INTERNATIONAL MOVEMENTS OF CAPITAL
AS AN AID TO WORLD ECONOMIC RECOVERY

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The purpose of this work is to set forth the great importance of the role played by International movements of capital in the economic system of the world; to show what that role has been in the past, particularly its connection with the events which led to the world depression; and to discover whether a resumption of the international movement of capital is possible, and if so, whether it will be of aid in furthering world economic recovery.

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THE INTERNATIONAL MOVEMENT OF CAPITAL

I. INTRODUCTION

In a study of the international movements of capital, an explanation of what is meant by the term "movement of capital" is a necessary preliminary. Capital can be described as wealth saved for use in further production. The term covers wealth in any of its forms, but as here used, it is taken to mean command over wealth, represented in terms of money. Nowadays, it rarely happens that the person who saves capital uses it himself in further production. There was a time, when, not only was little wealth accumulated, but what was accumulated was frequently used by the same person, or persons, in further production. The mediaeval merchants and most of the earlier tradesmen or master craftsmen largely financed themselves. With modern industrial development, first commerce, then industry became divorced from finance. As a result some means had to be devised of transferring capital from those who saved to those who used it in production. This transfer constitutes the "movement of capital". Its study is thus an analysis of the methods which have been adopted to meet this necessity.

Due to the growth of an international division of labor, capital frequently has to move between persons who are not inhabitants of the same country. When this is the case, there are additional forces to be taken into account, and the methods devised for transferring must be modified accordingly. This work is concerned with capital movements under such circumstances. The ordinary mechanism of capital movements is not studied except in so far as it is vitally affected by the movement of capital across national boundary lines.

What are the essential differences between international capital movements, and those within national boundaries that necessitate a separate study of the former? One is, that when capital movements become international the terms in which the value of the capital concerned are reckoned, must be changed. Our units of value are all national units. In one country a specific amount of wealth is worth so many dollars, in another so many pounds, in still another so many francs, etc. Even when the name and the nominal value are the same, as was the case of the Canadian and American dollars, these units are never identical. The complications

caused by this change in unit of value, are a distinguishing feature of International Capital Movements, especially when, as in the present period, the relative values of these units fluctuate to a considerable degree. Yet it is not that fact alone which gives the topic its great importance.

International Capital Movements deserve separate study because they are intimately bound up with the question of national finance and national policy. That does not imply that movements of capital within the nation are not also a matter of great interest to governments--in fact, regulation of such internal movement is a subject with which many are deeply concerned. But, except in so far as such regulation may drive capital from the country, it is a matter to be settled by the individual action of the country in question.

With regard to international movements the situation is quite different. The whole range of a country's relations with its neighbors, financial, economic and political, is involved. All countries are today very closely connected in many ways, and it seems increasingly evident that the present depression, covering all nations, can only be remedied by forces which operate internationally. Therefore any operation, such as Capital Movements which affects international relations, is worthy of intensive study.

the econ. question?

If capital, and also labor, flowed freely through the world, without let or hindrance, there would be a different story to tell. But, aside from all artificial interference, such things as ingrained habits, differences of language and customs, and ignorance of other areas cause friction.

When Nationalism is prevalent, the friction is much greater. A free movement of the agents of production causes many economic changes. In so far as such changes are, or are believed to be, detrimental to any nation, forces are set in motion, which serve either to check the free flow, if it is in progress, or to prevent it materializing.

As is well known, there was a period, during the last century, when, especially in England, there was far less belief in governmental regulation and control, and when Nationalism, particularly in its economic aspects, was less rampant. During those years there was the closest approach to the free flow of the agents of production that the world has yet seen. In consequence the subject of International Capital Movements received relatively less attention than it has in recent years. Compare the relative space devoted to this subject in the works of Mill, Bastable or Nicholson, to that in the works of such modern economists as Taussig, Cassel, or Keynes.

The first mentioned group of economists centred their thoughts very largely upon a world wide economy, not a national one. They believed that the closer we come to a world economy the better off each individual part of the world would be. Further, they assumed that at least an approach to such a condition existed. "The underlying assumption on which the free interchange of capital among nations was taken to be a safe and sound policy.....was, that the world was civilized to a point at which there was no need to fear that its whole economics arrangements would be upset by war--"[1]

The validity of this assumption was sadly shaken by the Great War. At present many openly advocate National self-sufficiency, or at least an approach to it. And others, while believing in a world economy, are dubious of its immediate practicability. It is felt that, as the free movement of the agents of production is seriously curtailed in many countries, each country should see that this curtailment is, so far as possible, in its own interests.

