adverse trade balance results in a decline in savings and in an adverse trend in the exchanges; these again cause comparatively high money rates and thus tend to discourage foreign borrowing, whether in the shape of loans or credits. In the long run, they bring about a depletion of the reserve represented by foreign investments. It is, therefore, obvious that a favourable trade balance and a substantial reserve for temporary adverse spells are essential conditions of financial supremacy.

An international financial centre, in the real sense of the term, does not confine itself to lending its own resources. The true function of the banker in a community is to borrow money and relend it at a higher rate. The same is the function of an international centre, which plays the part of banker between nations. Thanks to its well-established credit, technical organisation, and investment facilities, it is able to attract funds in spite of the comparatively low yield it offers. The inflow of foreign funds may assume the shape of long-term investment in the country's securities or temporary investment in short-term credits. In theory, only the reinvestment of the former is considered safe; it is anything but sound for a bank to reinvest in long-term loans funds that are subject to withdrawal at short notice. In practice, however, it is safe for a country to reinvest a great part of the short-term funds that are attracted from abroad. Although they may be shifted frequently, a certain amount is always left in the financial centre, and may be regarded as permanent. In any case, if

there are heavy withdrawals an increase of the Bank Rate can bring about a readjustment.

2. Another condition of international financial supremacy is the existence of an adequate banking organisation, well-equipped, both from a technical and a psychological point of view, for the handling of international banking business. The existence of well-established financial houses, with adequate resources and a solid reputation, and in a position to place in advance, with their permanent customers, a great part of the foreign loans they issue, is essential. If the issuing houses of a centre have a permanent set of underwriters of standing, and excellent connections with trust companies, insurance companies, and other big investors, it tends to reduce to a great extent the risk attached to international loan operations and contribute to the stability of the market. If they have a well-established reputation for successful banking, they are anxious to avoid any transaction which may be detrimental to their prestige, and are prepared to support the market even at the price of sacrifices. It is not sufficient to possess the facilities for floating a loan successfully. It is equally important, in the long run, to be able and willing to support the market against temporary adverse tendencies. While it is a mistake to bolster up a security against fundamental adverse factors, it is equally wrong to leave it to the mercy of speculation. Other things being equal, foreign borrowers prefer to deal with a market whose banking organisation provides the surest guarantee of the comparative stability of their loans.

The banking organisation of a financial centre cannot be regarded as adequate from the point of view

of developing an international market unless the banks are willing to work for fractional profits. In international competition, the centre which is able and willing to reduce the commission to the lowest figure will secure the largest turnover. Rate-cutting can be carried, however, too far, to the detriment of all parties concerned.

It is essential that the banks of an international centre should be willing to co-operate with foreign centres, so as to spread risks and to undertake transactions whose size is beyond the capacity of one single market. They should be willing to take reasonable risks, without being, of course, too speculative. Over-cautious banks, shirking risk and pioneer work, are likely to be left behind by their more enterprising rivals. It is essential that banks should be willing to make prompt decisions, and should possess executive officials with initiative who have authority to conclude transactions on their own responsibility.

3. A financial centre aiming at international supremacy should not have any restrictions whatsoever imposed upon banking activity. Thus, it should grant free entry to foreign banks that are anxious to establish branches or subsidiaries. It must not enforce exchange restrictions, or place any other obstacles in the way of the migration of capital. It should have a free gold market, in theory and in fact. It should have a free market for international loans—though in this respect a certain official control is permissible and even desirable. The absence of legal restrictions, in itself, is not sufficient. Unofficial discouragement on the part of the authorities can prove as effective a handicap to international business as legal restrictions. The hostile attitude of local banks, or of the Press, or of public

opinion, is also detrimental to the freedom of the market, and tends to handicap its international expansion.

Only a market with a thoroughly and sincerely international mentality can rise to permanent prominence as a world centre. Foreign bank branches should be welcomed, as, in the long run, they tend to increase the activity of the market, and attract additional business from abroad. They should not be handicapped by any hostile or ultra-nationalist legislation, such as, for instance, discriminating taxation; or by the unfriendly attitude of local banks, who may make their situation impossible by boycotting them; or by any hostile Press campaigns, which are bound to affect any company whose prosperity depends upon its friendly relations with a wide circle of customers. They must, of course, inevitably be excluded from certain privileges, such as membership of the clearing-house or rediscount facilities with the central bank. Otherwise it is a mistake to restrict the kind of business they may undertake. Though, to some extent, they may compete with the local banks, they are aware of the importance of remaining on friendly terms with them, and are not likely to abuse the hospitality extended to them. In any case, the additional business they attract to the market will more than compensate the local banks for any loss of business through their competition.

So long as the influx or efflux of capital, whether in the shape of transfer of balances, or the purchase and sale of securities, or the import and export of gold, is handicapped by legislation, the market cannot claim to be truly international. During and after the war, every country adopted a number of restrictive measures. The

removal of such restrictions is an essential condition to the development of a financial centre. Only in the market for foreign loans is the maintenance of certain restrictions sometimes a necessary evil. Although an embargo on foreign loans should only be applied in cases of extreme emergency, the authorities are entitled to retain, for considerations of public interest, a certain supervision of foreign issuing activities. As the demand for foreign loans is well in excess of the supply available for that purpose, it is essential that the market should be reserved for loans which secure, directly or indirectly, the maximum possible benefit to the lending country. It is a mistake, however, if the authorities use their power for political ends. Such an attitude is calculated to be detrimental to the international financial position of the market.

4. Even the largest possible volume of resources available for reinvestment abroad, and the best possible banking organisation, are in themselves unable to create an international financial market without the existence of an investing public able and willing to acquire and hold foreign securities. While the banks are in a position to grant short-term credits to their foreign customers, and to place privately a certain amount of long-term securities, they are, in themselves, unable to provide long-term loans on a large scale without the assistance of the general public. A loan is not well placed, unless the bulk of it is acquired by thousands of large and small investors with the intention of keeping it until maturity, for the sake of its yield, without regard to fluctuations in its market price.

While the creation of an adequate banking system for dealing with international business is a lengthy

process, it takes even more time to develop an investing public willing to acquire and hold foreign securities. Encouraging experience for generations is necessary to that end. A series of unfavourable experiences may quickly destroy the work of decades, and may make it most difficult to restore confidence.

5. The possession of a stable currency on a gold basis is the *conditio sine qua non* of the development of an international financial centre. It is essential that the currency should be stabilised both *de jure* and *de facto*, and that the system adopted should be the gold bullion standard. Although the gold exchange standard is sufficient to maintain stability, a centre claiming the lead cannot afford to base the stability of its currency on the stability of one or several other currencies. On the other hand, there is no need, from a point of view of international financial supremacy, to introduce the full gold standard with coins in circulation. Although the convertibility of notes into coins may reinforce internal confidence in the notes in countries where such reinforcement is needed, it does not in any way increase confidence abroad; in fact, it may be interpreted as a sign of inferiority. The argument that gold in circulation is a secondary reserve, upon which the central bank may draw in emergency, is most unconvincing, as experience has shown that it takes some time before the central bank is able to withdraw the coins from circulation.

It is equally superfluous to amass a huge gold reserve, well over the legal requirements. Undoubtedly, it is desirable to have a safety margin, so as to be able to resist temporary adverse influences; but the hoarding of a spectacular gold stock is as superfluous as the issue of gold coins. It will be remembered that the

Bank of England's gold reserve before the war was comparatively small, and in spite of this London was universally recognised as the world's financial centre.

What is important is that the country aiming at financial supremacy should possess a "first line of defence" to absorb the shocks delivered upon its gold reserve. This may assume the shape of short-term claims on foreign countries, either in the form of acceptance credits or balances abroad.

The amount of gold and foreign assets required for the purpose of securing the stability of a currency depends, to a great extent, upon the elasticity of the currency system, and upon the confidence of the public in the stability of that currency. The latter factor again is largely determined by the past record of the country concerned. Every currency has undergone a depreciation at one time or another of its history. There has been, however, a considerable difference in the degree to which they have been able to resist abnormal pressure. It also makes a considerable difference—not one of degree but of kind—if the currency was restored to its old parity after the crisis was over. The debasement of a currency is an experience which is not easily forgotten. Although it may be argued that such measures are only taken in extreme emergency, and that in normal conditions the stability of the currency concerned is beyond suspicion, those who trusted this argument before the war are not likely to be desirous of repeating the experience. It may take several generations before a country which has debased its currency can live down the effect of its action.

6. A financial centre aiming at international supremacy cannot be content with the possession of a

good market for foreign long-term loans. It must also be equipped with adequate facilities for short-term investment. Activity in the market for foreign loans is bound to be of a sporadic nature. It does not, in itself, secure a steady inflow and outflow of funds, which is necessary to keep the market alive, nor does it provide a sufficiently steady source of profits for the financial houses specialising in international banking. An international centre should possess a good discount market as well as a good market for call money or short loans. The existence of adequate facilities for short-term investment is likely to attract considerable funds from abroad, which are available for reinvestment. Foreign borrowers of long-term loans avail themselves of the facilities thus provided, by leaving in the lending centre the unspent balances of their loans. A good discount market or short loan market attracts substantial funds from abroad, which are available for reinvestment abroad.

While the existence of resources available for lending abroad tends to lead to the development of a market for long-term loans, it does not necessarily lead to the development of a discount market. The latter requires much more experience and technical skill, and its existence depends to a greater extent upon the habits and the mentality of bankers than the former.

7. An active foreign exchange market is also essential to an international financial centre. Foreign exchange markets and discount markets are complementary to each other, for an active discount market, which attracts foreign funds, increases the activity of the foreign exchange market; while a good foreign exchange market, enabling the transfer of funds and the covering of exchange risks at minimum costs, tends

to encourage the use of the discount market and the money market by foreign investors of short-term funds. The conditions of a good foreign exchange market are the following:

- (1) The largest possible number of foreign exchanges—both spot and forward—should be actively dealt in.
- (2) It should possess good cable and mail connections with foreign centres.
- (3) It should have banks with experienced dealers possessing a great extent of freedom of action, authorised to carry positions, and to transact large amounts.

There are several advantages attached to being a leading international financial centre. In addition to the direct profits of the banks engaged in international banking operations, there is the possibility of an increased export trade as a result of lending abroad. The country should also benefit from the acquisition of the control of foreign resources and enterprises and from the international prestige that attaches to financial leadership. Last but not least, the political influence that such a position carries is of undoubted value.

The primary motive that induces banks to endeavour to acquire or maintain the supremacy of their centre is the direct profit to be obtained through international banking operations. This may constitute an important item among the invisible exports of a country. Apart from the yield of commission on acceptance credits and on loan operations, the banks and the country benefit by the difference between the rate they pay to foreign depositors and the rate they

charge to foreign borrowers. For, as we pointed out above, in addition to lending its own resources, an international financial centre has the advantage of attracting foreign funds. It happens sometimes that it relends to the same country the amounts deposited or invested there by that country.

In itself, the direct profit obtained from international banking activity would hardly justify attaching a very great importance to it. It represents a comparatively small fraction of a nation's income. This fact is often used as an argument against any measure which appears to favour the banking community to the apparent detriment of industries—such as the restoration of the gold standard. It is often said that it is a mistake to jeopardise industrial interests for the sake of a few hundreds of brokers and bankers. Those who use this argument overlook the deeper significance of the possession of an international financial centre. In the first place, it leads to an increased export trade. We do not share the popular superstition that lending abroad must necessarily result in a corresponding increase of exports by some mysterious process which is never adequately explained by those who use this argument. The claim that the proceeds of a loan cannot be transferred otherwise than in the shape of goods can be answered by reminding that overlending leads to a depreciation of the exchange of the lender country, which again results in an efflux of gold; thus, the proceeds of loans beyond the resources of lenders may leave the country in the shape of gold. At the same time, it is undeniable that trade follows, to some extent, the trend of finance. In many cases, it is made a condition of the granting of a loan that the proceeds be spent in the lending country. In other cases, loans are

only granted to borrowers who are known to have the intention of spending a great part of its proceeds in the lending country. In some cases, the would-be exporters or public works contractors help the would-be purchaser to raise a loan in their market. The influence obtained by the lending group in the borrowing country is also often used to induce the borrower to place orders in the lending country. Lastly, the increase of the purchasing power of the borrowing country may directly or indirectly benefit the trade of the lending country.

The international banking activity of a community can also benefit the trade of that community by enabling it to acquire control of foreign enterprise. The acquisition of railways and public utility enterprises by British capital in Latin America was largely due to the international financial position of London, while their partial transfer to American hands during the last few years was largely the consequence of New York's increasing importance as a financial centre. The possession of the control over such enterprises naturally tends to influence the direction of orders.

The supremacy of an international financial centre lends the country considerable prestige abroad. This prestige tends to influence trade, and is otherwise also beneficial to those in contact with foreign business interests. International financial syndicates cannot be considered complete unless that centre is represented in them, and its representatives usually lead the group. It is difficult to imagine international banking groups engaged in important transactions under the leadership of a bank with its headquarters in a secondary centre.

As a result of the prestige and economic influence of

an international financial centre, financial supremacy has also considerable political advantages. Financially backward countries are desirous of becoming the political satellites of one or other of the leading financial countries, so as to be assured as to their requirements of financial support. In political combinations, financial strength plays, nowadays, almost as important a part as military strength. If the voice of the United States carries weight in world politics, it is not so much on account of the size of its Navy, or the potential size of its Army, as of its immense financial power. In international conferences, the word of a financially strong country carries more weight than that of a much larger, but financially weaker, country. It is often possible to obtain political advantages by means of financial transactions. A lending country usually acquires a certain amount of political influence in a borrowing country, not so much on account of past loans as owing to the anticipation of future loans.

Thus, financial supremacy is desirable, not only for its own sake, but also for the sake of its indirect advantages. In the case of Great Britain and the United States, the attraction is mainly the economic advantages involved, though political advantages are not disdained. In the case of France, financial supremacy is rather a means to political supremacy—though economic advantages are also duly appreciated. The divergence in outlook is explained by the fundamental difference between the Anglo-Saxon and Latin mentality.

The importance of financial supremacy for a country depends upon its economic structure. For countries that are largely self-supporting, it is merely a luxury. For countries which are far from self-supporting it is a

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necessity. Hence the determination with which Great Britain concentrated her efforts from 1920-1925 on recovering the lead in the field of international finance, and with which she seeks to hold this position against the competition of other countries.

CHAPTER III

LONDON'S LEAD BEFORE THE WAR

WE have seen in the previous chapter the conditions under which a financial centre may attain international supremacy. Our next step is to examine how far these conditions existed before the war in London and in its rival centres.

Until the war, London's position as the world's financial centre was beyond question. All other financial centres—Paris, Brussels, Amsterdam, Berlin, Zurich, and New York—were incomparably inferior, and were not considered seriously as London's rivals. Paris was fairly active as a market for international loans, but her significance as an international money market was comparatively small. She had no discount market, and, though officially on a gold basis, had no free gold market owing to the traditional reluctance of the Bank of France to part with gold. Brussels was an active financial centre, and the part it played in international finance was out of proportion to the relative importance of Belgium. The same may be said of Amsterdam. In both these centres, as well as in Paris, money rates were usually lower than in London. In spite of this, they did not develop as international markets. London usually acted as intermediary between these markets on the one hand, and New York and Berlin on the other, as in the latter centres money

rates were, as a rule, higher than in London. Switzerland, like Amsterdam, owes the development of its international finance market to war and post-war conditions. Before the war, the importance of both these markets was comparatively small. As for Berlin, during the last pre-war decade, it rose to some importance as a capital market, especially for Central Europe and the Near East, but as a money market it was in some ways second even to Frankfort-on-Main, and played a subordinate part in international relations. The New York financial market, though it was reaching the stage when it began lending as well as borrowing, was comparatively primitive.

The undoubted pre-eminence of London in the domain of international finance was due to the following circumstances:

(1) Great Britain possessed immense resources in the shape of external investments representing the accumulation of favourable trade balances during many decades. The amount of British capital invested abroad before the war was estimated at about £4 milliards. These investments were being constantly turned over, and the redeemed amounts were being reinvested abroad. Even if British external resources had been stationary, their administration would have, in itself, kept London's financial market moderately busy. But the external resources were far from stationary. There was, almost every year, a surplus of visible and invisible exports over visible and invisible imports, which was invested abroad. The exchanges tended to be mostly in favour of sterling, which, together with the control of the South African gold supply, made it possible to maintain a low Bank Rate and to grant loans on comparatively favourable terms.

Apart from its permanent external investments and current export surplus, London had also the task of reinvesting considerable amounts lent by foreign capitalists to this country. British Government bonds and other securities were always regarded as a favourite investment abroad. Great Britain was considered the safest country to invest in, and capitalists in countries where political conditions were not altogether stable made it a rule to keep part of their wealth in London. There were also large amounts of temporary foreign balances held in London, though perhaps not on the same scale as after the war. The London discount market, about which more will be said below, attracted considerable foreign funds seeking temporary investment.

In addition, the comparatively large volume of the foreign trade of Great Britain provided the international banks established in London with a fair amount of business. Being probably the least self-sufficient country with a high standard of living, Great Britain's imports were always very heavy. She had also an active transit trade which was financed in the London market.

(2) A second condition of financial supremacy is the existence of an adequate banking organisation. In this respect London occupied a unique position before the war. She possessed a large number of old-established banking houses, with traditions of international banking, a sound experience extending in some cases over two centuries, and a highly valuable goodwill, represented by their first-class reputation all over the world. As London had a larger banking turnover than any other financial centre, its banks could afford to work on a basis of a narrow margin of profit. As its

banking houses specialised in various branches of activity, and as they had old-established connections with reliable foreign houses, the risk attached to their work was relatively slight. The superiority of the technical equipment of London as a banking centre before the war is too well-known to require repetition. In addition, the London bankers possessed something which cannot be expressed in figures, but which is more important than any of the concrete factors, and that is the right mentality required for international banking. Although far from being speculative, they were prompted by a keen pioneer spirit and were anxious to break new ground. Before the war, no country possessed such an extended network of bank branches and subsidiaries in foreign countries as Great Britain. The merchant banks had customers even in the remotest countries. Thanks to their experience and good sources of information, they were able to select their customers among the best commercial houses of a country, so that the risk attached to dealing with countries where conditions were far from stable was more apparent than real.

Moreover, the London banker always possessed a faculty for quick decision, and allowed wide scope to the initiative of his senior officials, which largely facilitated business in the domain of international banking.

(3) A free international market is another condition essential to international supremacy. In this respect, London easily held the lead before the war. Her financial market has always been characterised by an essentially liberal spirit, which may be due, to some extent, to the British tradition of Free Trade. This spirit of freedom manifested itself, in the first place, in the hospitality with which branches of foreign

banks were welcomed in London. There were no legal restrictions on their establishment, and no direct or indirect compulsion was brought to bear on them to induce them to register themselves under British law. They also had complete freedom in selecting their personnel, and they enjoyed an equal treatment as to taxation. They were at liberty to transact business of every description. In fact, they held a very strong position in the foreign exchange market; they granted acceptance credits; they participated occasionally in the issue of loans; they were very active in arbitrage of every kind, especially bullion arbitrage. There was nothing in law to prevent them from accepting deposits—a branch of activity reserved in many countries for banks of their own nationality.