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[1] Hartley Withers, "International Finance" P. 28

Belief by the citizens of any country in a world economy, implies one of two viewpoints: Trust and confidence in other countries; or else a belief that their country is powerful enough to prevent others from disregarding their desires to any harmful extent. This situation did not exist even in pre-war days, but there was certainly a much closer approximation to it than at the present time. Fear and insecurity are the greatest enemies to the free flow of capital. When capital moves abroad, effective control over it is lost, and unless confidence, or security through strength prevails, the risk element looms so large as to become practically prohibitive. In many cases, before this happens, the Government of the investing country, fearful of losing too much capital, disallows or checks further movements.

Other developments, whose effects are now being felt have occurred within the present century. With the exception of earlier capital transactions for commercial rather than industrial purposes, capital movements began with the coming of the Industrial Revolution. Capital surpluses were accumulated in the hands of the Industrial countries. These countries desired two things, cheaper raw materials and foodstuffs, and new markets for the products of their expending industries. To hand lay vast

undeveloped regions needing only new capital to make them suitable areas for both purposes. Into these areas capital was poured in ever increasing streams, checked on several occasions, but rising again to greater volume. As this process continued, several changes occurred. The borrowing countries developed industries of their own, and were less eager to take all of the manufactured products of the more highly industrialized countries.

With the continued opening up of new areas, improved methods of transportation, and technological development, there was a decided tendency for raw materials, in general, to become cheaper. This was what the industrial countries desired, but when this process continued to such an extent as to affect their own primary producers, it was not regarded as quite so satisfactory. As long as industry continued to expend, and the displaced labor and capital could be absorbed into other activity, little attention was paid to this fact. But when this expansion was checked, and replaced by contraction, as has been the case in many countries and industries since the war, the protest of the hard bit minority of primary producers became more vocal.

As the process of financing by international loans continued, the interest burden of the borrowing countries grew steadily heavier. Where the capital was properly used, subsequent development has more than repaid the interest charges. Unfortunately, a good proportion of the capital borrowed by many countries has not been employed in such a manner as to make its repayment possible. In addition, changing circumstances have rendered it impossible for many enterprises, considered quite justifiable at the time, to service their debts. For example, while the burden of Canada's large foreign debt for railways is partly due to unwise expansion, changed conditions, which could not have been foreseen, are more to blame. Deflation, especially falling prices for exports, foreign tariffs hindering payment in goods, sudden dislocations in international payments, such as those caused by an abrupt cessation of foreign investment in the country, all these have played their part in making heavier the burden of Canada and the other debtor nations.

Many countries have had to ease their burden by default. Both creditor and debtor have suffered losses direct and indirect. All too frequently ill will has been generated. In United States, experience

with the War Debts, as well as other defaults, has strengthened the forces working for isolation. In Canada, the existence of heavy foreign debts, largely payable in United States, has been a hampering influence. It has had much to do with the prevention of any general lowering of interest rates. Again the large amounts payable in American funds, have been a powerful force in keeping the Canadian dollar up fairly close to the American, and have been a check on the action of those who would prefer the Canadian dollar to more freely follow sterling.

It is worth noting that Mussolini keeps a very close check on foreign investment in Italy and that one of Hitler's objectives is to close out Germany's foreign debts. The obligations involved in large foreign debts, and the freedom from external restraint demanded by Nationalism do not easily blend.

This is not the place to discuss Nationalism. But, there is one phase of it, of particular importance, the prevalent belief in economic self-sufficiency, or at least a close approximation to that state. This belief works to check both borrowing and investing countries. In the latter, the advantages of procuring cheap food and raw materials from abroad are weighed

against the ensuing dependence and found wanting. Thus the chief reason for investing abroad, the desire for return in the form of cheaper foodstuffs and raw materials is largely nullified. In addition, too great dependence of the investing country's industrial life on its ability to enter foreign markets, is in some cases looked upon as undesirable. As the newly developed countries build up industries of their own, many of them in competing lines, fear of strengthening such competition through any additional loans often outweighs the desire to open up additional markets, or to stimulate present ones. This is particularly the case when the governments of the borrowing countries, by tariff and other policies, do their best to keep their markets closed to outside competition. Thus the second chief reason for encouraging foreign investment loses much of its value.

What of the borrowing countries? Frequently they become too largely dependent on the sale of but one or two products abroad to cover their interest charges and other foreign obligations. The vital importance to Canada of finding a market for her wheat, is but one illustration of this. Development of other areas, or changes in demand,

place such countries in a precarious position. Interest charges which could easily be met under previous conditions, become a pressing burden. The present depression with its drastic falling off both in price and demand for many products has brought this condition to pass. Subsequent financial difficulties have strengthened the desire of these countries to become economically more independent, as well as rendering difficult the movement of capital to them for legitimate purposes of development.

One more factor complicating the present situation, should be mentioned. The birth rate in practically all countries has been steadily falling, till it has reached the point where many countries now face, not an increasing, but a stationary or decreasing population, In consequence, industrial countries, in the main, no longer feel that they need to develop further areas to provide foodstuffs for a future increase in population. In the debtor countries, the decline in the natural rate of increase, coupled with the cessation of immigration means that capital is needed more for what might be called consolidation, rather than expansion. Such uses do not provide the investor with the possibility of quick profits, which usually characterize periods of rapid development. Further, enterprises already undertaken, which would have been productive if followed by expansion, are certainly not so now.

In brief, conditions which led to extensive capital movements in the past have been greatly modified, and new forces are now in play. Despite this, there is still great need for additional capital in most parts of the world, and still a serious maldistribution, geographical, as well as otherwise, of existing capital, viewing the interests of the world at large. How, and to what extent can this condition be remedied, keeping in mind the changed circumstances now obtaining? Does the world need a restoration of capital movements, and if so, how can such a resumption be brought about? These are the questions that must be answered.

The problem of the free movement of capital between the nations is closely connected with that of the free flow of trade and of labor. The free movement of labor has been practically abolished since the War. Of more importance, however, than the flow and labor is the connection between international trade and international capital movements.

The method adopted in presenting this study is as follows: An outline of capital movements in the past to illustrate how they have reached to various political, economic and financial changes; a sketch of the background of the present situation; an analysis of the transactions making up the balance of payments between nations; a discussion of theoretical relations between capital movements

and the rest of these transactions; a mention of the various factors modifying such relations, particularly those of importance today. These lead to a description of the present day situation, an estimate as to the future of international capital movements, and finally the relationship between this future and economic recovery.

While capital movements throughout the world have been considered as a whole, their application to the Canadian situation has always been kept in mind, and such application is a leading purpose behind this work. However, as the history of foreign investment in Canada, during its period of greatest importance, has been thoroughly covered elsewhere,[2] the historical background is viewed largely from the world situation with no special place given to Canadian events.

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2 Viner--Canada's Balance of International Indebtedness, 1900-1913.

II. CAPITAL MOVEMENTS IN THE PAST

(1) Prior to 1875

This whole chapter is a brief historical sketch of the growth and development of international capital movements, showing the various changes which have affected such movements, and illustrating their connection with the growth and development of trade.

There are records going far back into the pre-Christian era of capital movements between the nations. These, however, were primarily political, and were gifts, not loans. The first people to invest their capital abroad were the merchants. While there are earlier instances of such investment,[1] the first persons to deserve our notice are the Italian traders of the later mediaeval period. With profits made in commerce, they loaned to princes and rulers who could offer adequate security. In so far as these merchants secured trading concessions in return for their services, trade benefited, although the loans themselves did not, in general, aid trade or industry, but were used to finance wars, or wasteful extravagance. Later, as industry began to develop, it needed outside capital. Thus an outlet was provided for surplus wealth gained from trading or otherwise, and a great incentive was given to saving. Established industry in turn

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[1] For the merchant bankers of early Rhodes, see Cambridge Ancient History. (Volume VIII, Ch. on Hellenistic Commerce)

gave rise to further owners of surplus capital, and further investment.