The only differentiation against foreign branches was that they were not admitted for membership in the Clearing House. But in this respect Colonial Banks, Exchange Banks, and merchant banking houses were in a similar position, so that it cannot be regarded as a measure specially devised to handicap foreign branches. Another point in which they were in a less favourable position than British banks was that they did not enjoy rediscount facilities, and their acceptances could not be discounted with the Bank of England. Apart from that, there was no handicap to their activity, either in law or in practice. Although they were, to some extent, competitors of British banks, the latter did not regard them as intruders. They fully realised the extent to which foreign bank branches contributed to the development of London as an international centre.

There was also complete freedom for the employment of foreign subjects in British banks, and for the

establishment of private banks by foreigners. Although, in some quarters, this freedom is criticised from a political point of view, it has certainly contributed to the development of a thoroughly international spirit in the London market, and has given London several prominent banking families.

As regards dealings in exchanges and the international transfer of funds, there were no restrictions whatsoever in London before the war. In this respect, however, most centres were in an equally favourable position, for exchange restriction is a war-time and post-war invention. Where London was superior to some of her rivals, especially Paris, was in the essentially non-political character of the lending policy of her financial market. While in Paris the authorities often took a hand in preventing certain loans and in encouraging others, for considerations of a political nature, in London the principle of *laissez-faire* with regard to the issue of foreign loans was never questioned. An occasional hint was given by the authorities, but it was not stressed sufficiently to interfere with freedom of action.

The point, in respect of which London was incomparably superior to any other centre, was in the absolute freedom of her gold market. The Bank of England followed a policy of strict neutrality towards gold movements, and did not, in any way, interfere with the free working of the gold standard. It was in a position to pursue a liberal policy because of the huge external reserves of the country and the steady supply of South African gold which came to the London market, and upon which the Bank had first call. While in other countries the export of gold was very often hindered, and the import of gold was very often stimu-

lated, in London, gold movements were allowed to take care of themselves. The only way in which the Bank of England influenced them was through the normal manipulation of its rediscount rate.

(4) Another condition to which London owed her pre-war supremacy was the existence of a large and wealthy class of investors who were willing to take up and hold foreign securities. Having been accustomed to invest in the Colonies, British investors found it comparatively easy to acquire a taste for investment in foreign countries. Pre-war experience encouraged them to do so, for the amount of losses suffered from foreign investments was, on the whole, small. Thanks to the conservative policy of discrimination of the well-established London issuing houses, the class of securities placed in this country was generally good, and the risk was not, therefore, unreasonable.

Moreover, London had the great advantage of possessing a unique class of investors—the investment trusts, which, before the war, were an exclusively British institution. The large resources they controlled, and their highly intelligent management, had made them into a very important factor in the financial market. In addition, London being the principal insurance centre of the world, had a number of big insurance companies with huge reserves to invest.

(5) A stable currency which is above suspicion is one of the most important conditions of financial supremacy. In this respect, too, London was at an advantage as compared with her pre-war rivals. Sterling had a longer tradition of stability than any other currency. It was regarded as absolutely safe in every part of the world, and was considered as the stable international means of payment *par excellence* not only in

civilised countries, but even in primitive countries. Such was the confidence in sterling that British banking houses, when granting long-term loans to foreign borrowers, never considered it necessary to insert in the contracts the so-called "gold clause", meaning that the loan was repayable in terms of sterling and not in terms of gold. This was because the pound was always considered as being synonymous with a fixed quantity of fine gold.

It is necessary to emphasise that this confidence in the stability of sterling was not acquired by means of possessing a huge gold reserve. The Bank of England's metallic stock was small in relation to the immense volume of international banking business transacted in London. It was smaller than the reserve of the Bank of France, and the amount of gold coin in circulation was also smaller than that of France. Confidence in sterling was inspired by the British traditions of integrity in finance, and by the existence of a large "secondary reserve" in the shape of foreign securities and short-term claims.

(6) The possession of a good money market, in the broader sense of the term (including a market for call money, short-term loans, and a discount market), is also one of the essential conditions of supremacy. In this respect, London's superiority before the war is a matter of common knowledge. Thanks to the existence of well-established discount houses and bill brokers, the London market provided unequalled facilities for short-term borrowing and lending. Its bill market was unique. No other centre even attempted to compete with the London market, and the sterling bill was regarded as a universal means of payment in international trade.

The large turnover of the bill market and the narrow margin between buying and selling rates provided a guarantee to both buyers and sellers of bills that they would be able to obtain a fair rate. The freedom of the gold market provided a guarantee as to the withdrawal of their funds from London.

(7) An international centre has also to possess a good foreign exchange market. In this respect, pre-war London left much to be desired. The number of foreign currencies quoted was comparatively small, and the houses actively engaged in foreign exchange business were few. In this respect, London did not take full advantage of her favourable position, and there was ample scope for future expansion. Her geographical position, her excellent mail connections, the large volume of her foreign trade, and her foreign banking activities, contained the elements of the development of her foreign exchange market, which was, however, handicapped by the extensive use of sterling as an international means of payment. This was, of course, an advantage from the point of view of London's international importance, but tended to reduce the activity of her exchange market.

Let us now examine the conditions of pre-war Paris. She was undoubtedly second in importance to London, but lagged far behind London and did not make any serious effort to develop into a dangerous rival.

(1) Although France possessed large capital resources, and was the second largest foreign investor before the war, her foreign investments were much smaller than those of Great Britain. Her export surplus was also inferior, and so was the volume of her foreign trade. Being a self-supporting country to a much greater extent than Great Britain, France did not require nearly

as much banking activity in connection with her foreign trade, including transit trade, as Great Britain. The amount of foreign funds invested in France and available for reinvestment was also smaller than in Great Britain. French securities were quoted in some foreign markets, but were not acquired as investments to any great extent outside France. Paris had no extensive discount market, and her money market did not attract any foreign funds because interest rates were usually low.

(2) Although Paris possessed a number of well-established banks, her banking organisation, from the point of view of international finance, was decidedly inferior to that of London. Owing to the popularity of the habit of hoarding, banking resources were comparatively small. Specialisation was not developed to the same extent as in London. The mentality of the French banker was also unsuitable to development in an international sense. About this more will be said in Chapter VI., dealing with post-war conditions.

(3) The principle of freedom of the financial market was not developed to the same extent as in London, and the French Government did not adopt an attitude of non-interference with banking activity. Although the movement of funds was as free as in London, lending abroad was largely influenced by political considerations. The disadvantages of this influence did not manifest themselves greatly until the war. Where Paris was at a great disadvantage as compared with London was in respect of the freedom of the latter's gold market. The Bank of France pursued a policy of gold accumulation, and to that end it was liable at any time to make use of its right to pay out silver instead of gold, and to encourage gold imports

by the payment of a premium over and above the legal buying price.

(4) As to the investing public, Paris was in a very favourable position. Thanks to the thrifty habits of the French middle classes and rural population, there were large resources always awaiting investment. French *rentiers* were willing to acquire foreign securities and provided good material for the issuing activities of French banking houses. It was probably the lack of a sense of discrimination amongst this class of small investor that encouraged the issue of types of foreign securities which, already before the war, led to unfavourable experiences and which resulted in huge losses to the French investing public after the war.

(5) The French franc enjoyed a high degree of confidence before the war. The fact that the Franco-Prussian War of 1870-1871 did not bring about any spectacular depreciation of the currency tended to increase this confidence. The connection of the franc with other currencies, through the Latin Monetary Union, was also a factor of some importance. At the same time, it is impossible to overlook the fact that in France confidence in the franc was not as strong as confidence in sterling was in Great Britain and in foreign countries. Thus the majority of foreign loans issued in France were issued in terms of "gold francs", and this suggested that French banks had no absolute certainty that the franc would always mean gold. But this qualification of the confidence in the franc was not sufficiently pronounced to interfere with the international position of Paris.

(6) The Paris money market was fairly active and was essentially a lending market owing to the low rate

of interest prevailing there. On the other hand, a discount market was non-existent, from an international point of view.

(7) The Paris foreign exchange market was perhaps more active than London, especially as far as dealings in Continental currencies were concerned.

Let us now turn to New York. Before the war that centre was too occupied in financing the interior economic expansion of the United States to pay much attention to the development of an international market. Further, until a few years before 1914, the United States was one of the principal borrowers in London and in other European markets. Although she had been participating to some extent in the issue of foreign loans, she did not claim to be a rival to London.

(1) Prior to 1914, the capital resources of the United States, available for lending abroad, were comparatively very small, and the willingness to lend abroad was slight. After all, there was a great deal to do at home, and all the available resources were required for domestic purposes.

(2) The banking organisation of New York was built essentially for financing domestic trade. As the demand for domestic financing was much in excess of the supply of facilities, it was not the ambition of the New York banks to develop their international activities to any great extent. They had absolutely no tradition of international banking, and the mentality of the average New York banker was anything but international.

(3) In the circumstances, there was little advantage in the freedom of the international market of New York, which in any case compared unfavourably with the freedom of London.

(4) As to the willingness of the American investing public to acquire foreign securities in pre-war days, it was practically non-existent. Most people possessing capital were financing their own business with all their available resources, and if they acquired any securities these were usually American stocks with a promise of capital appreciation.

(5) The dollar did not play a substantial part as an international means of payment. As the banking system, prior to the adoption of the present Federal Reserve System, was inadequate and subject to periodical crises, confidence in the stability of the dollar in foreign countries was not altogether strong enough for the requirements of an international centre.

(6) The New York money market was a persistently borrowing market, and, as such, played no active part in international finance.

(7) As for the foreign exchange market it was comparatively undeveloped, even for pre-war days.

It is thus obvious that, before the war, both Paris and New York were much inferior to London as international financial centres. The difference was very marked, especially in the case of New York. In normal circumstances it would have taken several decades before either of them could have developed to a sufficient extent to threaten London's supremacy. Owing to the abnormal war and post-war conditions, however, they underwent an unexpectedly rapid development, which will be dealt with in later chapters.

CHAPTER IV

LONDON AFTER THE WAR

WAR and post-war conditions have radically changed the international financial position of London. Although in most respects they have affected it adversely, from certain points of view, the international financial market of London has benefited by the change. The scope of this chapter is to compare the present with the pre-war position.

(1) The amount of British capital resources invested abroad underwent a considerable decline during the war. The American securities, which were a substantial item on the list of British holdings of foreign securities, were called in by the Government, and used for the support of sterling in the United States. Other blocks of securities found their way to the United States by sales in the open market or by agreements between British and American interests. This was recently the case with regard to British holdings of public utility enterprises in South America. The existence of British Government indebtedness to the United States Government has scarcely reduced the net amount of British investments abroad, as it is balanced by British claims against Germany and against the Allied countries.

The amount of foreign funds invested in Great

Britain is probably higher than it was before the war. The adoption of the gold exchange standard in many countries has resulted in the acquisition of sterling balances by a number of foreign central banks. Considerable amounts of British securities have been acquired on American account. The London discount market provides as strong an attraction for foreign funds seeking temporary investment as at any time in the past.

The volume of British foreign trade is larger than it was, and requires a large amount of financing. If, as seems possible, Protection is introduced, it will tend to reduce the volume of foreign trade, and to that extent the amount of activity originating from foreign trade will diminish.

The trade balance (including invisible items) still continues to show a surplus of exports over imports amounting to about £150 millions per annum, and the reinvestment of that amount provides London's banks with some international banking activity.

(2) The banking facilities of the international financial market of London have greatly improved since pre-war days. The amalgamation of commercial banks has resulted in the creation of banking units of unprecedented magnitude, with immense resources. While, before the war, clearing banks were not particularly active in the domain of foreign banking, at present they devote a considerable part of their attention and their resources to foreign business. Although it is open to argument whether this development is desirable from the point of view of financing home trade, we are concerned here with the international position of London, and from that point of view the change is certainly to the good. The capacity

of London for dealing with foreign business has, indeed, increased to no slight extent. In addition to the banking houses which specialised in foreign business before the war, there are now the foreign departments of the Joint Stock Banks. The war did not affect in any way unfavourably the international spirit of the London banking community. It has not forgotten anything of its pre-war knowledge, and has gained additional experience, while its technical equipment has decidedly improved.

(3) As a result of the war, the spirit of *laissez-faire* could not help, to a certain extent, losing ground. During the war the property of German banks established in London was sequestrated and their branches were closed, and for some years after the war there were restrictions against their reopening. These restrictions, however, have been removed, and at present the market is as free for the establishment of foreign banks as ever before.

Whatever may be the notions of bankers about Free Trade and Protection, they are almost unanimously liberal, as far as the freedom of the international market of London is concerned. There is no hostility towards any foreign bank established in London, and the post-war period witnessed the establishment of a number of new foreign branches. On the other hand, the German branches, which were closed during the war, have not been reopened, but this has not tended to reduce the volume of international business transacted in London, for the German banks which had branches here in pre-war days work to a great extent through English banks and financial houses.

Great Britain was one of the first countries to remove every kind of restriction on exchange opera-

tions and on the international transfer of capital. At present, the situation in this respect is exactly the same as it was before the war. Admittedly, there is still an unofficial embargo on foreign loans which is detrimental to the freedom of the market. This, however, does not place London at a disadvantage as regards other centres, for, in both France and the United States, the issue of foreign loans requires the consent of the authorities, which amounts to the same thing as the unofficial embargo in London. Nevertheless, it is desirable to do away with this restriction as soon as circumstances permit, for its existence is detrimental, both from a point of view of prestige as well as from a point of view of practical business. If her rival centres precede London in this respect, it would weaken her international position.

The freedom of gold movements was restored in 1925 and has been maintained, both in law and practice, ever since. In spite of the comparatively narrow margin of its gold stock, the Bank of England has pursued a policy of non-interference with gold movements. The South African gold supply has provided an independent source for those wanting to withdraw gold from London: although there has been a certain amount of Press criticism against withdrawals from the Bank, this should not be interpreted as being detrimental to the freedom of the gold market. These criticisms were directed against the hoarding of gold by certain central banks, and were inspired by considerations of international interest rather than by questions of the convenience of the London market. Moreover, even in New York, gold movements of this kind met with similar criticisms, in spite of the superiority of the American gold reserves.

(4) The British investing public suffered considerable losses on its foreign investments during and after the war. Holders of Russian securities lost their capital completely, while the holders of Turkish, Bulgarian, Austrian, etc., securities had to consent to considerable reductions in value. Inflation in several countries, especially in Germany and France, has also caused substantial losses to British investors. In spite of these losses, however, the willingness of the British public to acquire foreign securities has not diminished to any great extent. Although, for the moment, there is no demand for foreign securities, this is due to temporary world-wide causes, and not to causes peculiar to the London market.

With its large number of investment trusts and insurance companies, which have increased their resources since pre-war days and are willing to acquire foreign securities, the London market continues to have a good background for its international issuing activities.

(5) As to the stability of sterling, pre-war conditions have been fully restored. Although during and immediately after the war sterling underwent a fairly considerable depreciation, the decline of its value was much less pronounced than that of the currencies of any other European participant in the war. The range of its fluctuations between 1919 and 1925 was much narrower than that of any other European currency, with the exception of the Swedish, Swiss, and Dutch exchanges. Since 1925, when the gold standard was restored, the movements of sterling have been limited by the gold points. Although the gold points are somewhat wider than before the war, and are liable to much more frequent and pronounced changes than in pre-

war days, this factor affects every currency, including the dollar. In any case, the range of possible movements is, for most exchanges, rather less than one per cent, which can hardly be considered abnormal. Since the restoration of the gold standard, sterling has undergone some rather severe tests. In 1926 there was the General Strike and the Coal Strike, while in 1929 there was exceptional pressure upon the exchange on account of the westward movement of funds caused by the Wall Street boom. The pound sterling has, however, stood the test, and there was never, for a moment, any danger of a suspension of the gold standard.

In spite of this, rumours are circulated from time to time on the Continent as to the possibility of a departure of sterling from its gold basis. It would be superfluous even to notice these rumours, but for the persistence with which they reappear. There can be no question of any departure of Great Britain from the gold standard. Although its gold reserve is not nearly as big as that of the United States or France, it still has, on the other hand, the largest holding of foreign securities which may be considered as a kind of secondary reserve to the currency; and though they cannot be converted into foreign exchanges and mobilised in defence of sterling at short notice - for the simple reason that they are owned by individuals and not by the monetary authorities—in practice, persistent adverse conditions usually result in the selling of part of the British holding of foreign securities to foreign buyers.

Another reason why a departure from the gold standard is most unlikely is that in practice the gold reserve is no longer considered as security for the internal note circulation and is available to a greater extent than

ever before for the purpose of meeting international requirements. The Bank of England is prepared to allow a considerable decline of the gold reserve if it is brought about by an adverse trend of sterling. Moreover, the British monetary authorities can always rely upon support from the American monetary authorities, if necessary, in order to protect sterling against some abnormal adverse factor. The American authorities are fully aware of the international importance of maintaining the gold standard in Great Britain, and would not spare efforts to that end. Thus it is obvious that, taking a short view, the safety of sterling can be subject to no question.

As to the prospects of sterling, in the long run (meaning thereby a period of several decades), the best answer to any doubts would be to point out that, in spite of the great upheaval of 1914-1918, sterling was restored to its pre-war parity at the cost of heavy sacrifice. For this reason it is most unlikely that circumstances should arise in which sterling would be abandoned to its fate, like some other European currencies. The confidence of British banks and the British investors in sterling is duly illustrated by the fact that, notwithstanding the experience of the war, foreign loans issued in London continue to be expressed in terms of pound sterling and not in terms of "gold pound". While in France, every loan is now expressed in terms of gold francs, and in the United States, foreign loans are expressed in terms of dollars "representing the present weight and fineness of gold" of that currency, in Great Britain it is considered superfluous to add the word "gold" to sterling. This was the pre-war practice, and this has remained the uninterrupted practice since 1914.

(6) The facilities of the London money market and discount market are at least as good as, if not better than, in pre-war days. Although sterling does not enjoy any longer the monopoly it enjoyed before the war, it is none the less the chief international means of payment. The competition of New York, Paris, and other centres has not diminished the volume of business in the discount market, and short-term Treasury bills have become as popular a form of investment as fine bank bills. Possibly discount rates are more sensitive to international influences than before the war, but this again is by no means peculiar to the London market; it is a world-wide phenomenon, due to the abnormal international movements of funds.

The activity of the money market, from an international point of view, has increased as compared with pre-war days, and a considerable market has developed in short-term loans or deposits, expressed in terms of foreign currencies. It is now possible to lend or borrow in London in terms of dollars or reichmarks with the same facility as in terms of sterling.

(7) In the foreign exchange market developments since the war have been decidedly favourable. Although the present volume of activity in the London market is only a fraction of the corresponding figure of a few years ago—this being due to stabilisation which has ended speculation in many foreign exchanges—a comparison of the table of foreign exchange quotations published in the daily Press with a pre-war table is sufficient to indicate the extent to which the market has expanded. The number of quotations is several times as great as in pre-war days. Almost every currency in the world is quoted in London. Moreover, an active market has developed in the forward quota-

tions of the principal exchanges. It is an opinion shared by most impartial foreign experts that the London foreign exchange market is the largest and best in the world. In Europe, it is practically the only market which deals regularly in South American and eastern currencies, and it has the monopoly of British Dominion currencies. It is the best market in Europe for dollars and a number of European currencies. Although its activity in some of the eastern and south-eastern European currencies is inferior to that of Paris or Zurich, the total volume of foreign exchange activity is probably higher than in any other market. This is largely due to the fact that dealers in London are allowed a comparatively free hand to carry positions. While most banks in Paris or other Continental centres would not quote firm dealing rates for considerable amounts, in London it is possible to obtain firm rates even for amounts of several million dollars. For this reason, if a Swiss bank, for instance, wishes to buy dollars, it approaches London in the first place, in spite of the proximity of Paris or Berlin.