Though the Italian merchants spread their loan and banking operations throughout many countries, their capital was drawn from world trading not particularly from the people of their own country. The first country to export capital, in the true sense of the term was the Netherlands, a small land with a large foreign trade and little use for surplus capital. Here capital investment and trade grew hand in hand. Most of this capital was used by Britain, to finance the Industrial Revolution. But, while still absorbing Dutch capital Britain began to invest abroad. British capital, through the East India Company, Concerns trading with America, and other countries, was already at work developing overseas regions, and building up British foreign trade; and before the Napoleonic Wars higher interest rates had begun to attract British capital to the apparently more stable parts of Europe.

The Napoleonic Wars broke Dutch trade and ability to invest abroad, but they did not seriously check Britain's industrial growth. With the profits arising from this growth, aided by her expanding trade, she was able to answer, at least to a considerable extent, a successive call for new capital, despite the financial strain of the war. There were at this time two sources of demand

for capital. One source was Europe, which needed capital for stabilization after the strains of war, the other was the New World, seeking capital for development purposes. In general, in answering these needs, Britain obtained both an increase in political security, and vast new foreign markets for her expanding industries, along with new and cheaper sources of raw materials for her industrial development.

Not all the loans of this period, however, were ultimately beneficial, either to trade, or to the general prosperity of the countries concerned. The large investment in the South American republics which occurred during the period 1815-1825, while leading directly to a great increase in British trade,[2] and some progress in the borrowing countries, was largely wasted, partly at least due to the effects on the rulers of new and unstable countries of an overabundance of capital. There were subsequent financial difficulties which hindered trade and further development for many years.

British loans to the United States of America were much more beneficial. But, even here, there were abuses, and the loans were overdone. When political uncertainty and a trade slump developed elsewhere, they

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2. Jenks "The Export of British Capital to 1875". p.59. British exports to Latin America. 1814-1818--£2,800,000 (av. per year). 1825--£6,425,000.

ceased abruptly, and their cessation caused, or rather furthered, depression in America, followed by numerous defaults.

These early cases of British foreign investment are given so much space because of their striking similarity to American foreign loans of the period 1924-1929. Like America now, Britain had not then the years of international financial experience behind her. In both instances the loans while serving in general a useful function, were overdone, and similarly in both cases the flow of funds ceased abruptly, causing serious dislocation.

In that earlier era, capital movements on a large scale were resumed sooner than might have been expected, the chief reason being the revolution in transport caused by the first steam railways. At first the railway boom in England caused a great home demand for capital, but as Europe began to follow suit, British capital was needed in great quantities. In the 1840's, France alone imported over £40,000,000 annually.[3] Another, somewhat later, stimulus to foreign investment was the discovery of gold in Australia, and in California. Based on these discoveries were rising prices, an increased volume of credit, expansion of trade, and plenty of use

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3. Jenks. op. cit. P. 149.

for all surplus capital. However, the business collapse of 1857, which ended this period, was accompanied, as in all similar cases, by a great curtailment of foreign investment.

This marks the end of British predominance in the capital markets of Europe. Due to rapid industrial growth, Western Europe was now in a position to supply its own capital needs to a reasonable extent, and interest rates in Europe, except in the more unstable countries, no longer compared favorably with rates to be obtained overseas. As Britain was at that time following a policy of no committments in Europe, and one of agressive Imperialism abroad, it followed that in so far as political considerations had any part in determining where surplus funds should be invested, they went elsewhere than to Europe.

From then on, Eastern Europe turned largely to France for its capital needs. Unlike Britain, France desired to use her available capital to support her interests in Europe, both political and commercial--political in cementing alliances--commercial in fostering French exports. In loan contracts, France has usually required

the borrowing country, or foreign firms, to use at least a percentage of the borrowed capital in the purchase of French goods.

While British capital never again flowed to Europe in proportionally the same extent, it once more, as soon as the business cycle was on the upward trend, was busily engaged in fostering the economic progress of the Empire,[4] as well as aiding the railway boom and Pre-Civil War development of the United States.

The next new force favoring capital movements was an improvement in financial machinery, namely, the appearance of the Joint Stock Company, with limited liability. This type of company became lawful in England in 1865. Of particular aid in furthering foreign investment was the formation of Joint Stock Banks and Investment Trusts. These latter were at first especially strong in France. The result was the utilization of hitherto untouched savings, small in individual amount, but large in total volume.