We have seen above that, notwithstanding the changes brought about by the war, London is still in possession of the facilities to which she owed her financial supremacy in pre-war days. If her supremacy is no longer uncontested, this is not due to any decline of the London market, but to the more rapid progress of the two rival centres. In international loan operations of any considerable size it is difficult to form a financial group without the participation of London banks. London is still the Mecca of all would-be borrowers, whether they require long-term loans or short-term credits. The monetary policy of the Bank of England is still of decisive importance in shaping the

monetary policy of other countries. To give only one example, it was the restoration of the gold standard in Great Britain that induced practically all advanced countries to return to a gold basis. There is no doubt that had the British authorities chosen to adopt a managed currency their lead would have been followed by a large number of other countries. The fact that Great Britain did not reintroduce gold coins in circulation is largely responsible for similar decisions by practically all the other central banks. From the point of view of prestige it is not considered derogatory to any country not to possess an active gold coin circulation so long as Great Britain is satisfied with the gold bullion standard without any issue of coins. The Bank Rate decision of the Bank of England is often taken for guidance by a number of Continental banks. Tendencies in the price level in Great Britain greatly affect the tendencies of the world price level. The trend of the London discount market determines discount rates in other markets, while the London foreign exchange market takes the initiative in changing tendencies of exchange rates probably more often than any other market.

CHAPTER V

NEW YORK AFTER THE WAR

FROM a financial market of hardly more than local importance, New York has developed, almost overnight, into an international financial centre of first rate magnitude. This was the result of the accumulation of wealth in the United States during the war. Apart from having acquired a large part of the American securities issued in Europe before the war, the United States has become the creditor of practically every European nation. A considerable part of the gold stock of European countries was shipped to New York during and after the war. Without having originally any ambitions to develop into an international financial centre, New York has attained that end by the force of circumstances. *L'appétit vient en mangeant*. Once American finance became conscious of its immense power, it endeavoured to make use of it and to increase it. As the result of the fluctuation of European currencies, the dollar became, during and after the war until 1925, practically the only stable currency. As such it was adopted more or less as a universal means of payment in place of sterling. American financial interests have endeavoured to retain this position for the dollar, even after the stabilisation of sterling. To that end, considerable efforts have been made to develop a discount market in New York.

Let us try to determine how far the war has changed the essential factors affecting the international financial position of New York.

(1) The capital resources of the United States invested abroad attained a fantastic figure during and after the war, a considerable part being represented by Allied debts. The annual amount obtained in interest and redemption is a most important item in the balance of payments of the United States. It is largely responsible for the surplus of visible and invisible exports over visible and invisible imports which has been shown almost every year since the beginning of the war. This amount has to be reinvested in some form abroad, and provides New York with a fair volume of international banking activity. Owing to the situation of the trade balance, the United States had to develop as an international centre.

In addition to the formidable resources owned by the United States in the shape of claims on foreign countries, she is also in a position to reinvest the foreign capital that has been imported into the United States. During the boom, American industrial, railway, and public utility shares have become favourite investments all over the world, and, although the United States is a large creditor of the rest of the world, at the same time, other countries have acquired counter-claims in the shape of holdings of American securities. These holdings have been considerably reduced since the Wall Street slump, but are believed still to represent an important figure.

Apart from the foreign capital invested in securities, large amounts of foreign funds were at one time invested in New York in the shape of large deposits or brokers' loans. During the boom, when the rate of

interest paid on brokers' loans attained a fantastic figure, immense amounts of liquid funds were attracted from every country; but since the slump these funds have been withdrawn. On the other hand, the amount of foreign deposits held by American banks is believed to be still substantial. The New York discount market does not seem to attract any foreign capital, apart from the dollar-bill holdings of foreign central banks. The authorities do not seem to encourage the investment of foreign short-term funds in New York. In fact, there is a special tax on interest earned by foreign corporations. It is obvious that, from the point of view of funds available for investment or reinvestment abroad, New York easily holds the lead over London or any other financial centre.

(2) The banking system of New York has adjusted itself to a very great extent to changed requirements. While, before the war, it was equipped mainly for domestic financing, after the war it developed an organisation to deal with international business. As in London, so in New York, the amalgamation of commercial banks has resulted in the creation of huge banking units with immense resources. Although the principal task of these banks remains the financing of home trade, they have also developed foreign departments. The financial houses have also taken up a great deal more foreign business than before the war. It is stating the obvious to point out that the American banker and his staff lack tradition in international banking and experience to deal with international transactions. Such experience cannot be acquired overnight, and must necessarily be a slow development. It is unquestionable, however, that considerable progress has been made in this direction during the last

few years, thanks largely to the immigration of many European bankers. The American banker is at a disadvantage in international competition in the margin of profits he requires. Overhead charges are higher in New York than in any other centre, and banks there are accustomed to substantial profits on domestic banking business. They are reluctant to work for the same narrow margin as their European rivals. This does not mean that it is an easy task to defeat American bankers in a rate-cutting contest. If it comes to that, they are prepared to work without any profit or even at a loss in the field of international business, and to make up for their losses in the field of domestic business.

(3) The freedom of the financial market of New York leaves little to be desired. No obstacles are placed in the way of the establishment of foreign branches, although it is more advantageous to establish subsidiaries registered under American law, in order to be able to transact certain types of business from which foreign branches are excluded. In many cases, foreign banks have both a branch and a subsidiary in New York. The existence of important foreign colonies of various nationalities assists the development of foreign branches, as it provides them with a certain amount of steady business. There is, further, no restriction whatsoever on foreign exchange transactions or transfer of funds. The issue of foreign loans, on the other hand, is subject to the approval of the State Department, which occasionally interferes to no small extent with the freedom of the market. From time to time violent campaigns are launched by politicians and the Press against lending abroad, or to Europe in general, or to one country in particular. This interferes in practice with the freedom

of the loan market, for the investing public of the United States is easily influenced by such propaganda.

The gold market is, of course, entirely free, which is only natural considering the size of the gold reserve. At the same time (as was pointed out in the previous chapter), in cases of heavy gold withdrawals for destinations which are not approved, there is a fair amount of adverse Press criticism.

(4) The principal weakness of the international market of New York lies in the absence of an adequate investing public for foreign loans. During the last seven years or so, bond-selling houses spared no effort to educate the American investor to appreciate the advantages of investing in foreign bonds. Through applying every device of their highly developed art of salesmanship they succeeded, between 1923 and 1928, in placing a formidable amount of foreign bonds of every description with the American public. The experience of the last two years, however, has proved conclusively that it was premature to rejoice over their triumph. As a result of the Wall Street boom, ninety-nine out of a hundred holders of foreign bonds sold out in order to be able to buy shares. The major part of the bonds placed in the country, at the cost of considerable efforts and sacrifices, in the course of four or five years, found its way back to the New York market in the course of a few months. Large amounts were sold back to Europe, as their depreciation made their yield attractive to the European buyer. At present the bond-selling houses are congested with foreign bonds, which paralyses their activity and prevents them from participating in new issues to any great extent. Thus, notwithstanding the immense amount available for investment abroad, the international banking

activity of New York has rather narrow limits, at any rate as far as the issue of long-term loans is concerned.

The New York market itself is well aware of this shortcoming. Even during the most feverish activity of foreign issues, its financial houses were anxious to create a market for the bonds in other countries. A portion of almost every foreign dollar loan was issued in the smaller Continental financial centres, such as Amsterdam, Switzerland, and Stockholm, while for years great efforts have been made to place dollar bonds privately in Great Britain.

While the lack of experience of American bankers in foreign business will undoubtedly be overcome in the course of time, there is very little hope that the reluctance of American investors to acquire and hold foreign securities can be entirely overcome in the lifetime of this generation.

(5) The stability of the dollar is certainly above suspicion. Indeed it occupies at present a similar position to that of sterling before the war, and it is difficult to imagine any circumstance which could bring about a depreciation of the dollar in relation to gold. Nothing but a calamity of immense dimensions could have such effect.

(6) The New York money and discount markets have undergone considerable expansion since the war. From an international point of view, only the market for brokers' loans is of special significance. As pointed out above, the Wall Street boom resulted in the transfer of large amounts of foreign funds into New York for brokers' loans. There has, however, been no steady flow of foreign funds after the experience of last year, and it is doubtful whether the same phenomenon will repeat itself on a similar scale. On the other hand, the

leading banks are fairly active as lenders and borrowers, to and from abroad, in terms of dollars, which is a steadier activity than that provided by the market for brokers' loans.

As it is obvious that international financial supremacy cannot be obtained by a centre unless it possesses a good discount market, certain American banking circles have endeavoured to develop the New York discount market. They formed an institution called the "Acceptance Council", whose task was to encourage the use of acceptance credit by means of propaganda. At the same time, firms similar to the discount houses of the London discount market were established. How far these efforts were responsible for the development of the New York discount market is difficult to ascertain. It has undoubtedly made spectacular progress as far as amounts are concerned. There is reason to believe, however, that the quality of the bills is inferior, from an international point of view, to that of the bills circulating in the London market. Thus while in London no acceptance credit is granted to finance home trade, in New York a fairly large proportion of bills are drawn on such credits. What is more important is that in New York there has been a tendency to encourage rather than to discourage the use of finance bills. The market in promissory notes, called commercial paper, is of entirely local importance and does not attract any foreign funds.

(7) The New York foreign exchange market has made good progress since the war. Thanks to the establishment of cable and telephonic communications with a number of centres, its activity has greatly increased. It has an active market in Canadian and South American exchanges, as well as in Far Eastern

exchanges. The increasing tendency to establish direct relations between foreign centres and other American centres is, of course, detrimental to the New York market.

If we compare New York with London, we find that both centres have advantages over one another. The resources of each are very large. Taking their foreign security holdings—apart from political debts—London still holds the lead, while, if we include political indebtedness, London is a close second to the United States. As far as current resources, represented by the surplus of trade balance, are concerned, the United States has the advantage over Great Britain. On the other hand, it is reasonable to assume that there is a steadier flow of foreign capital for investment in Great Britain than in the United States, and this is available for reinvestment abroad. As a banking organisation, the superiority of London—from the point of view of international business—is unquestioned. At the same time, it ought to be recognised that New York is making progress in that direction. In certain respects New York has already equalled London, while in others the discrepancy is likely to disappear sooner or later. In some fields, however, London will always be superior. As to the freedom of the market, there is very little to choose between London and New York. With regard to general confidence in the stability of the currency, New York has again the advantage, although, as was pointed out in the preceding chapter, fears as regards sterling are unjustified. It is quite probable that in the course of the next few years those who doubt the stability of sterling will be convinced by facts that there is nothing to be afraid of. As to the attitude of the investing public towards foreign bonds, New York is

incomparably inferior to London and presumably will remain so for a very long time. With regard to the market for short-term funds, the superiority of London is also beyond doubt; but there is a possibility that New York will reduce the discrepancy. In the foreign exchange market, New York does not even attempt to vie with London.

The conclusion that is likely to be drawn by an impartial observer is that New York has not superseded London as the world's banking centre, and is not likely to do so. Although it is a natural and legitimate ambition on the part of the wealthiest nation in the world to endeavour to be first in regard to everything, those responsible for the financial policy of the United States are not likely to devote much energy towards the development of the international aspects of the New York market. The fact that, so far, the intense propaganda conducted in favour of abolishing the tax on interest earned by foreign funds has failed to produce any result is, in itself, a proof that the authorities in the United States are not anxious to support those endeavours.

CHAPTER VI

PARIS AFTER THE WAR

THE war has affected the international position of Paris far more than that of London. As a result of the default of many of France's debtors, her external resources became depleted to a great extent after the war. Although French capital was exported on a large scale after the war, its export assumed the shape of a flight from the franc—a process hardly encouraging to the development of Paris as an international banking centre. In fact, from a lending nation France became a borrowing nation during the post-war period until about 1927, which, in itself, ruled out the possibility of maintaining an active international financial centre. There were other disqualifying factors; the franc underwent a sharp depreciation between 1919 and 1926 and fluctuated within very wide limits. It was, indeed, the most speculative exchange during the post-war period of foreign exchanges gambling. For several years, the franc was at the mercy of international speculation. A number of exchange restrictions and embargoes on the export and import of securities were adopted, and it was only quite recently that the last of them was removed.

This does not mean that during the dark days of inflation France had given up altogether the idea of in-

ternational financial expansion; in fact it was precisely the developments during that period that prepared the way for the spectacular recovery Paris made after the stabilisation of the franc. A considerable amount of French capital was exported, some of it without authorisation, to escape the effects of the depreciation of the franc, while some of it was exported in pursuance of a systematic policy of expansion. In spite of the depreciation of the franc and of bad financial conditions, the French Government and industrial and financial interests pursued an ambitious policy of expansion which had a strong political flavour. They endeavoured to establish themselves in countries which were in the French political sphere of influence, such as Poland, Roumania, Yugoslavia, etc. Far more important than this export of capital was the unauthorised flight from the franc. Large amounts of French funds took refuge in foreign centres, and since the franc was stabilised their owners have repatriated these funds. As a result, the Bank of France, through whose hands all these transactions passed, has accumulated an immense volume of foreign exchange reserves.

(1) As regards the present position of France's external resources, it is essential to differentiate between long-term and short-term credits abroad. We have already pointed out that the former have suffered a marked decline as a result of the complete or partial default of France's debtors. At the same time, there has been a spectacular increase in French short-term claims against other countries. The total of French investment abroad has probably been substantially inferior to the pre-war total. Owing to the unusually large proportion of short-term investments, however, the monetary importance of French capital invested

abroad, from the point of view of international banking, has very greatly increased. Long-term investments, it is true, have to be turned over from time to time, while the amounts received for interest and redemption have to be reinvested; but this is a gradual process. On the other hand, the whole amount of a liquid balance is available, at any given moment, for reinvestment abroad and represents a potential source of issuing activity. Moreover, liquid balances are more liable to frequent changes, such as transfers from one centre to another, or from one type of investment to another, than long-term securities.

The real significance of the French balances has consisted, however, not so much in the actual and potential volume of activity they have supplied to the French financial centre, as in the potential danger they have represented to international monetary stability. The shifting of these funds may tend to disturb the foreign exchange market, and may give rise to inopportune gold movements. This whole question is, however, dealt with at greater length in a later chapter.

At the same time, since the completion of the reconstruction of the devastated areas, the French balance of trade has produced a considerable surplus every year, and this has inevitably increased the international financial importance of Paris.

We have to ask ourselves how far these favourable factors are of a permanent nature. The liquid balances will have to be reinvested sooner or later; in which case, they will cease to represent a power out of proportion to their amount. The favourable trade balance is largely the consequence of the stabilisation of the franc at a rather low level. The advantage attached to this is temporary, and as soon as prices, wages, and the

cost of living in France have adjusted themselves to the world level, the favourable balance will disappear.

(2) The French banking system has certainly improved its equipment for dealing with international business. It has begun to specialise in foreign transactions. The system is, however, at a considerable disadvantage, as compared with that of London, or even the minor Continental financial centres, mainly owing to the lack of an international mentality amongst French bankers. Their spirit of co-operation is weak. Indeed, the view is held in international banking circles that it is most difficult to do business jointly with French banks.

Apart from this, French banks are accustomed to think only in terms of small amounts. They carry conservatism, with regard to spreading the risk, to the extreme. If a transaction of only a few hundred thousand pounds is proposed, a French bank is not prepared to undertake it unless it can form a syndicate of about half a dozen banks to participate in the business. The hypnotic power of the million makes them overlook the fact that the million francs of to-day are only equivalent to 200,000 pre-war francs. They are, to-day, quite as circumspect at deciding about a transaction of a million francs as they were in pre-war days, although it only represents one-fifth of the pre-war amount.

Another shortcoming of the French banking system is the lack of initiative on the part of senior officials. Whereas in London the general manager of a bank has a free hand to conclude business transactions up to a fairly considerable amount—and makes full use of his freedom—in Paris, transactions of comparatively small amounts have to be submitted to the preliminary ap-

proval of the board of directors. This means, of course, a delay which is a handicap in international competition. Other things being equal, the would-be borrower goes to a centre where he can get a prompt answer to his application for credit, rather than to a centre where he may be kept waiting for a week or more, only to be told afterwards that the bank is prepared to undertake one quarter or less of the amount proposed.

Another great disadvantage of the French banking system is the strong political atmosphere that prevails in Paris. The attitude of the French banks is influenced quite excessively by considerations of a political nature. If there is disagreement with a certain country, French banks will immediately call in the credits they have granted to that country and decline to renew them. This has been done on more than one occasion to Germany. In 1929, when the Paris Conference of Reparations Experts was threatened with a deadlock, the Bank of France raised its rediscount rate for German bills, and the French banks called in all their outstanding credits, thereby causing their clients considerable inconvenience. In September, 1930, as a result of the victory of the National Socialist Party in Germany, the same situation arose, this time without any specific lead on the part of the authorities. This places the Paris market at a great disadvantage, as compared with other markets where political considerations are well in the background and influence banks only on occasions when they tend directly to affect the security of the credits. Other things being equal, would-be borrowers will always prefer to avoid a market where they are exposed to unpleasant surprises on account of political developments over which they have no control.

It is not merely for reasons of a political nature that French bankers occasionally jump unpleasant surprises on their foreign clients. Apparently they have not yet acquired the tradition of nursing connections with foreign customers, and do not go out of their way to avoid causing them serious inconvenience. For instance, towards the end of 1928, credits granted to Austrian banks were called in suddenly to meet end-of-year requirements, without regard to the inconvenience caused thereby to their clients. It will take long years of experience for them to learn that it is a wise policy to consider the interest of customers.

(3) As regards the freedom of the Paris market, conditions have improved considerably during the last few years. Exchange restrictions and the embargo on the import and export of securities were only recently removed, and in 1930 the taxation on foreign securities was reduced. The Paris market is open to foreign branches, but experience has shown that it is desirable to establish subsidiaries under French law.

The issue of foreign loans is still subject to the approval of the authorities, and is likely to remain so. The authorities repeatedly exercise their right to veto issues, as they are guided by the consideration that all transactions must secure for France the maximum possible political and economic advantages. France is very anxious to finance the countries which are in the French sphere of political influence; such as Poland, and the little Entente. If any of these countries needs to issue a loan, the French authorities make it a condition to the participation of a French market that the international banking group engaged in the operation should be headed by a French bank. If that is not the case, French banks decline to participate in the loan

and the authorities use their political influence in the borrowing country concerned to prevent the issue from being made. In many cases, the greater part of the loans granted to these countries has been provided by markets other than Paris, but, as the syndicate was managed by a French bank, France benefited to a full extent by the transaction from a political point of view. Another basis on which the authorities withhold their permission from a transaction is if it does not appear to result in an increased order for French goods. No loan the proceeds of which are to be used largely for the financing of contracts placed in countries other than France is ever likely to be authorised in Paris.

Yet another cause for vetoing foreign loan transactions is the existence of a pre-war debt which is not being paid in full. It is a well-established rule in every centre that no defaulting debtors can ever borrow unless and until they have undertaken to meet their liabilities. France, however, goes much further in this direction to protect the interests of French bondholders. If a disagreement exists as to the means of payment, whether the pre-war loan should be paid in gold francs or paper francs, the debtor is not allowed to borrow in Paris—not even if he has agreed to submit the case to international arbitration. In this respect, the existence of a disagreement with one single municipality is sufficient reason for vetoing any loan coming from that country. For instance, the French participation in the Japanese Conversion Loan in 1930 was vetoed on the ground that the city of Tokyo had not yet come to terms with French holders of its pre-war loan. What is more, even the existence of an agreement in which French bondholders have actually consented to a concession to the debtors is insufficient. For in-

stance, although the city of Vienna had concluded an agreement with the French bondholders, the French Government refused to authorise the French bankers to participate in the Austrian Government International Loan in 1930, unless the city of Vienna agreed to a revision of the existing agreement in favour of the French bondholders.

This policy may secure France advantages in individual cases, but is decidedly detrimental to the freedom of the Paris market, and tends to reduce the importance of Paris as an international financial centre.

(4) As to the extent to which foreign loans can be placed with the investing public, the change that has taken place since the war is for the worse. As was pointed out in Chapter III., the French small *rentier* used to be only too willing to acquire foreign securities; but as a result of the heavy losses French investors have suffered on their pre-war holdings of foreign securities, they are at present less ready to buy foreign bonds. For this reason, the absorbing capacity of the French market is limited. The change in their attitude was, however, not nearly as profound as many people, in France and abroad, are inclined to imagine. After all, French investors have lost a great deal more on their French securities than on their foreign securities, as a result of the depreciation of the franc. In spite of this, there has been a great demand for new French issues. The fact is, that the attitude of the French investor towards foreign loans has not been tested so far. Since the obstacles to foreign issues in Paris have been removed, conditions in the world market have been anything but favourable to the issue of foreign bonds. The reluctance of the French investor to take up

foreign bonds during this world-wide adverse trend cannot be regarded, therefore, as an indication of his attitude in the long run.

(5) As regards the stability of the French currency, it is necessary to discriminate between the short view and the long view. The possession of the second largest gold reserve, and an additional huge foreign exchange reserve, places the franc above suspicion. Taking the long view, however, opinions are somewhat less settled. Although the memory of the public is short in these matters, they have not yet forgotten altogether that until 1926 the franc depreciated as a result of inflation, that it fluctuated within very wide limits, and that it was eventually stabilised at a level corresponding to about one-fifth of its pre-war value. Undoubtedly, France would never repeat the experience of 1919-1926, except in cases of extreme emergency. But, taking the long view, the possibilities of extreme emergency cannot be altogether eliminated. Although everybody hopes for the best, another European war during the lifetime of the present generation is by no means out of the question. It may well be asked if, in case of the event, France could be trusted to the same extent as Great Britain to do her utmost to pursue a sound monetary policy. Remembering recent experience, the answer is decidedly in the negative. Even though the possibility of a war is too remote to deter people from trusting the franc, any war scare may result in a wholesale efflux of funds, both French and foreign, from France.

(6) While the French market for short loans is good, its international significance is limited. Considerable efforts have been made, during the last year or two, to develop a discount market. It has been realised

that an international financial centre cannot claim supremacy unless it possesses a good discount market. For this reason, the French authorities have spared no effort to improve on existing facilities. While, originally, the object of these efforts was to develop the international importance of Paris, subsequently it has been realised that the development of a discount market is desirable also from the point of view of the domestic monetary system. Owing to the absence of facilities, in France, for liquid short-term investments, the French banks have to keep the greater part of their idle reserves abroad. This means that whenever these funds are required in Paris, it is necessary for the banks to withdraw funds from foreign centres, thereby unsettling the exchanges. Apart from considerations of an international nature, this is contrary to the best interests of the French banks themselves; for if they try to repatriate their funds all at the same time, they are bound to suffer losses on the exchange. It is hoped that, by means of the development of a discount market, adequate facilities will be provided for the purpose of investing idle reserves in the domestic market.

To that end, a special bank was established in Paris in 1929, under the name of Banque Française d'Acceptation. It specialises in acceptance credits and, apart from its own acceptance credits, it also acts as intermediary to arrange credits with other French banks which participate in its share capital. One swallow does not, however, make a summer. The acceptance credit facilities in Paris are far from adequate to provide a sufficiently large amount of bills to secure an active market. Another disadvantage of the Paris discount market is that French banks are not in

the habit of keeping their reserves in bills to anything like the extent that banks in other countries keep their reserves in that form. There are no discount houses or bill brokers in Paris. The market, therefore, is decidedly a bad one. The margin between dealing rates is very wide; not infrequently, there is a discrepancy of $\frac{1}{2}$ per cent between rates quoted in various banks for the same type of bill on the same day. For this reason, the Paris discount market does not, so far, attract any foreign funds.

The mentality of French bankers is also an obstacle to the development of the discount market. Quick decision and willingness to grant acceptance credits of considerable amounts, or to discount bills for large sums, are preliminary conditions for the development of a good discount market. It is anything but helpful if would-be borrowers or holders of bills have to wait for a decision until the French bank which they approached with their offer has succeeded in forming a syndicate to participate in the amount. The lack of an experienced personnel is yet another obstacle, but this can be overcome much more easily than the lack of the right mentality.

(7) For the same reason, the Paris foreign exchange market is also far from adequate. If a French bank is approached for a quotation of exchange rates, it hardly ever quotes a firm buying and selling rate. The answer to inquiries as to rates is usually introduced by "*On dit . . .*", thereby evading responsibility for the rate quoted. French foreign exchange dealers are not, as a rule, authorised to carry positions, and transactions for large amounts have to be submitted to the approval of the management, which naturally handicaps the activity of the dealers. The dealers have not got

the same independent nature and initiative as in other centres. Red tape is carried to an extreme in French banking. Every item has to go through the hands of a number of officials before it assumes definite form. When paying in funds to a French bank, however small the amount may be, the receipt has to be signed by two senior officials, usually the manager and a holder of procuracy, and very often the customers are kept waiting for some length of time. This system is anything but helpful to the development of an active foreign exchange market.

We have seen that, although in many respects Paris has made progress since the war, in several respects the situation has changed for the worse from the point of view of international banking activity. A comparison with London shows that in two respects, at least, Paris has become superior, namely, as to the amount of her liquid balances available for reinvestment abroad, and as to the confidence in the stability of the franc, taking a short view. This situation, however, is essentially temporary, and there is reason to believe that the discrepancy will disappear in the course of some years.

There are, on the other hand, several considerations in respect of which London has retained her lead as compared with Paris. The amount of foreign securities held in Great Britain is infinitely larger than the amount of French capital invested abroad. The banking organisation of London is incomparably superior, as regards international business, to that of Paris in almost every way. The London market has a greater freedom than the Paris market in most respects. The British investing public is more willing to absorb foreign securities than the French investing public,

and, therefore, the absorbing capacity of London is superior to that of the French market. While, as has been said above, the short view favours the franc, as compared with sterling, the long view is most decidedly in favour of sterling. In spite of the efforts of the French authorities and banks to develop their discount market, there is no comparison between the two markets. Further, the Paris foreign exchange market is considerably inferior to London. In most respects there is ample scope for improvement in the French market, and it is possible that, within a few years, the discrepancy between Paris and London will not be so marked. The chances are, however, that there will always remain a difference in favour of London.

CHAPTER VII

NEW YORK *v.* LONDON

THE history of relations between London and New York since the war is calculated to prove that rivalry between two financial centres does not necessarily mean bitter fighting and cut-throat competition. As was pointed out in Chapter I., the fight for international financial supremacy between London and New York was fought with due regard to the rules of the game. New York has proved a chivalrous opponent who readily assists its rival when it is in the general interest to do so.

As far as the official monetary authorities are concerned, there has been no sign of any rivalry whatever. On the contrary, almost immediately after the war a close co-operation was established between the Bank of England and the Federal Reserve authorities, and more especially with the Federal Reserve Bank of New York. This co-operation was largely due to the cordial relations existing between Mr. Montagu Norman, Governor of the Bank of England, and the late Mr. Benjamin Strong, Governor of the Federal Reserve Bank of New York until 1928. Mr. Strong was broad-minded enough to realise that, from an American point of view, it was more important to assist in the financial reconstruction of Europe than to pursue

ambitions of a rather illusory nature aiming at the permanent substitution of the dollar for the pound sterling as the international currency. He was also aware that the way from New York to Europe led through London, and that it would be impossible to achieve financial reconstruction on the Continent without the close co-operation of Great Britain. In order to be able to co-operate, Great Britain had to recover from the eclipse she suffered during and immediately after the war.

The American authorities remained, therefore, perfectly neutral in the so-called fight between the dollar and the pound. While desirous of increasing the use of the dollar, they realised that this was a secondary consideration from the American point of view. Had the management of the official monetary policy of the United States been in the hands of aggressive and ambitious people, pursuing a policy of prestige, they would have probably withheld all support from the British authorities, so as to gain time for the establishment of the dollar as the principal means of payment. Instead, the American monetary authorities gave valuable assistance to Great Britain when, in 1925, they granted a substantial stabilisation credit. It is even said that, on several occasions, the discount rate policy of the Federal Reserve Bank of New York was guided by a desire to help the Bank of England, though it is difficult to ascertain how much truth there is in this theory, which has been the basis of heated attacks against the Federal Reserve Bank of New York by the politicians of the Middle West. There is no doubt there has, however, been close co-operation in the fixing of rediscount rates between London and New York, and the discount rate policy

of New York was occasionally guided by a desire to help London; the service thus rendered was reciprocated on several occasions.

The same cordial relations that developed between the monetary authorities have also existed between banks in London and New York. In this respect, co-operation was based on century-old traditions. There are about half a dozen prominent private banking firms in London with associate houses in New York. Since the war, the relations existing between London and New York banks have been drawn closer. While, before the war, in most cases London joint-stock banks were unquestionably superior to their New York equivalents, the discrepancy has now disappeared; they now deal with each other as between equals, and often avail themselves of each other's assistance. Ever since the issue of the Austrian Reconstruction Loan, British and American bankers have co-operated in the floating of a number of foreign loans. As a rule, it has been found easy to come to terms with American banking groups.

If co-operation sometimes failed to produce satisfactory results it was due to the difficulty of isolating the American portion of the loans from the British portion. Although the latter was originally expressed in sterling and the former in dollars, this did not prevent the importation of a large amount of American bonds to the British market. It became a practice that when a joint issue was made, the bonds of the American portion were offered at a discount simultaneously with the issue of the British portion, much to the inconvenience of this market.

Thus, while, from a British point of view, the co-operation of the American market was undoubtedly

useful, the American banking interests also benefited to a great extent by co-operation. As was pointed out in a previous chapter, the absorbing capacity of the American investing public was comparatively small, even previous to the Wall Street boom. There was a tendency among American financial houses to undertake more than they could hope to handle successfully. In their keenness to participate in foreign issues, they often disregarded the limits of the absorbing capacity of their market. In order to be able to distribute issues for which they had assumed responsibility, they endeavoured to place a large part of them in London. To that end several leading American financial houses established branches or subsidiaries in London, whose main task was to approach insurance companies, and other big investors, to induce them to take over some of their dollar bonds. The practice of placing such bonds privately on a large scale became widespread, and although the amount of any individual transaction was comparatively moderate, with regard to the large number of issues part of which were placed here, the total amount of dollar bonds disposed of was considerable.

This practice was obviously against the interest of London as an international financial centre. As London's resources available for lending abroad have been rather limited since the war, it was obviously to her interest to reserve her resources for her own requirements and not those of a rival centre. The amount of dollar bonds placed in this country automatically diminished the amount available for lending directly to the regular customers of the London market. Even during the unofficial embargo on foreign loans in London, the practice continued unabated. This meant

that while London banks had to decline the offers of their customers and had to send them to their New York rivals, part of the loans granted by the latter were eventually raised in Great Britain and affected sterling to exactly the same extent as if a direct issue had been made in London. There is also another point of view from which the practice must be regarded as highly undesirable. To some extent the issue of foreign loans in London brings orders to British trade. If, however, the loan is issued in New York, and part of the bonds find their way to this country, British trade does not benefit by it.

The possibility of placing dollar bonds privately was, of course, limited by the absorbing capacity of insurance companies, investment trusts, and other large investors. The general investing public kept aloof from this type of investment, in spite of its higher rate of interest as compared with the equivalent sterling security. In this respect the instinct of the public, ignorant in matters of investment, proved to be sounder than the policy of well-informed and over-sophisticated large investors. Experience has shown that the smaller yield of foreign bonds issued in London is more than compensated by the advantage of a comparatively stable market. Almost all large investors who acquired dollar securities in the past have suffered very substantial capital depreciation during the last few years. Although it may be argued that, as they intend to hold these bonds until maturity, eventually they will not be losers, the argument is not convincing, as the necessity of carrying these bonds until maturity has probably prevented these investors from taking advantage of other investment opportunities. It is probable that the unfavourable result of this experience will tend

to discourage this practice in future. The attempt to induce the general public to buy dollar bonds, by means of introducing American methods of bond-selling, has failed completely. It may be in accordance with the requirements of the American public, but it is certainly not viewed with favour by British investors, to be called upon by travellers attempting to sell them bonds. As, in the past, only securities of a doubtful character were hawked about in this manner, the British investor instinctively distrusts such methods.

The placing of dollar bonds privately in this country is certainly the least desirable form of co-operation with the United States. If American financial houses feel that the amount they have undertaken to issue is beyond the absorbing capacity of their customers, then the obvious solution is to come to terms with British financial houses to float part of the issue in London, instead of attempting to place them here privately above the heads of their British correspondents.

Generally speaking, the attempt to make New York into an international financial centre was not guided by any political considerations. Towards Europe the United States has adopted, since the end of the régime of President Wilson, a policy of *désintéressement*. To give only one example of the essentially non-political character of the attitude of Washington towards the New York market, although the United States Government has been very keen on naval disarmament, it has never used financial weapons to bring pressure to bear upon the parties concerned. As far as countries of Latin America and the East are concerned, it must be admitted that the American authorities have made use of the financial power of New York to advance politi-

cal interests, but their object has not been primarily political, but mainly economic. Political influence was brought to bear merely to secure contracts for American interests. Although, in this respect, occasionally they have clashed with British interests, on the whole the fight has been without bitterness.

An example of the clash of economic interests of Great Britain and the United States, and of the way in which the New York financial market has been used to support the latter's interests, has been provided by the case of the Polish Loan. The international group which issued the Polish Stabilisation Loan was headed by an American firm, and, consequently, an American financial adviser was appointed—Mr. Dewey. There were frequent complaints against him on the part of British financial houses, industrial enterprises, and engineering contractors, and it was alleged that he used his influence to a great extent to secure advantages to American interests. Thus he is said to have vetoed the offers of British firms and to have favoured competing American offers, although the latter were not, by any means, more favourable to the interests of Poland. Another case is the activities of Dr. Milspaugh, the American financial adviser to the Persian Government. Although his appointment was not accompanied by any loan transaction, one of the reasons why he has such a strong position in Persia was the hope that, sooner or later, he would be able to obtain a large American loan for the country. It is a recognised fact that Dr. Milspaugh used his great influence to attempt to weaken the influence of British interests in Persia—especially that of the Anglo-Persian Oil Company. He did not, however, succeed in this object, and as his activities have decidedly improved the

finances of Persia, they were, in the long run, also beneficial from a British point of view.

The year 1927 constituted a turning-point in the relations between London and New York. Until then, New York's superiority was beyond question, and manifested itself both in competition and in collaboration with London. Since 1927, however, the international financial position of New York has been somewhat eclipsed. The last act of support given by New York to London was the reduction of the Federal Reserve Bank rate in August 1927. The late Governor Strong was subject to violent attacks on account of that move, which is held to be responsible for the Wall Street boom. He was accused of having jeopardised American interests in order to help London. Although it seems probable that the main motive of the reduction of the Bank Rate was to enable London to avoid raising its own Bank Rate, it seems unlikely that a reduction of $\frac{1}{2}$ per cent should have been able, in itself, to bring about the enormous boom that went on during the following two years.

As a result of the general upward trend of American shares, the American investing public lost interest in foreign bonds. After the middle of 1928, foreign borrowing in New York was reduced to a minimum. In fact there was a strong tendency towards the repatriation of the European bonds issued in the United States during the previous three or four years. As the price of these bonds had declined considerably, they became attractive to the Governments and the investors of the borrowing countries, and were acquired by them on a large scale. At the same time, American banks gradually ceased to lend in the European money markets. While, until 1928, the

movement of American short-term funds to and from London was one of the principal factors in sterling and dollar exchange, after 1928 the major part of these funds was withdrawn owing to the more remunerative rates offered in the New York market for brokers' loans. Similarly, American funds also left Berlin and other European centres. What is more, European banks and other owners of liquid funds discovered the advantages of lending to Wall Street, and there was a very pronounced westward flow of liquid capital. Thus, from a lending centre, New York became a borrowing centre, both as regards long-term investments and short-term funds. Her borrowing assumed such enormous dimensions that it endangered the stability of the European exchanges and was responsible for a general upward movement of interest rates throughout the world.

As a result of this change, New York ceased to be able to assist other markets. Undoubtedly, the fluctuation of interest rates in the market for brokers' loans had a decisive influence over the international money market, and to that extent New York continued to control international tendencies throughout the boom, but there was no longer any deliberate policy to that end on the part of either the American authorities or the American banks. That they still had the control of the world's money markets was the outcome of their weakness rather than of their strength. On several occasions, they had to be assisted by the Bank of England, which institution had rapidly to raise its rediscount rate, mainly in order to discourage the flow of funds to New York, which was becoming a source of embarrassment to the American monetary authorities.

As a result of the slump in November, 1929, the rôle played by New York in international finance has further declined. The monetary authorities have been too much engaged, since the slump, with their domestic troubles to pay much attention to international affairs. As for the banks, their freedom of action has been curtailed by the necessity of carrying their excessive loans on securities. Although these loans were supposed to have been amply secured, the slump has eliminated the margin of cover, and the banks were unable to unload their stocks without fear of bringing about a further disastrous fall in values. This experience has proved the inadequate nature of brokers' loans as a type of short-term investment. Although in theory they may be well secured, in practice their liquidity in times of emergency leaves much to be desired. The present experience may contribute to discourage foreign capitalists from making direct loans to Wall Street. The greater part of European funds lent to Wall Street during the boom was lent through the intermediary of the leading American banks, and was, therefore, safe.

At the time of the slump, it was hoped that the American investing public would change over to fixed interest-bearing securities, and particularly to foreign bonds, but this has not, so far, been the case. A great part of the capital available for investment has been destroyed by the slump and by the subsequent trade depression. In any case, investors in America—as in other countries—are most reluctant to commit themselves in any direction owing to the obscurity of the outlook. Thus, there has not been any revival of foreign issues in New York. Nor has there been any noteworthy revival of lending of short-term funds, for the simple reason that American banks are still carrying

the loans they granted on securities, and are borrowers rather than lenders abroad. The bond market remains hopelessly congested, and the issue of new loans is as difficult as ever. For the time being, therefore, New York cannot either compete or collaborate with London to any great extent.

The experience of the last two years has decisively proved that New York can never rise to permanent supremacy as an international financial centre. Undoubtedly, she will recover in a few years from the temporary embarrassment caused by the slump, and will resume, once more, her international activity on a large scale. However, it is now obvious that her interest in international affairs will always remain of an essentially spasmodic nature. The United States is too much engaged in the development of her own resources to take a really keen permanent interest in international finance. The two domains of New York's activity are bound to clash from time to time, and on every such occasion the international aspect of the market will be overshadowed by the domestic. The speculative interest the public takes in American shares makes it difficult to get them permanently interested in foreign securities.

Although from time to time New York will rise to predominance in international finance, this, in itself, is not sufficient to justify the view that New York has acquired the lead. The market which aims at international financial supremacy has to devote to that end a steady and permanent attention. Sudden flares of interest, followed by reactions, are calculated to be detrimental in the long run to the international position of a centre. Other things being equal, would-be borrowers will always choose a centre which is not

exposed so greatly to the caprices of domestic developments as New York.

In some banking quarters in New York, the view is held that it would be worth while to make every possible effort to change the balance of the New York market from the national to the international. To that end, it is suggested that the discount market should be developed to the detriment of the market for brokers' loans by means of the introduction of fortnightly settlements on the New York Stock Exchange, as a result of which the amount required for financing speculation would diminish considerably and the funds thus released would help to forward and develop an active discount market. Those, however, who advocate this remedy do not seem to take into account the mentality of the American public. If speculation is driven to excess when settlements take place daily, the introduction of fortnightly settlements would provide further stimulus and would result in a further increase of the gambling spirit. This would be detrimental to the stability of the New York market, and would not be helpful to the development of the discount market. It is unlikely, therefore, that this remedy will ever be adopted. The New York discount market is likely to remain a comparatively neglected section of the financial market and will not endanger the supremacy of the London discount market.

CHAPTER VIII

PARIS *v.* LONDON

IN order to appreciate the sudden revival of France's ambition to create a first-rate international market in Paris, and to attain supremacy in international finance, it is necessary to understand French political mentality. It is a well-known fact that in no country is the atmosphere so essentially political as in France. While in Great Britain and other countries foreign policy is largely governed by economic considerations, in France economic activity is largely determined by political considerations. If France is anxious to attain financial supremacy, it is not so much on account of the immediate financial benefit obtained therefrom as on account of the political power it represents.

For several years, France was at the mercy of international finance. The franc was the principal gambling counter in foreign exchange markets from Vienna to Buenos Aires. It was a decidedly humiliating experience for a great nation, and it is only natural that everything should be attempted to avoid the repetition of this experience. It is a time-honoured military slogan that the best defence is to attack. In order to protect herself against the tyranny of international finance, France is endeavouring to beat international finance on its own ground by establishing herself as a first-rate

financial power. After having been in an inferior position, French high finance was most anxious to take the first opportunity to make itself felt once more as an active factor instead of a passive one. Rightly or wrongly, international financial circles in foreign centres are credited in France with having pursued an anti-French policy. They are credited with having endeavoured to induce various Governments to prevent France from enjoying the fruits of her victory. This belief is not altogether without foundation. Apart from the fact that German elements are strongly represented in every international centre, financial interests in almost every country have been inclined to favour Germany against France since the war. This was due, however, to their desire to accelerate the financial reconstruction of Europe. They were not pro-Germans, but pro-reconstructionalists. As they regarded the policy of France which culminated in the occupation of the Ruhr as the chief obstacle to financial reconstruction, they used their influence against France.

Whether or not they were justified is a matter of secondary importance from the point of view of our inquiry. Their attitude was against the apparent immediate interests of France, and this was sufficient to evoke in France the desire to be in a better position in the future for coping with them. If she became strong enough in that domain, she might be able, in the future, to counteract the influences set into motion against French policy after the war.

Another reason why the French have endeavoured to establish an international financial centre of predominant importance is that France had to restore the stability of her currency almost entirely without any

support from the other financial centres. While support was generously forthcoming to assist Germany, Austria, Hungary, Bulgaria, Poland, Greece, and Belgium, France did not succeed in getting any assistance in the shape of stabilisation loans or stabilisation credits. The only noteworthy support the authorities received from abroad was in 1924, when a British banking group, headed by Lazard Bros. & Co., and an American banking group, headed by J. P. Morgan & Co., granted France a substantial credit to support the franc. Apart from this, the only support received was loans granted to French railway companies and other public utility enterprises in foreign centres. No credit was granted to the Bank of France by any group of central banks, nor any stabilisation loan to the Government. It is said that on two occasions at least, the Bank of France approached the Bank of England for assistance, but no arrangement could be arrived at. It is not unreasonable to assume that the unwillingness of the Bank of England to assist the Bank of France in the stabilisation of the franc was largely responsible for the latter's attitude in 1927 and in subsequent years, which will be dealt with later in this chapter.

It is necessary, however, to point out that support was not withheld without reason. In the first place, France refused to consolidate her inter-Allied debts to Great Britain and the United States until 1926, and the debt-funding agreements were not ratified until 1929. As it was a general rule adopted by both the above countries not to grant any Government new loans until its War Debt was re-funded, no exception could be made in favour of France, especially as she was in a better position to pay than any other debtor.

Apart from this, the general financial situation of France was also such as to make it appear undesirable, even from a French point of view, to grant credits or loans for stabilisation purposes. Until the second half of 1926, no serious efforts were made to balance the Budget by means of increased taxation. Had stabilisation credits been granted before the Budget was balanced there would have been no apparent inducement for the French Government to face the unpopularity of draconic fiscal measures with the object of balancing the Budget, and thus preventing a further fall of the franc. French taxpayers could not have been convinced of the necessity for making heroic fiscal sacrifice if it had not been for the very real threat that the franc would collapse. Thus it was a blessing in disguise that foreign centres withheld their support from France. It is, of course, understandable that very few people on the other side of the Channel should realise this.

Anyhow, rightly or wrongly, at the moment of the *de facto* stabilisation of the franc, the mentality of the French authorities and of Paris *haute finance* was marked by a feeling of bitterness against international finance, and a desire to get even with it for the humiliating rebukes they had had to endure for so many years. Human nature being what it is, it is only natural that, when they acquired the power to do so, they should take an early opportunity to retaliate.

The first clash occurred in the early part of 1927. The Bank of France was anxious to liquidate its secured indebtedness towards the Bank of England, contracted during the war, which had been gradually reduced and which at that time amounted to about £33 millions. Against this, a security of about £18

millions of gold was held in the Bank of England. Although the credit was not due for some time, the Bank of France expressed its desire to repay those credits out of its accumulated balances in London and to withdraw the £18 millions of gold thereby released. Apparently what the French authorities had in mind was merely to obtain a revision of the terms of the agreement. There is reason to believe that they worked on the assumption that the £18 millions of gold existed no longer, as the Bank of England was supposed to have used it during the war for the support of sterling. They considered it unfair, therefore, to pay interest on £33 millions while the actual amount was, in their opinion, only the difference between the £18 millions and the credit of £33 millions. Much to their surprise, the Bank of England declared itself willing to restore the gold deposit the moment the credit was repaid, thereby disproving the assumption that the deposit was used up. The settlement of the affair in this way caused a considerable amount of irritation in Paris, and to emphasise this, in May and June, 1927, the Bank of France withdrew gold from the Bank of England on several occasions. As it was a matter of common knowledge that the French balances in London were considerable, even after the repayment of the credit of £33 millions, it was feared that, should these withdrawals be continued, they would cause serious embarrassment to the London money market. The French attitude was subject to severe criticism in the London Press. About the details and technical explanations of this situation, more will be said in the next chapter. It is sufficient to point out here that the French authorities eventually agreed to refrain from making direct gold withdrawals from the Bank of England. At the

Conference of central banks held in August, 1927, in Washington, the principle of non-interference between central banks with each other's gold reserve was adopted. This means that central banks have agreed not to withdraw from each other any gold without the consent of the bank whose gold reserve is thereby diminished.

It must be acknowledged that in agreeing to this the French authorities showed their willingness to cooperate. The question is, however, whether this willingness existed in practice or only in theory. While there have not been any more gold withdrawals on account of the Bank of France since the agreement, there have been a number of withdrawals which—rightly or wrongly—have been attributed indirectly to the policy of the Bank of France. Technically they were ordinary commercial transactions, but many people were inclined to regard them as special transactions stimulated by French authorities.

The Paris market thus succeeded in making itself felt as soon as it had recovered its strength. Its first action was destructive rather than constructive, but it was followed by efforts of a constructive nature. It decided to develop a discount market of considerable importance. The scheme was not unanimously approved by every shade of French public opinion. In some quarters the view was held that, if France was desirous of restoring her pre-war standard as an international centre, she should concentrate her efforts on the development of the market for long-term loans, rather than on the development of the discount market. As was pointed out before, while Paris was important in pre-war days as a capital market, she was of little importance as a discount market. In spite of

this, efforts have been made for the creation of a discount market, while comparatively little has been done so far to bring about a resumption of French lending abroad in the shape of long-term loans. It would be a mistake to interpret this endeavour for the establishment of a discount market as a blow directed against London's position. Every centre has the right to attempt to improve its facilities, and a good discount market is decidedly one of the most important fundamental conditions of international financial supremacy. While, therefore, the gold policy of the French authorities—if it be responsible for the excessive import of gold—may be open to criticism, their policy aiming at the development of a discount market cannot be accused of being aggressive.

It is, of course, difficult to say how the Paris discount market will develop, but at present it cannot be regarded as a serious rival to London. As we stated in Chapter VI., its technical facilities are far from adequate, and the mentality and traditions of French banks are also against rapid expansion.

Another sphere in which Paris has attempted to rival London was the market for long-term loans. To some extent there has been co-operation, but this co-operation has assumed the shape of British participation in loans issued under the auspices of French groups rather than the reverse. In the course of 1930, almost every attempt to induce French banks to participate in international loans failed. For instance, in the case of the state of San Paolo Loan, participation was refused at the eleventh hour, as the French banking interests involved were said to have insisted that the bonds of the loan should be international in character and should be transferable from one market to

another. This same claim was upheld in every case when negotiations were carried on for the issue of an international loan with French participation. There is reason to believe, therefore, that this represented the wish of the French authorities. The other members of the banking group were unwilling to accept a condition that would have exposed their market to influences from other markets. London banking interests were afraid that if bonds were marketable indiscriminately in London and Paris, large blocks of the French issue might be suddenly unloaded in London.

In the case of other international loans, French interests put forward a variety of excuses for declining to co-operate in the issue. These and other symptoms seem to indicate that the French authorities and banking interests are, for the present, not at all keen on participating in loans, unless they are the leaders of the group. In the case of the Yugoslav loan negotiations, for instance, they categorically refused to participate in the international group formed under the leadership of a London banking house, and made a competing offer to the Yugoslav Government.

Considerations of prestige play a great part in the attitude of the French market towards loans. The French authorities have shown themselves most anxious that countries, which are the political followers of France should not cover their loan requirements in centres other than Paris. At the same time, one cannot regard the reluctance of the Paris market to grant long-term loans as the outcome solely of political considerations; for they were not very anxious to grant loans, even to the political followers.

While the French market for long-term loans was not particularly active during 1930, France still con-

tinued to issue loans abroad. The object of these loans was the conversion of old issues. This does not alter the fact, however, that Paris has remained to some extent a borrowing centre, a fact which is certainly detrimental to her international financial position. Everything seems to indicate that the authorities are not anxious to encourage lending abroad because they do not wish to reduce France's liquid foreign balances. As will be explained in the next chapter, these balances—because of their liquidity—represent a far greater power than an equivalent amount of capital invested in long-term loans. The authorities are apparently desirous of retaining the weapon represented by these balances, which can be used much more effectively so long as they are thoroughly liquid. The French foreign trade position greatly assists the French Government in its policy. As the franc was stabilised at a low level, French export trade has received a stimulus which has not yet completely disappeared. As a result, the French balance of trade, including invisible items, has shown considerable surpluses during the last few years. Far from declining, the amount of liquid balances abroad has shown a tendency to increase.

The insistence of the French authorities on making any foreign bonds issued in France international in character, also seems to aim at the same end, namely, that, at any moment, these long-term investments should be reconvertible into liquid balances. This desire of the French led to a clash between the British and French representatives at the Paris negotiations for the issue of the first instalment of the Reparations loan. As France is the principal beneficiary of the commercialisation of the Reparation debt, it was expected that she should take over the greater

part of the Reparations bonds. In the course of the negotiations, however, the French authorities endeavoured to fix at as low a level as possible the amount of bonds to be issued in Paris. At the same time, they insisted that the bonds should be made international, so that they should be able to circulate freely between the various markets. On this point, however, the British delegates adopted a very firm attitude, and, on the provisions of the Young Plan, insisted that the reparation loan should be issued only in terms of the currency of the country in which it was issued. They wanted to avoid thereby a sudden flow of reparations bonds to the London market, which could have otherwise become a very important potential source of danger to the stability of sterling. Eventually the French authorities had to accept the British point of view, and the bonds were made non-interchangeable.

Although the existence of a certain amount of securities that have free access to several markets is desirable, an excessive amount of such international counters may endanger international monetary stability. We have seen during the boom of 1929 how the flow of funds represented by the buying and selling of American shares on European account affected the exchange situation in Europe. The same phenomenon might have easily repeated itself in the case of the reparations bonds; since it was impossible to foresee the total amount to be issued within the next few years, the extent of the danger could not even be measured. It was only natural that various markets should be anxious to take measures of precaution against being flooded with such bonds. The case of France, however, was totally different. There was no hope of placing with the French public large quantities of these bonds as,

for sentimental reasons, the French investor was most unlikely to acquire German securities; consequently, the greater part of even the first instalment was left with the issuing group and had to be carried by the banks, and, to some extent, by the French authorities. As large amounts of these bonds are still believed to be held by bankers and possibly the Government, it would always be possible to unload these amounts in foreign centres without regard to the market price. If the British authorities had agreed to make the bonds international, the result would have been equivalent to a potential increase of French balances in London, which was the last thing to be desired. Even as it is, the French balances are far too large, and are a constant source of danger. Their movement may, at any moment, cause considerable inconvenience to the London market. In this respect, New York is also at a disadvantage, for the French balances in that centre are sufficiently large to make themselves felt, in spite of the larger gold surplus that exists in the United States.

It appears that, while in the case of New York collaboration with London was the rule and competition the exception, in the case of Paris, rivalry was the rule and collaboration the exception. For this reason the attitude of France in the fight for financial supremacy deserves particularly close attention. In the two following chapters, we propose to go into the details of the policy pursued by France, with special regard to the French balances abroad and the French gold imports.

CHAPTER IX

THE FRENCH BALANCES ABROAD

WE have seen in the two previous chapters that there have been two factors which have endangered international monetary stability, namely, the Wall Street situation and the French balances abroad. While the former was essentially a temporary factor, the latter appears to be permanent. French balances have assumed considerable importance in the international money market ever since 1927, and there seems to be no indication that their importance will decline to any great extent in the near future. They are, therefore, a factor to be reckoned with. We propose to examine in this chapter the origin of these much-discussed balances, the effect of their existence, and the chances of their disappearance or of their reduction to normal proportions.

According to one theory, the French balances were created by the purchase of francs by foreign speculators during the period 1926-1928. As the franc appreciated during the second part of 1926 from about 250 to 124 to the pound, it was then believed that the appreciation might continue, and that the French monetary authorities had it in mind to restore the pre-war value of the franc. As a result, there was a strong demand for francs on the part of foreign speculators,

and the French authorities, in order to prevent a further appreciation of the franc, had to buy all the foreign currencies offered in connection with this demand. Unquestionably this factor may have been originally responsible for the accumulation of a substantial amount of foreign exchange reserve by the French authorities. The fact that they allowed about a year and a half to elapse between the actual stabilisation of the franc and its legal stabilisation gave rise to the assumption that they wanted to encourage this process. So long as there was a possibility of a further appreciation of the franc, there was also a demand on the part of foreign speculators.

Although speculation certainly contributed to the accumulation of foreign balances, its rôle in the creation of those balances is grossly exaggerated. After all, once the franc was legally stabilised there was no longer any object in keeping foreign balances in the hope of a further appreciation, and those balances were probably withdrawn without exception, as money rates in France have been anything but attractive since 1928. It is thus obvious that speculative demand for the franc from 1926 to 1928 contributed only temporarily to the increase of balances. The fact that, after the legal stabilisation of the franc, there was no wholesale withdrawal of funds from Paris shows that the amount held by foreign speculators was not nearly as large as was popularly believed.

If international speculation played a certain part in the origin of the French balances, it was before and not during the period of stability. Towards the middle of 1926, when it appeared as if the franc would follow the mark and other continental currencies in its depreciation, the whole world was speculating against it. There

was a huge bear position in francs in every centre, and international speculators who had sold francs short when the rate was anything between 175 and 250 to the pound, found, as a result of the sudden appreciation of the franc, that they had to cover their position at rates varying between 175 and 125 to the pound. Although it is impossible to estimate even approximately the amount involved, or the average rate at which the francs were sold and repurchased by speculators, it is certain that the difference was very considerable, and that it contributed to no slight extent to the accumulation of French balances. Thus France fully avenged herself on international speculators for the harm the latter did her prior to 1926. Apart from the moral satisfaction of her victory, she received also a very material indemnity in the shape of the profit arising from squeezing bears in francs.

This, however, does not, in itself, explain the creation of the huge French balances which are estimated to be somewhere in the neighbourhood of £300,000,000. By far the greater part of this amount is due to the return to France of French funds which took refuge abroad during the period of inflation. As we pointed out before, restrictions imposed upon the transfer of capital from France failed to prevent the wholesale flight of funds. It was mainly French holders of funds abroad, rather than foreign speculators, who hastened to transfer their funds to France so as to take advantage of a further appreciation of the exchange. While, as we said above, foreign speculators withdrew their funds as soon as their hopes of capital appreciation had vanished, French capitalists retained them in their country, thereby contributing permanently to the creation of the ex-

ternal balances held by the authorities. All that happened in reality was that the funds held abroad were transferred from the hands of many thousands of individual investors to those of the banks, the Bank of France, and the Treasury. While formerly the major part of these funds was kept in the shape of foreign securities, after the transfer it was kept in the form of liquid balances, holdings of commercial bills, or Treasury bills, and time deposits.

It is generally assumed that the creation of these balances was the result of deliberate policy on the part of the French authorities. Although their successful effort to stabilise the franc deserves the highest praise, it is hardly justifiable to credit them with such amazing foresight as to have organised the accumulation of hundreds of millions of pounds abroad. The possession of these balances surprised them presumably as much as it surprised everybody else.

When speaking of the French balances, it is necessary to discriminate between three categories, viz. the foreign balances of the Bank of France, those of the French Treasury, and those held by French banks. The first is by far the largest, and is subject to comparatively little alteration. It is believed that the amount of Bank of France balances in London is not much less than £100 millions, while the amount held in New York is even larger. In 1928 the Treasury held substantial balances in London to meet the requirements of the war debt and other external liabilities of the Government. The amount of the Treasury's balance in this market has declined, however, considerably during 1930. Part of it was used for the repayment of external loans guaranteed by the French Government, while part of it was transferred to the

Bank for International Settlements. As for the amount of sterling balances held by French banks other than the Bank of France, it is impossible to make an even approximate estimate. They are subject to wide fluctuations, and their movements cause much more inconvenience than those of the official balances.

As stated in the previous chapter, the possession of these huge liquid balances carried considerable advantages for France, of which the following were the main:

(1) It markedly strengthened her international financial position, and enabled her to make herself felt in international finance soon after the stabilisation of her exchange.

(2) It enabled her to restore confidence in the stability of the franc. After the experience of 1919-1926, it would have taken, under normal conditions, at least a decade to make the holders of francs—both in France and abroad—forget their disastrous experiences. As it is, the franc is now considered one of the safest currencies, thanks to France's possession of huge external balances.

(3) It restored the financial prestige of France abroad. Would-be borrowers are aware that, possessing those balances, France is in a position to lend them.

(4) It placed a powerful weapon at the disposal of the French authorities, with the aid of which they are in a position to bring financial and even political pressure to bear upon other countries.

In spite of these advantages, many people in France would prefer to see a decline in the French balances abroad. They are considered to be the least desirable

way of investing French capital in foreign countries for the following reasons:

(1) The rate of interest on short-term investments has declined to a great extent during the last two years. Even while it was high, the French authorities could not take full advantage of it, for they were not in a position to make direct loans to brokers. Since the decline of money rates in 1930, these balances hardly yield more than an average of 2 per cent per annum. On the other hand, if these holdings were converted into long-term investments, they could easily yield an average of 7 per cent per annum. Assuming that the amount of liquid balances is £300,000,000, this difference is equivalent to the loss of interest of £15,000,000 per annum.

(2) Though the possession of the liquid balances increases the strength and the prestige of the Paris market, it helps, at the same time, the two rival centres. After all, these balances are placed at the disposal of British and American banks, which can make use of them to their own advantage, and can relend them to foreign countries.

(3) The existence of liquid balances does not benefit French trade. If these funds were to be used for lending to foreign countries, they would bring in orders for French goods, and would secure the control of foreign enterprises.

(4) The existence of the French balances controlled by the authorities is a constant source of irritation abroad, and inspires distrust of France. Whenever the franc moves against sterling, some quarters are always inclined to suspect the hand of the French authorities behind the adverse tendency. Even if the French authorities were to do their utmost to prevent any

disturbance of the international markets through the transfer of their funds, their mere possession tends to make France rather unpopular, and the belief that she is the principal cause of disturbing tendencies in the international money market is becoming more and more general.

For all these reasons, there is a strong feeling in influential French quarters that these balances should be liquidated. To that end, the Finance Act of 1930 has provided for the repayment of the French loans issued abroad under Government guarantee during the post-war period. As these loans pay an interest of 6 to 7 per cent, the saving obtained from their conversion into internal loans on a 4 per cent basis is considerable. The amount involved, however, does not represent more than a small fraction of the French balances abroad.

There are two alternative ways of disposing of the rest: either by the import of gold, or by resuming the issue of foreign loans and the introduction of foreign securities into France. We shall see in the next chapter that to some extent the first alternative has been chosen. It is, however, impossible to imagine that the whole amount of abnormal French balances would be repatriated in the shape of gold. It seems probable that, in the course of the next few years, these balances will be reduced to less abnormal proportions by means of the second alternative. But although fiscal obstacles to the issue of foreign securities have been eliminated, it seems that the French authorities are not at all keen on bringing about a rapid reduction of their balances by means of lending abroad. Possibly this is an advantage. Were France to begin lending abroad on a large scale, it would result in the wholesale with-

drawal of funds from London and New York. For it is obvious that France would not lend to Great Britain and to the United States—apart from other reasons, because neither of these countries wants to borrow in France—but to countries willing to pay a higher rate of interest and willing to spend in France at least part of the proceeds of their loans. The granting of loans to these countries would result in the withdrawal of sterling and dollar balances in favour of the borrowers. It would disturb the equilibrium of the market to the same extent as would the direct withdrawal of the funds to France. It is, therefore, desirable that the liquidation of these balances should be spread over a period of several years.

Meanwhile, the balances will continue to represent a source of danger to international monetary stability. Their very existence constitutes a disturbing factor. Whenever it is difficult to explain an exchange movement, the markets are always inclined to assume that it is due to transfers of French balances. As a result, the psychological effect of the movements become grossly exaggerated.

A simple way to counteract these effects would be for the British and American authorities to acquire for themselves substantial credit balances in Paris. By such means it would be possible to neutralise any exchange movement having the appearance of abnormality. As, however, for considerations of prestige, neither London nor New York would care to borrow in Paris, this solution has to be ruled out as impracticable.

CHAPTER X

THE FRENCH GOLD IMPORTS

WE have seen in the previous chapters that, ever since 1927, Paris has, from time to time, proved to be a disturbing factor in the international money market. How far has this been the inevitable result of circumstances over which the French authorities have had no control, and how far has it been the outcome of deliberate policy? This question has been the subject of heated controversy.

Until the legal stabilisation of the franc in June, 1928, there was a persistent demand for francs on the part of foreign speculators who hoped for further appreciation. When, in May and June, 1927, the French authorities withdrew gold from London, their explanation was that the object of these withdrawals was to create stringent monetary conditions in the London market, in order to check the demand for French currency, which was said to be becoming embarrassing to the French authorities. The argument was hardly convincing, as no country has the right to interfere, by means of direct action, with the situation in the money market of another country. The Bank of France was at liberty to check the inflow of funds by means of a reduction of the Bank Rate, but it was certainly pursuing an aggressive policy when it took upon

itself to create stringent conditions in another money market. For this reason, the sharp criticism of its action by the British Press was fully justified.

M. Poincaré, the then Prime Minister and Minister of Finance, who is known to have inspired the policy of the Bank of France, is said to have adopted the line of argument that, as Great Britain enjoyed the advantages of having returned to the gold standard, she should also put up with its inconveniences. On the other hand, the British authorities are credited with having answered that the freedom of the gold market had not been re-established for the convenience of authorities of other countries anxious to increase their gold reserves, but for the purpose of meeting normal commercial demands. It is to the credit of the French authorities that eventually they realised the necessity of adopting a more conciliatory policy. It is beyond doubt that if the French authorities had made full use of their power to withdraw gold, it would have created an embarrassing situation, and would have resulted in a set-back to the progress towards international monetary stability. It was, therefore, obviously also to the interest of the French authorities themselves to refrain from taking advantage of their right to withdraw gold. It is, nevertheless, to their credit that they adopted a reasonable policy by agreeing in Washington to refrain from further gold withdrawals.

Since the legal stabilisation of the franc in 1928, the exchange has been almost continuously at a premium in relation to sterling, dollar, and guilder, and, as a result, private arbitrage from time to time has shipped large quantities of gold from London, New York, and Amsterdam to Paris, with the consequence that the

French gold reserve has increased to the formidable figure of £420,000,000, as compared with about £800,000,000 in the United States, and only about £150 to £160 millions in Great Britain. We have to ask how far the firmness of the franc, which has brought about the influx of gold, has been due to the deliberate policy of the French authorities, aiming at an increase of the gold reserve. The opinions prevailing in various quarters may be summarised as follows:

(1) According to one theory, from time to time the French authorities have made use of their influence over the exchanges to bring about an import of gold for considerations of a political nature.

(2) The French authorities are also said to have encouraged the import of gold in order to increase the importance of Paris as an international financial centre.

(3) The French authorities, although they did not actually encourage the influx of gold, adopted a policy of benevolent neutrality towards the movement, and did not make any effort to check it.

(4) The French authorities were helpless against the movement, which caused them considerable embarrassment.

Those who believe that the influx of gold into France was due to the deliberate policy pursued by the French authorities for political ends, base their assumption on the fact that, whenever relations between the British and the French authorities became strained, the exchange always moved against this country and gold was withdrawn. The first instance of this was in June, 1929, after the victory of the Labour Party at the General Election. Mr. Snowden's anti-French attitude then coincided with withdrawals of gold on French

account. Subsequently, during the first conference of The Hague in August, 1929, which witnessed a serious clash between the French and British delegates, there were further heavy withdrawals. It is said that Mr. Snowden's remark to the Conference that M. Chéron was talking nonsense cost the Bank of England many millions of pounds of gold. Another conspicuous example was after the clash of British and French interests in Paris in May and June, 1930, in connection with the negotiations for the Reparations bonds issue, which was referred to in the previous chapter. The French authorities resented the insistence of the British authorities that the whole of the proceeds of reparation bonds issued in London should be retained by the British Treasury. Within a few weeks of the issue, an amount of gold practically equivalent to the British share of the Reparations issue was gradually withdrawn on French account, and M. Frédéric Jenny triumphantly pointed out in the *Temps* that it was useless to insist on retaining the proceeds of the London issue of Reparations bonds, as gold was nevertheless withdrawn.

Many people are, of course, inclined to give the French Government the benefit of the doubt. As the disagreement was always accompanied by a fair amount of publicity, it is possible that the market discounted any possible action on the part of the authorities, so that the exchange depreciated without any actual intervention. Whatever may have been the case, it is certain that the British authorities would never surrender to political pressure of this kind. If it comes to the worst, they would always be able to obtain support from the United States. The British authorities would not, of course, invite outside support,

except in case of extreme emergency, but if they had to choose between the two evils, they would certainly choose the lesser. It would be decidedly detrimental to London's prestige if, five years after the restoration of the gold standard, she should still have to depend upon support from New York. It would, however, be much more humiliating to have to submit to French demands, in order to avoid a loss of gold.

The second theory, according to which, although the French authorities are responsible for the firmness of the franc which has brought about the inflow of gold, they have not been guided by political considerations, appears to be more acceptable to the majority of banking opinion. It is a well-known fact that, even before the war, the Bank of France was always anxious to hoard gold. After the dark period of inflation and fluctuating exchanges, it was only natural that the old policy should be resumed as soon as possible. To some extent it was necessary to acquire a large gold stock in order to restore confidence in the franc at home and abroad. Although, to all intents and purposes, the holding of foreign exchanges is exactly the same safeguard for the stability of the franc as the holding of an equivalent amount of gold, the psychological effect of a large gold reserve is decidedly stronger than that of a large foreign exchange reserve.

It was seen that, in the case of New York, a large gold reserve had contributed to the development of her international financial importance. On the surface, therefore, it appeared expedient from the French point of view to acquire a large gold reserve to the same end. The difference was that the inflow of gold to the United States was the inevitable consequence of war and post-war conditions; while, according to the

theory in question, the inflow of gold in France was artificially stimulated.

As was pointed out in the introductory chapter, the size of the gold reserve does not, by any means, determine the international importance of the market. It certainly gives the holder of the gold reserve a feeling of confidence, and it makes the market less dependent upon temporary tendencies, but, in the long run, it does not determine the extent to which a centre can play the part of the world's banker. It is a mistake, therefore, to attach such great importance to the size of a gold reserve from the point of view of the fight for international financial supremacy.

The third theory, that although the French authorities did not take the initiative in bringing about the appreciation of the exchange which was responsible for the inflow of gold, they nevertheless carefully avoided making use of the power they possessed to prevent such an inflow, differs from the previous theory only in degree. There is little to choose between actually encouraging certain tendencies and abstaining from counteracting them if the power to do the latter is at one's disposal.

Whenever the French authorities defend themselves against the accusation of deliberately bringing about the influx of gold, they are at pains to emphasise that the deficiencies of the technical organisation of the market, and the rigidity of the statutes of the Bank of France, prevent them from remedying the evil of the gold inflow. It is difficult, however, to convince intelligent opinion that such technical obstacles could not be overcome, had there been a real desire to do so. After all, the statutes of the Bank of France are subject to alteration by means of legislation, and, if the

French authorities really considered the gold influx inconvenient, they would certainly have been in a position to pass the necessary laws enabling the Bank of France to carry out operations to counteract the appreciation of the franc.

It may be objected that the increase of the French balances abroad, as a result of an excessive purchase of foreign exchange by the Bank of France, would be anything but desirable. In fact, some quarters are inclined to hold the view that the withdrawal of gold is preferable, as it tends to reduce the French balances. This argument, however, is hardly convincing, as the worst possible result of the existence of excessive quantities of French balances is that they may be withdrawn in the form of gold. The actual withdrawal of gold is not to be preferred to the existence of a possibility of withdrawal. Moreover, it would be possible to check the withdrawal of gold from London by means of the transfer of part of the Bank of France's balances from New York to London, without increasing their total.

According to the fourth theory, which is put forward by the French authorities, France is a victim of the influx of gold, against which she has had no means of defending herself. The authorities have done their best to encourage lending abroad, but the French public is reluctant to acquire foreign bonds. The freedom of action of the Bank of France is restricted by legislation enacted under Napoleon I., which forbids it to do anything that is not expressly set out in its statutes. This same theory also considers the inadequate facilities of the French money market as a contributory cause to the withdrawal of gold. As there are no adequate facilities in Paris for the investment of

idle reserves in liquid form, the French banks have to keep these reserves in London and elsewhere. Whenever these funds are required, whether for the purpose of the end-of-month settlements or for any exceptional purpose—such as the subscription to the shares of the Bank for International Settlements, or the increase of the cash reserve of banks, necessitated by the Oustric crisis—it is necessary to withdraw balances from abroad. This again tends to result in the appreciation of the franc and a flow of gold to Paris. This theory sounds very plausible, but for the fact that the tendencies have always been rather one-sidedly in favour of the withdrawal of funds to Paris. If it is true that the balances were required month after month for the monthly settlements, it is difficult to explain why those balances were not returned to London after the turn of the month, and why they did not provoke a corresponding depreciation of the franc. Undoubtedly, the heavy applications for the shares of the Bank for International Settlements necessitated considerable withdrawals of funds from London. These funds have, however, not been returned, even after the allotment of the Bank for International Settlements' shares.

There is no doubt about it that the inflow of gold is causing inconvenience to France from an economic point of view. In the long run, it is bound to result in the adjustment of the French price level to the world price level, and, if carried to the extreme, may even bring about inflation or a speculative boom. Thus it would be justifiable, and even desirable from a French point of view, to do everything possible to prevent an influx.

From an international point of view, the disadvantages of the hoarding of gold in France are only too obvious. In the opinion of a number of prominent

economists, the flow of gold to France was largely responsible for the decline of the world price level during 1929 and 1930, and was thus a contributory cause of the world-wide trade depression. Although it may be one-sided and exaggerated to put all the blame for the fall of prices upon the French gold policy, it is none the less certain that the withdrawal of gold from other markets to Paris was a very important factor, and had a large share in the responsibility for the international economic crisis. The persistent firmness of the French exchange and the frequent withdrawals of gold are, moreover, detrimental to international monetary stability and tends to delay the restoration of normal monetary condition.

From a British point of view, the hoarding of gold by France is particularly inconvenient, because London has to bear the major part of the burden. For the last two years or so, sterling has always been at a discount in relation to the franc, and most of the time it has been in the close vicinity of the gold export point. In fact, on several occasions since June, 1930, it has actually declined below its normal gold export point, owing to special circumstances which require detailed explanation.

At the beginning of June, 1930, the Bank of England discontinued the paying out of bars of fine gold, and supplied only bars of standard fineness ($\cdot916\frac{2}{3}$). The reason for this decision was that its stock of bars of fine gold had become depleted. On the other hand, the Bank of France refused to accept bars of gold inferior to a fineness of $\cdot995$. As a result, gold withdrawn from the Bank of England had to be refined first before it could be delivered in Paris. This meant additional expense and delay, in consequence of which

the gold export point of the sterling-franc rate declined from about 123.89 to a figure that depended upon the refining charge. As the refining charge was subject to frequent alteration the new gold point changed accordingly.

In addition, even this variable gold point (which may be named a "relative gold point") was valid only for an amount of £300,000 to £350,000 per day, which was about the limit of the total capacity of the refiners in London and Paris. Thus, if on any given day the demand for francs exceeded that amount, it brought about the depreciation of the exchange considerably below the rate which was the gold point for £350,000 on that particular day. This fact gave the impression that, for amounts exceeding that figure, there was no gold point at all, and that, in case of particularly heavy demand for francs, sterling might have depreciated to an unlimited extent.

This was a mistake, however, and a dangerous one, as it was calculated to undermine confidence in sterling. The fact is that the sterling-franc rate continued to have an absolute gold point for the transfer of unlimited amounts of gold, which was determined by the cost of triangular arbitrage operations. As the Reichsbank, for instance, was prepared to accept bars of standard fineness and was also prepared to pay out fine gold bars, the lowest rate to which the sterling-franc rate can decline was determined by the expenses of the shipment of gold from London to Paris via Berlin. This rate is calculated at about 123.45. In practice, of course, had such operations been carried out on a large scale, the depletion of the Reichsbank's fine gold bar stock would have compelled it either to stop accepting bars of standard fineness or to stop

paying out bars of .995 fineness. Three of the central banks—the Swiss National Bank, the Netherlands Bank, and the National Bank of Belgium—found it necessary to resort to the former alternative in anticipation of a depletion of their fine gold stock. Even if the Reichsbank had followed their example, there would have remained the theoretical possibility of shipping standard gold to New York, and then shipping fine gold from New York to Paris. Such operations would be, of course, too absurd to be considered seriously; it is, nevertheless, important to lay down the fact that they were possible to a practically unlimited extent, and that the expense of such operations determined the lowest point—the absolute gold point—beyond which sterling would not have declined. This fact is held to dispose of the belief that the anomalous situation that existed for over seven months has removed every limit to a possible depreciation of sterling.

One of the consequences of this unusual situation has been that the South African refined bar gold handled in the London market has risen to substantial premiums, the extent of which has been determined by the fluctuations of the French exchange. The French exchange, in turn, was largely influenced by the refining charge, which was first lowered from $1\frac{1}{2}$ d. to $\frac{3}{4}$ d. per oz., and was then gradually raised to $1\frac{3}{4}$ d., only to be reduced again subsequently. So long as there was a strong demand for francs, the Paris rate always tended to be in the close vicinity of its relative gold export point, which again depended upon the refining charge. As there is only one firm of refiners which is in a position to refine gold on a large scale, it was thus placed for a while in a position to determine the sterling-franc exchange rate and the market price of

fine gold. As soon as the insistent demand for francs relaxed, however, the refining charge had to be adjusted to the exchange rate so as to make it worthwhile for arbitrageurs to ship gold in spite of the rise in the sterling-franc rate.

The exchanges of the countries which followed the French example in refusing to accept bars of standard fineness—especially Belgium and Switzerland—moved in sympathy with the franc, bringing about some moderate shipments of gold from London to those countries. On the other hand, the exchanges of countries which continued to accept bars of a standard fineness—such as the United States, Germany, and Sweden—remained comparatively stable in relation to sterling. Considering that the abnormal appreciation of the franc in relation to sterling resulted in the transfer of funds from London to Paris via other centres, and brought about, therefore, a demand for reichsmark, dollar, and guilder, it is rather puzzling to know why these exchanges did not move against sterling. Failing a better explanation, this phenomenon may be attributed to the work of the psychological factor, *i.e.* the existence of links of solidarity between the currencies which are on a standard gold basis as against the currencies which are on a fine gold basis.

It was very unfortunate that the highly delicate and difficult international gold situation was further complicated by the Bank of France's attitude to insist upon a minimum fineness of .995. The Bank of England's decision, to deliver bars of standard fineness only, was dictated by necessity, as a result of the depletion of its stock of fine gold bars. The bulk of its influx consisted of sovereigns; its stock of bars of standard fineness has increased during and after

the war through the melting down of sovereigns withdrawn from circulation; while, during the same period, it exported to the United States the greater part of its stock of fine gold. During the twelve months ended May 31, 1930, the Bank sold fine gold amounting to £63,615,000, while the amount of fine gold bought was only £18,334,000; the bulk of its influx consisted of sovereigns. It is necessary to emphasise that, according to the Gold Standard Act of 1925, the Bank of England is only obliged to pay out "gold of the standard fineness prescribed for gold coin by the Coinage Act, 1870", so that there is no reason why that institution should incur expenses by refining its stock of standard bars in order to be able to deliver fine gold. It is for the arbitrageurs to stand the cost of refining if there is a sufficient margin of profits in the shipment to make it worth their while. Had the present situation remained in force for a prolonged period, it would have resulted in the gradual refining of all the existing stock of gold of a fineness inferior to .995, which includes not merely bars of standard fineness, but also bars of .900 fineness originating from the melting down of gold francs, eagles, etc. The process would have been a lengthy one, however, and it would have involved superfluous expense. At the time when efforts are being made to reduce uneconomic expenses caused by international gold movements, by means of earmarking operations between central banks and by means of the projected gold clearing system of the Bank for International Settlements, it would have been illogical to incur additional expenses merely in order to raise the fineness of the world's gold stock to the arbitrarily fixed figure of .995. It would have constituted a retrograde

step, calculated to increase the number of those condemning the fetish-worshipping of gold.

So long as that state of affairs existed, there could not but be a feeling of uncertainty in the foreign exchange markets as to the figure of the gold points, which was highly detrimental to the stability of the exchanges. As bars of fineness inferior to .995 were "demonetised" in several countries they were taken with reluctance also by other countries; for, in cases of emergency, they may not have been able to sell to countries on a fine gold basis. It is thus obvious that the discrimination against bars of inferior fineness caused considerable inconvenience to most central banks, as they possessed a fairly large amount of such bars. It caused inconvenience to the international money market and to the business world in general, as they could not reckon with the figures hitherto known to represent approximately the limits of possible exchange movements; nor did the French holders of sterling balances themselves entirely escape the inconveniences of this regulation, as they had to withdraw their funds at a time when sterling was temporarily at an abnormal discount in consequence of the refusal of bars of standard fineness by the Bank of France.

Nobody could attempt to put forward any arguments in favour of the general adoption of the use of gold bars of .995 fineness for securing the note circulation on the ground that they would serve that purpose better than bars of .916 $\frac{2}{3}$ fineness or .900 fineness. As the fineness of the French coinage has been fixed at .900, there was no advantage, even from a minting point of view, in insisting upon a minimum fineness of .995. The explanation put forward by the French authorities in a circular sent to their diplomatic

representatives, that the refusal of standard bars has been made necessary by the regulations of the Mint, sounded therefore unconvincing, especially as it was very easy to change these regulations, and even easier to change their interpretation. That is, in fact, what actually happened early in January, 1931, when the French authorities decided to waive their embargo on standard gold, and fixed .900 as the low limit of the fineness of the bars accepted by the Bank of France. There was no need to pass any legislation whatever to that end, and the facility with which the change was brought about makes it all the more difficult to understand the stubbornness with which the French authorities insisted until January, 1931, upon a minimum fineness of .995. Although their decision to remove this irksome restriction ought to be welcomed as a gesture indicating their willingness to co-operate in this respect, it ought to be borne in mind that the change was only brought about after a delay of seven months.

Paradoxical as it may sound, the restriction upon the import of gold of standard fineness tended to stimulate rather than discourage the flow of gold. Many people inclined to believe that the Bank of England benefited by the restriction as it prevented the withdrawal of large consignments of gold on French account. The fact is that, instead of taking a small number of large consignments, French gold importers took a large number of small consignments. While the withdrawal of large amounts within a few days would have resulted in a rise of the discount rate in London, and would have thus stimulated natural tendencies to check the efflux, the slow drain of gold that went on for months until the middle of January,

1931, failed to impress the discount market, and could have continued for a prolonged period without setting corrective influences in motion. Moreover, the depreciation of sterling below its normal gold export point, and the popular belief that in the changed circumstances it had no gold export point at all, and therefore might depreciate considerably, accentuated the withdrawal of French funds from London, and tended to increase the gold efflux. It is obvious, therefore, that the net result of the French embargo on standard gold was an increase and not a decrease of French gold withdrawals from London.

Some quarters were, in fact, inclined to regard the French attitude in this respect as deliberate sabotage aiming at undermining confidence in sterling. Even if we do not accept this extreme view, it is difficult to put forward any valid excuse for the delay of the French authorities in adopting the obvious common-sense solution, the removal of the embargo on standard gold. The fact that it took seven months before co-operation could be established on a purely technical point of this kind is calculated to damp the optimism of those who believe that the movement of co-operation is making satisfactory progress.

Even if we admit that no deliberate action has been taken to encourage the import of gold, it is impossible to exonerate the French authorities from the blame of having done nothing to prevent the movement. It is true that, in December, 1930 and January, 1931, the Bank of France supported sterling, but the extent of its support was not sufficient to check the outflow of gold. Moreover, after the removal of its embargo on standard gold, it unloaded the greater part of the sterling it purchased in the course of its

action of support; as a result, the efflux of gold continued at a time when it would have otherwise stopped. Some quarters are inclined to take the view that it would be indeed too much to expect the French authorities to go out of their way to help the Bank of England, considering that they received no help from this side when they were in trouble. This argument is highly unconvincing, however, as we pointed out in a previous chapter. Circumstances from 1924 to 1926 were such as to make it undesirable, even from a French point of view, to stabilise the franc so long as the Budget was not balanced. On the other hand, at present, it is to the interest of every country, including France, that the hoarding of gold should cease. It is, therefore, reasonable to expect the French authorities to take steps to prevent the influx, even if in doing so they may render a service to London.

CHAPTER XI

THE BANK FOR INTERNATIONAL SETTLEMENTS

THE plan for the establishment of the Bank for International Settlements has provided another field for the clash of French and British interests in the fight for financial supremacy. It is the irony of fate that this should be so, considering that the fundamental idea of the Bank is to assist the movement towards financial co-operation between various countries. That at least was the British conception of the plan. It was hoped that, with the aid of the International Bank, it would be easier to find a common basis for various countries to collaborate in an endeavour to maintain international monetary stability and to secure the comparative stability of the world price level. There are, however, signs which seem to indicate that the French idea was that the new institution should become the means to the furtherance of France's financial supremacy in Europe as an intermediate stage to world supremacy.

This is the reason why French interests were, from the very beginning, rigidly opposed to the idea of establishing the Bank in London, notwithstanding the fact that London would have been the most suitable centre for the activities of the Bank as the following considerations may tend to show:

(1) London is still the most important banking centre in the world, with an unparalleled banking organisation to transact international business of the kind that has to be transacted by the International Bank. From that point of view no other centre can be compared with it. We have seen, in previous chapters, the deficiencies of New York and Paris. Amsterdam, another alternative, possesses an international banking organisation and also an international outlook, but compares unfavourably with London in its resources and in the extent of its activities. Berlin has comparatively little international business. The same is true of Brussels, while, from an international point of view, neither Milan nor any Italian centre deserves consideration. Switzerland transacts a great deal of international business, but divides it among Zurich, Basle, Geneva, and Berne.

(2) London's foreign exchange market is more suitable than that of any other centre for the transaction of the foreign exchange operations of the international bank. We have seen in Chapter IV. that London is easily the best market in dollars, and that is the currency that matters more than any other. London is, moreover, in an almost monopolistic position in Europe as regards Latin American and Eastern currencies, and has the actual monopoly of most of the exchanges of the British Empire. Wherever the Bank is situated, it will have to transact any business in these currencies via London, so that it would have simplified matters to establish the Bank in London itself.

(3) London possesses the only gold market where there are regular supplies of gold in addition to the reserves of the central bank. Although, for the moment, London is at a slight disadvantage because the margin

of her gold stock—above the minimum requirements—is narrower than that of either New York or Paris, this is obviously only a temporary state of affairs. As the Bank is not meant to be established for only a year or a decade, but as a permanent institution, it is the long view that matters. There is no doubt about it that, in the long run, the Bank of England will be as well in a position to part freely with any amounts of gold, without inconvenience to the market, as any other bank. Moreover, the regular free supplies of gold will also continue to come to London, wherever the Bank is established, since owing to close political, commercial, and financial association with London, and owing to the exceptional transport facilities to this centre, South Africa will always continue to send her surplus gold to the London market, where she can depend on a regular demand.

Nor is it at all certain that the central banks who possess gold stocks larger than those of the Bank of England will part with gold as freely as the latter institution, whose willingness to part with gold has undergone a real test since the war.

(4) London's superiority as a bill market is so generally known and admitted that this point needs no further arguments. It is, in fact, the only really good bill market in the world. We have seen in previous chapters how much inferior both Paris and New York are to London, as far as the bill market is concerned, and also that it is unlikely that they will ever equal London in this respect. The Amsterdam bill market is about the best in the Continent, but its turnover cannot be compared with that of London. As for Switzerland, the system of discrimination adopted by the national bank against bills financing foreign trade be-

tween two foreign countries makes the development of an active bill market impossible.

(5) London's geographical position may not be as advantageous from the point of view of intercourse with Continental countries as that of some Continental centres—especially Switzerland—but it is certainly more advantageous from the point of view of the intercourse of Europe with other continents in general and with the United States in particular. It would be a mistake to regard the Bank as being destined to remain an essentially European institution. Admittedly European interests predominate—although American and Japanese interests are also well represented—but its authors meant it to develop into a world bank. None of the Continental centres nor New York is in such an advantageous geographical position as London as the clearing-house of the world. Mail routes and cables from East and West converge upon London to a greater extent than upon any other single centre.

In addition, London has a stronger claim than any other centre to house the head offices of the Bank on moral grounds. Having been the financial centre of the world for many generations, she has a justified claim to regard that position, with its privileges and burdens, as her personal property. The establishment of the Bank in a rival centre tends to some extent to weaken London's position, while it does not weaken the position of other centres which cannot lose what they have never possessed. Thus, the centre receiving the Bank gained largely at the expense of London. As no special British interest attached to the establishment of the Bank, there was no reason why Great Britain, of all countries, should sacrifice part of the

advantages she possessed for the sake of it. Had the centre been established in London, it would have merely confirmed the existing state of affairs. As it is established in Switzerland, it gives a present to that country which has no more claim than any other country to receiving such a gift.

The experts of the Young Committee were unable to come to an agreement as to the seat of the Bank. They deferred the decision to a later date; and the question was discussed at the first Hague Conference, but no decision was reached. It seems that, at that time, neither Mr. Snowden nor the British monetary authorities appreciated the true significance of the location of the Bank and did not make adequate efforts to secure the institution for London. This is to be regretted from a British point of view, as, at that moment, it would perhaps have been possible to obtain the agreement of the other Powers to the location of the Bank in London. The organising committee of the Bank, which met at Baden-Baden in October and November, 1929, decided to choose Basle for the seat of the Bank. The belated British claim for its establishment in London met with the determined opposition of the French delegation. It was understood that the French authorities were prepared to jeopardise the Bank scheme and the whole Young Plan rather than agree to the establishment of the Bank in London. Undoubtedly its establishment at Basle is about the next best solution, both from the point of view of the Bank and from a British point of view; in spite of this, it is to be regretted that the British claim was not adequately pressed from the very beginning. Although, at the present moment, the loss of business brought about by the establishment of the

Bank in another centre does not appear excessive, it is premature to form a judgment in that respect. Nobody knows into what the International Bank may yet develop. Possibly, within a few years, its importance will greatly increase and with it the loss caused to the London market by the policy of jealousy followed by the French authorities.

The location of the Bank at Basle was a decided set-back for British interests in the fight for international financial supremacy. The French authorities have followed up their victory by strengthening their position in the management of the Bank. According to the Young Plan, the Bank of France was entitled to appoint three directors against the two directors to be appointed by the Bank of England. Moreover, the French authorities have secured for themselves the post of the General Manager. The importance of this post cannot be too greatly stressed. After all, the Board of Directors meets only ten times a year, so that there is an interval of at least four weeks between two meetings. As the statutes are very vague, the management has considerable freedom of action. This appointment met with the persistent opposition of German interests, who realised the disadvantages of the situation, and insisted on the appointment of a neutral to that post. Their opposition was, however, waved aside. On the part of British interests, nothing was done to secure the post. It might have been possible to insist on an Englishman filling the post, in compensation for agreeing that the Bank should not be established in London. This opportunity was also missed, however, and the British authorities were satisfied with the allotment of a few secondary posts to British nationals.

Another move in this supreme game of chess was the decision of the Board of Directors to confine the activities of the Bank, for the time being, to Europe. This excluded the participation of the British Dominions and of the Latin-American countries which, most probably, would have been favourable to British, rather than French, interests. Moreover, the idea of making the Bank into a European Bank, rather than a truly International Bank, fits in remarkably well with M. Briand's scheme of the "United States of Europe". France is well aware that she stands a better chance of attaining hegemony in a European combination than in a world combination. This is, however, against the intention of the authors of the scheme, and it is of great importance that the activities of the Bank should be extended all over the world, even if it is only from the point of view of spreading the risk.

French interests made yet another attempt calculated to complete their victory. At the meeting of the organising committee of the Bank for International Settlements, the French delegation submitted a proposal for the establishment of an international unit of account, called "grammor", equivalent to one gramme of fine gold. They did not suggest that the Bank should issue currency in "grammor" denomination; that would have been, in fact, against the intentions of the Young Plan, which expressly precluded the Bank from becoming a bank of issue. The "grammor" was suggested to be merely a book-keeping unit in which all the accounts of the Bank were to be kept. According to the memorandum submitted by the French delegation, every central bank was to keep a "grammor" account with the Bank, and an international clearing service would have to be organised in terms of "grammor".

There were some very obvious reasons for opposing this scheme. It would merely have complicated the book-keeping of the Bank, as every item which passed through it would have had to be converted into and from "grammor". Against this it was difficult to see any compensating advantage. Moreover, there was reason to believe that the proposal of the French delegation was the first step in a most ingenious plan aiming at the increase of the international financial importance of France. Though no actual information is available to that effect, it is highly probable that the intention of the French authorities was to adopt the "grammor" as the French monetary unit as soon as it was adopted by the International Bank as its official unit of account. The present monetary unit in France has no traditions, and has no connections whatsoever with any other currency. The re-establishment of the Latin Monetary Union is entirely out of the question. If, however, France were to adopt a unit which appeals by its simplicity, it might be possible to induce a movement of other countries to adopt the same unit; especially if that unit was, at the same time, that of the International Bank. It is possible that the majority of European countries, and even perhaps a number of countries outside Europe, would have agreed to adopt the "grammor" and would have formed thereby a strong link with the French currency. On the other hand, it is entirely out of the question that either Great Britain or the United States would have abandoned their currencies for the sake of the "grammor". The world would have been divided, from the monetary point of view, into one big block of countries grouped around France with a uniform monetary unit, and two smaller groups,

namely, the British Commonwealth and the United States, together with countries in the American sphere of influence. The influence of France would have been predominant in the group of countries that adopted the "grammar". It would have secured for France considerable economic as well as political advantages at the expense of Great Britain and the United States.

It is not surprising, therefore, that the French proposal was not received with enthusiasm at the Baden-Baden conference. It met with the almost unanimous opposition of the other delegations and was rejected by a large majority. This, however, does not necessarily mean that the French authorities have abandoned their favourite scheme. It seems probable that, sooner or later, another attempt will be made in the same direction.

CHAPTER XII

CONCLUSION

WE have seen in the preceding chapters that while co-operation with the United States is, on the whole, satisfactory, co-operation with France leaves much to be desired. In all fairness, it should be admitted that the fault for this does not lie exclusively with France. At the same time, it is impossible not to admit that France has been pursuing an aggressively ambitious policy which is incompatible with co-operation. The French idea of co-operation seems to be the formation of a European block and the hegemony of France. It has been a favourite dream of the French authorities to create a united front of European debtors of the United States, in the hope that, by such means, it would be possible to force concessions from Washington in the matter of the debts. The European United States plan is a modified form of this idea, but pursues the same end. It is hardly necessary to say that the endeavours to bring pressure to bear upon the United States by such means are doomed to failure. Any reduction of the American debt must necessarily be an act of grace on the part of the United States, and any political, economic, or financial manœuvring to that end is likely to do more harm than good. From a British point of view, there is little to be gained and a

great deal to be lost as a result of participating in such a combination. Although, geographically, Great Britain forms part of Europe, politically she is, in the first place, part of the British Empire. The chances are that, within the next few decades, the non-European character of the British Empire will become accentuated, namely, by the expansion of Canada—which Dominion is on the eve of an evolution similar to the one witnessed in the United States during the last few decades. This, in itself, makes it undesirable for Great Britain to become wedded to Europeanism, especially as it would mean an incessant struggle for hegemony with France. From an economic point of view, Great Britain is more closely associated with the four other continents than with Europe, both as regards the supply of raw materials and markets for manufactures. From a financial point of view, Great Britain has closer links with the United States than with Europe. In the past, the two Anglo-Saxon countries have found it easy to create a common basis for financial co-operation, and there is every reason to believe that this will also be the case in the future. It would be anything but wise to sacrifice these advantages for the sake of the doubtful benefits that can be derived from the adoption of an inverted Monroe doctrine as the basis of Great Britain's European policy.

This, however, does not mean that Great Britain should keep away in splendid isolation from European financial affairs. Her participation in these affairs would be by no means incompatible with a non-committal policy towards Europe. In fact, London has played in the past, and is likely to play in the future, a very important part as an intermediary between Europe and New York. In this capacity, she can

render much more useful services to Europe than in her capacity of a member of the European block directed against the other continents.

If London were to be faced with the alternative of choosing between co-operation with New York and Paris, there could not be any doubt about the decision. There is, however, no necessity for co-operation with one exclusive of the other—unless the ambition and aggressive policy of Paris compel London to turn towards New York. It would be indeed a very short-sighted policy on the part of Paris to enforce such a trend of developments, for she stands no chance against the combined strength of the two Anglo-Saxon centres. An aggressive policy on her part would lead to her isolation, and, in the long run, she would be bound to pay a price for it. The success of the Bank for International Settlements itself would be jeopardised by such an extreme policy; for if that institution becomes the hotbed of political intrigues it cannot possibly fulfil its object. Should the French authorities use their predominant influence in that Bank to pursue their political or politico-financial ends, the inevitable consequence will be that the interest of Great Britain in that institution will be reduced to a minimum, and co-operation with her will become formal and superficial. In that case, developments might take such a turn as to culminate in the collapse of that institution.

It is equally important to lay stress on the political effects of excessive rivalry. Although France may score victories in the struggle for international supremacy, as she did in the case of the International Bank and in the case of gold movements, such victories will prove costly in the long run. They are bound to be detrimental to Anglo-French relations. A policy

of pin-pricks may cause momentary satisfaction to the hotheads of political and financial circles in Paris, but will be detrimental to the fundamental interests of France. The influence of financial considerations upon the external policy of Great Britain and upon British public opinion should not be undervalued. At present the majority of British public opinion holds the view that a victorious Germany would be a much more unpleasant proposition to deal with than a victorious France. During the last few years, short-sighted French policy has done its utmost to bring about a change in British public opinion in this respect.

It is thus obvious that France has a great deal more to lose than to gain by an uncompromising attitude in matters of international finance. This does not mean, however, that she has to purchase the sympathy of British public opinion by means of abandoning her ambitions to develop Paris as an international financial centre. Sound competition is all to the good, and is certainly not likely to cause ill-feeling between two nations. To some extent the development of Paris as an international financial centre is decidedly favourable from the point of view of London; even if her development exceeds those limits, it is unlikely to be a source of irritation on this side of the Channel, so long as the rivalry is carried on with due observation of the rules of the game.

There is indeed wide scope for co-operation between the three centres; none of them is at present strong enough to support any really large international loan transaction without the assistance of the others. If all three were to adopt the attitude which characterises the French financial houses, namely, to refuse to participate in any transaction unless they led the syndicate,

there could, of course, be no question of any co-operation at all. If the three centres are to work together, each must be prepared, from time to time, to play a secondary part in international syndicates.

Another field in which co-operation should produce useful results is that of acceptance credits. In this respect, cut-throat competition has resulted in the reduction of the rates of commission on acceptance credits to a figure which is barely sufficient to pay for the clerical work involved, and, as such, does not allow an adequate margin for risks. It is equally important that acceptance markets should co-operate with each other by exchanging information so as to avoid over-borrowing by firms who draw upon the limit of their credits in every centre.

Above all, co-operation is necessary in order to bring about stability in the international money market, as well as a comparative stability of the world price level. Without co-operation the world would be constantly exposed to disturbing influences threatening the stability of various currencies, and it would be impossible to prevent wide movements of international prices such as have taken place during the last two years.

APPENDIX I

AMSTERDAM AS AN INTERNATIONAL CENTRE

ALTHOUGH this book is primarily concerned with the fight for supremacy which is going on between the three leading financial centres, it is not superfluous to cast a glance upon the minor rivals which have arisen since the war. Amsterdam is easily the most important of these. Her discount market holds the lead among the discount markets of the Continent, in spite of the spectacular development of the Paris discount market since the stabilisation of the franc. Her foreign exchange market is also as good as any on the Continent. In a small way, the Amsterdam market provides very good facilities for foreign loans.

While the development of Paris and New York has received a great deal of publicity, that of the banking centre of Amsterdam has passed almost unnoticed. This is probably because the progress of Amsterdam was gradual, whereas that of Paris and New York was sudden, and because the ambitions of Amsterdam were far more modest than those of Paris and New York. In the case of Amsterdam, the development was an inevitable consequence of the inflow of German and other foreign capital after the war. The handling of these funds provided a certain amount of international banking activity and necessitated the development of a discount market. A large portion of these funds were kept in a liquid form, so as to be ready to be transferred at a moment's notice. Although the facilities for short-term investment were adequate for the normal requirements of Holland, they proved to be inadequate for these abnormal temporary requirements. Amsterdam suffered, consequently, from an acute *embarras de richesse*. For this reason, the Nether-

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lands Bank induced commercial banks and private banks to take up and expand acceptance business. The establishment of German banks' "affiliates" has also helped considerably the development of the Amsterdam bill market. A great part of the acceptance business which was done by the London branches of German banks before the war is now done by these "affiliates".

After the plethora of liquid foreign funds dried up there was no longer any need to force the expansion of the discount market. Far from encouraging a further rapid increase, the Netherlands Bank is, in fact, desirous of checking any undue expansion that may become detrimental to stability. It has restricted the volume of bills by exercising extremely strict discrimination against finance bills and other bills of an undesirable kind. Thanks to the disciplined and loyal co-operation of the banks, it has succeeded in establishing an absolute control over the bill market. Every bank of standing, before granting an acceptance credit of any importance, submits the full particulars of the transaction to the Netherlands Bank for preliminary approval. The latter informs the banks whether or not the bills to be drawn on the credits in question would be eligible for rediscount. As in London, so in Amsterdam the great majority of bills are never actually presented for rediscount, so that the reply does not bind the applicant bank in any way. But in spite of this, the preliminary blessing of the Netherlands Bank is essential to make the bills marketable. While in London ineligible bills—such as acceptances of foreign bank branches, for instance—are actively dealt in at rates above the prime rates, in Amsterdam ineligible bills are practically not marketable, and no bank of standing would either accept or discount such bills.

Thus, although the amount of rediscounts of the Netherlands Bank is comparatively small, its moral control over the market leaves nothing to be desired. It is probably owing to this circumstance that the authorities can afford to pursue a policy that is in several ways more liberal than that of other central banks. The acceptances of foreign banks established in Holland are admitted for rediscount on the same terms as those of Dutch banks. It was found desirable to grant this equality

of footing, not merely because the foreign banks assisted in the development of the Amsterdam market, but also because, having admitted them to equal privileges, the authorities are in a better position to control their activities. Owing to their strength, the German banks established in Holland would have probably been able to develop a market for their acceptances, even if they had not been given rediscount facilities; this market would have probably escaped the control of the Netherlands Bank. It is worth noting that, although these acceptances are now eligible for rediscount, the rate they command in the discount market is slightly above prime rate.

Thanks to its control over the market, the Netherlands Bank is in a position to keep bill rates low, to the benefit of domestic trade, without thereby provoking an abnormal increase of foreign acceptance credits which would eventually lead to a rise in discount rates. There is no discrimination against bills financing trade between two foreign countries; so long as they appear to be genuine commercial bills they are admitted. As, however, it is in most cases impossible to ascertain beyond doubt whether or not a bill is genuine, the strict or lenient attitude of the authorities towards the large number of doubtful cases determines to a great extent the volume of bills.

But for the conservative policy of the Netherlands Bank it would have been possible to bring about a considerable expansion of the Amsterdam bill market, for there has always been a keen demand for bills on the part of Dutch banks. There is also some demand on foreign account; the Netherlands Bank often buys bills on account of foreign central banks, and part of the French balances in Amsterdam has assumed the shape of bill holdings. Generally speaking, however, there is no systematic foreign demand for bills as in London, and it may be said that the Amsterdam bill market is local rather than international in character.

It is probably for this reason that the development of the Amsterdam bill market did not arouse any jealousy in London or in New York. On the other hand, the subsequent development of the Paris discount market aroused no jealousy in Holland. Dutch banking circles are well aware that, if the

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development of Paris continues at its present pace it will soon overshadow Amsterdam as the leading Continental discount market, but the Amsterdam banker does not begrudge the progress of Paris, even if it is more rapid than that of Amsterdam, so long as the former's expansion does not actually divert business from the latter. Generally speaking, no such diversion of business has in fact occurred. Amsterdam can attract as much business as it is able to carry without overstraining its resources. So long as this is the case, the question whether Amsterdam is first or second on the Continent is considered of little importance in Dutch banking circles.

For similar reasons, the decline of the demand for Dutch acceptance credits for Central European countries, brought about by the recovery of these countries, did not worry banking interests in Amsterdam. In 1924, though monetary stability in Central Europe had been restored, London and New York were reluctant to grant direct credits. Amsterdam acted as intermediary until confidence in progress towards stability had been sufficiently restored to make the establishment of direct links with the two leading centres possible. The Amsterdam bill market did not, however, suffer a setback as a result of the change. If there was a decline in the volume of certain types of acceptance business, it was more than offset by the expansion of other types. Nor did the withdrawal of part of the German, French, and Belgian balances after the stabilisation of their currencies deprive the Amsterdam market of the liquid resources necessary for maintaining a steady demand for bills. Although originally it was the existence of these balances which necessitated the creating of a discount market, meanwhile Dutch banks and business houses recognised the advantages of keeping their liquid reserves in the shape of commercial bills, and their gradually increasing demand has more than counteracted the decline of demand on foreign account. In fact, the authorities are in a way relieved at the reduction of elusive foreign resources to comparatively normal proportions, as it has contributed towards the stability of both bill market and foreign exchange market.

Amsterdam, like every other discount market, has been

affected by the world-wide increase of demand for short-term investments, which, together with the simultaneous decline of demand for acceptance credits by first-class borrowers, has created a rather anomalous position. There is every reason to believe that, once equilibrium is restored, the Amsterdam discount market will continue its moderate expansion. Dutch banking quarters are well aware of the limitations of their resources, and the sober and practical spirit of the authorities will safeguard the market in future, as in the past, against the disturbing effect of sudden growth followed by sharp reactions. There is a natural desire for expansion, but only because it means additional business, and not for the sake of the somewhat illusory benefit of the enhanced international prestige attached to it.

The Amsterdam foreign exchange market was especially active during the period of speculation in foreign exchanges. In fact, it was regarded as the most speculative of all foreign exchange markets. While exchange restrictions prevailing in Germany, and other considerations, prevented the German banks from taking a very active part in foreign exchange speculation in Berlin, the activities of their subsidiaries in Amsterdam were not fettered. In addition, Amsterdam became the meeting-place of professional speculators in foreign exchanges. As a result her turnover in foreign currencies was quite out of proportion to the resources of the market. Fortunately for Amsterdam, the gambling fever in foreign exchanges died down, and the activity in the foreign exchange market subsided to normal dimensions. Amsterdam has succeeded in retaining a fair volume of normal commercial business in foreign exchanges, and will continue to play an important part as one of the foreign exchange centres.

In her issuing activities Amsterdam was very fortunately placed during the period 1924-1928. As a result of the unprecedented prosperity of the Dutch Colonies, the Motherland had ample funds at her disposal for lending abroad. For this reason she could afford to participate in a number of international loans; in fact, hardly any loans were issued, either in London or New York, without the participation of Amsterdam

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to a small extent. In a way, the investing public of the Netherlands is even more international than the British investing public. While in Great Britain it is impossible to issue a loan in terms of foreign currency, the Dutch investor has no objection to such loans, which makes it easier for international banking groups to come to terms with participating Dutch banks. The fact that a great many foreign dollar loans were introduced into Amsterdam has had rather unfavourable consequences for that centre. During the Wall Street boom, large amounts of these dollar bonds, which were badly placed in the United States, found their way to Amsterdam. While foreign bonds issued in terms of guilders suffered comparatively little during the depreciation of the international bond market in 1928-1930, dollar bonds interchangeable between New York and Amsterdam were entirely at the mercy of tendencies in New York. This state of affairs disclosed the weak point in the Dutch system, which may yet become the source of considerable inconvenience. It shows that the insistence of the London market that foreign loans quoted there should be expressed in terms of sterling and should not be interchangeable is by no means unreasonable.

Apart from her participation in loans issued in New York and London, Amsterdam has also displayed a fair amount of independent issuing activity in conjunction with Switzerland and Sweden. During 1928 and 1929, when the leading markets became increasingly reluctant to issue foreign loans, these three Continental centres, usually under the leadership of Amsterdam, issued a considerable number of small loans.

As a result of the slump in colonial produce in 1929 and 1930, the absorbing capacity of the Amsterdam market has declined to a great extent. Although a revival in the price of colonial produce may bring about a favourable change, it is evident that the limitations of the Amsterdam market are comparatively narrow. It will never develop into a dangerous rival to London or the other leading centres. Nor is this the ambition of the authorities. They are content with the secondary rôle Amsterdam plays in international finance, and are not likely to make any effort to develop into a financial centre of first-rate magnitude.

APPENDIX II

SWITZERLAND AND STOCKHOLM AS FINANCIAL CENTRES

IN addition to Holland, Switzerland and Sweden have also made good progress since the war in the field of international finance. Without competing with the three leading financial centres, they have succeeded in establishing themselves safely as financial centres of secondary importance. Curiously, it is a matter of common belief that the Swiss financial market is more international than any other. The origin of this belief is the general international character of the country with its population speaking four different languages; the hospitality with which international institutions are received on Swiss territory; the favourable geographic situation of the country; the great extent to which it has been used as a refuge of foreign funds during and after the war; and the large number of international bankers, arbitrageurs, and foreign exchange dealers of Swiss origin who have established themselves in foreign banking centres. In spite of appearances, however, the Swiss financial market is essentially national in character. In this respect, it is in sharp contrast with Amsterdam, which, if possible, is even more international than London. While in Holland the subsidiaries of foreign banks and foreign finance companies are welcome, in Switzerland they are discouraged by restrictions in law and in practice. While in Holland the issue of foreign loans meets with no opposition, in Switzerland there is a hostile public opinion against foreign loans, which often discourages Swiss banks from making public issues on foreign account. While in the Dutch discount market the authorities do not discourage bills financing trade between two foreign countries—provided they are genuine commercial bills—in Switzerland the

central bank has adopted measures of discrimination against such bills.

We pointed out in Appendix I. that an excessive expansion of the use of guilder acceptances is prevented by the discipline prevailing among Dutch banks, who are willing to submit every transaction to the preliminary approval of the Netherlands Bank. In Switzerland, the same end has been attained by a totally different method. The Swiss National Bank has laid down the rule that only bills financing Swiss trade are eligible for rediscount. As the volume of Swiss import and export trade is not very large, the amount of prime bills that may come to the Swiss market is thereby confined within comparatively narrow limits. The National Bank can thus discourage the flooding of the Swiss market by bills financing trade between two foreign countries. At the same time, it effectively prevents finance bills from benefiting by rediscount facilities. For it is easier to verify the genuine character of a bill that claims to represent the value of goods bought or sold by a Swiss firm than that of a bill financing alleged commercial transactions between two foreign countries. According to the experience of the London market, such bills are, as often as not, finance bills pure and simple. Thus, in addition to keeping the volume of bills down, the restriction adopted by the Swiss National Bank tends to improve their quality.

The policy of discrimination against bills financing trade between foreign countries does not, however, altogether prevent Swiss banks from accepting or acquiring such bills. While in Amsterdam bills that are not eligible are practically unmarketable, in the Swiss discount market there is active dealing in such bills. There is a keen demand for bills not only by the commercial banks, but also by the "Kantonalbanks", which control considerable liquid resources, and, not least, by foreign holders of Swiss balances. The volume of eligible bills is inadequate to satisfy this demand, and ineligible bills are, therefore, easily marketable—at a higher rate than that for prime bills. Those who acquire them usually intend to keep them till maturity; if they change their mind they can always find buyers for the bills, especially as the discrepancy between the rates of

eligible and ineligible bills tends to be smaller for short-dated bills.

Normally, there is a discrepancy of at least one-half per cent between the rates of a three-months' eligible bill and a three-months' ineligible bill. This has the advantage of preventing foreign borrowers from taking advantage of the low money rates prevailing in Switzerland. Thanks to this system, the National Bank was able to maintain a low bank rate throughout the upward trend of international money rates during the Wall Street boom. As a result, Swiss home trade benefited by low rates of interest, while foreign borrowers, so far as they availed themselves of Swiss credits, had to pay a higher rate, and thus contributed towards keeping up banking profits. It appears that the discrepancy tends to be wide when it is important from the point of view of the Swiss home trade that foreign borrowing should not raise domestic money rates, while it tends to be narrow when there are ample resources available for foreign credits—an ideal system from a Swiss point of view, as the Swiss authorities do not attempt to develop a discount market of great international importance. If the decline in the rate for ineligible bills should result in an excessive expansion of the volume of such bills this need not necessarily affect the rates paid by Swiss trade. All that would happen is that the discrepancy would be widened through a rise in the rate for ineligible bills, and the rate for eligible bills would not necessarily be affected.

There is no rigid rule preventing the National Bank from rediscounting bills financing trade between foreign countries. If its rediscounts decline to too great an extent it may, if it chooses to do so, rediscount such bills. In practice, it has given preference on such occasions to short-dated bills. If, at any time, it wants to increase the international rôle of the Swiss financial market all it has to do is to relax the self-imposed restriction. For the present, however, there is no intention to embark upon any ambitious expansion.

The Swiss financial market is essentially decentralised, owing to the existence of four financial centres of importance, viz., Zurich, which is considered the chief banking centre; Berne,

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where the headquarters of the National Bank are located; Basle, whose importance has been greatly increased by the establishment of the Bank for International Settlements; and Geneva, with its French and Italian connections. This decentralisation may be detrimental to the development of an important Stock Exchange, but does not in any way handicap the development of the discount market, loan market, or foreign exchange market. Owing to the proximity of the four centres, and to their excellent telephone connections, their banks can deal with each other almost with the same ease as if they were situated in the same centre. From an international point of view, the decentralisation of the financial market makes no difference, for foreign banks may get in touch with any of the four centres and find no difficulty in receiving a quotation of rates. As the market is active, it is comparatively easy to deal in fairly large amounts. But for the extreme conservatism of the authorities, the Swiss market could develop into a strong rival of Paris as well as of other centres without, however, rising to international supremacy.

The Swiss foreign exchange market had a very busy time during the period of wide fluctuations, and has succeeded in obtaining a substantial volume of permanent business. In fact, it may be regarded as the leading Western market in the currencies of smaller central and south-eastern European countries. The issuing activity of the Swiss market is handicapped by the unpopularity of foreign loans and by the frequent campaigns conducted against them. Otherwise Switzerland would play a more important part in this respect.

The establishment of the Bank for International Settlements in Basle will help considerably in the development of Switzerland as an international financial centre. It will also raise the relative importance of Basle among the Swiss centres. It would be a mistake to believe, however, that the Bank for International Settlements will develop Switzerland into a first-rate financial market. After all, it should be remembered that the greater part of the activities of that Bank will be carried out in currencies other than the Swiss franc, and the greater part of its operations are in foreign markets. Undoubtedly, the

presence of the International Bank will attract a number of international companies to Basle; possibly, in the course of time, she may become as important a financial centre as Amsterdam. Owing to the limitations of the resources of the country, however, it will never become a dangerous rival to London.

The development of Stockholm as a financial centre is largely due to the spectacular international expansion of certain specialised industries in Sweden. As a result, Stockholm has assumed a comparatively important rôle. She has participated to a modest extent in a large number of issues, and has even undertaken the issue of loans independently from any other centres.

The Swedish authorities and banking interests do not, however, aim at developing Stockholm into a leading international banking centre. Their ambition is merely to become the banking centre of Scandinavia and Northern Europe. To a very great extent they have already attained this end. The other Scandinavian countries and the Baltic States look upon Stockholm as their natural financial market, and have developed close banking connections with her. But the Swedish banks do not attempt to develop a discount market proper in Stockholm, and this makes it clear that they are not aiming at international supremacy. They realise that a market in krona acceptances would necessarily be rather limited, and would not provide adequate facilities either to investors or to borrowers. For this reason Swedish banks do not grant direct acceptance credits to their Swedish and other northern European customers, but arrange acceptance credits for them in London or other centres. As they enjoy excellent standing abroad, they are in a position to obtain such credits on the basis of the minimum commission charged to first-class banks, and they are thus in a position to secure for their customers cheap credits with reasonable profits to themselves.

The Stockholm foreign exchange market is a local northern European market, rather than an international market. One of the most important branches of its international banking activity is stock arbitrage. In this respect, Stockholm is second

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to none of the Continental centres, owing to the comparatively large number of Swedish industrial securities which are well introduced in foreign stock exchanges.

It is obvious that Stockholm is even less likely to develop into a first-class rival than either Switzerland or Amsterdam. These three centres, being aware of their limitations, seek to co-operate with the three leading centres. While Amsterdam and Stockholm are decidedly more closely connected with London than with the other two centres, the relations of Switzerland are about equally close to London and Paris. The authorities of the three centres are wise enough to display complete neutrality in the struggle for international supremacy between the leading centres, as they have nothing to gain or to lose by the victory of any one of them.

THE END