Unfortunately, as has been the case in more recent instances, past experiances were neglected, and what was originally sound progress, degenerated into

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4. Between 1854 and 1869, £150,000,000 of British capital went to India, and from 1860 to 1876, £50,000,000 went to the Governments of the various Australian states, £25,000,000 to Canada, and another £30,000,000 to private enterprises in various parts of the Empire. Jenks, op.cit. pp. 225 and 231.

into gross overexpansion. (A similar case of more recent date was the opening up of Western Canada, largely under the stimulus, direct or indirect, of outside capital, which culminated in the over-expansion of the real estate boom.) The virtue of development with the use of borrowed capital was proclaimed. "A people is so much the richer, its economic life so much more prosperous and progressive, the greater the part of its public expenditure which is made up of interest on public loans."[5] Following this advice usually meant borrowing abroad, in most cases, from London. Besides long time investments, booming conditions and rapid business turnover led to the issue of a great deal of short term foreign credits.

This riot of borrowing, and general overexpansion of trade and industry, culminated in the great crash of 1873. This crash deserves notice for several reasons. The years which followed show a closer approach to a world depression than any experienced up to that date. Unlike in previous depressions, Europe and the overseas countries were mutually involved. The connection between this depression, and the financial dislocation caused by the American Civil War or the Franco German War is worth noting, as is the fact that a boom intervened between these wars

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5. Quoted in Jenks, op.cit. p. 265.

and the depression. A similarity to present conditions also lies in the strengthening of protectionist views in many countries, for example, these years saw the formulation of Sir John A. MacDonald's "Canada First" plan. Again, capital movements dwindled to practical non-existence for some years. Finally, there was, as there has been in recent years, a shifting in the location of international investments.

By about 1875 the leading nations had assumed approximately the same debtor-creditor position as they held prior to 1914. The transfer of the indemnity of the Franco-German War to Germany, marks that country's emergence as a creditor nation. British investors turned more than ever to non-European regions, and there was even a withdrawal of British capital from the Continent.

TABLE I

[1]FOREIGN INVESTMENTS OF THE LEADING COUNTRIES, 1872

COUNTRY	TOTAL AMOUNT INVESTED ABROAD (est.) (IN MILLIONS OF DOLLARS)
Britain	4,000
France	2,000
Germany	2,000[2]
Switzerland, Belgium and Holland	500

(1) Jenks, op.cit. p. 281.

(2) For an explanation of this surprisingly large figure for Germany, see p. 27.

(2) 1875-1914

This period contains few outstanding developments. The first part of it was characterized by falling prices and generally slack times. While there was a slow resumption of foreign investment, it was on a very moderate scale. Parallel with this was the slow growth of trade. In Britain and United States, trade per capita actually decreased in value. Allowance, however, must be made for falling prices. Even so, the figures are striking. In the United States, between 1880 and 1890, population increased from 50 to 62 millions,[1] that is, 24 per cent and trade from $1,503,000,000 to $1,647,000,000,[2] that is, under 10 per cent. The population of England and Wales grew from 25,974,000 to 29,002,000[3] between 1881 and 1891, that is, nearly 12 per cent, while the trade of the whole British Isles only increased 11 per cent in nearly double the length of time, from £631,000,000 in 1876, to £702,000,000 in 1895,[4].

Eventually, the continued decline in interest yields on domestic securities, notably in Great Britain, coupled with relative security elsewhere somewhat increased the flow of capital to various countries. In the late 80's and early 90's there were temporary booms in some non-European countries, for example, Canada, United States

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1, Encyclopoedia Britannica, 17th ed. Vol. 27, p. 635.
2, ib. p.644 3, ib. Vol. 9, p.418 4, ib. Vol. 27, p.601.

Argentine, and Australia. These were short lived. Soon the American panic of 1893 and subsequent railroad bankruptcy, Argentine financial difficulties, drought in Australia, Latin-American and European defaults, and early mining difficulties and losses in South Africa, combined to hamper any noticeable ardour for foreign investments. One point should be noticed. The fact that Britain had now had years of experience in foreign investment, and that many people therein had become accustomed to the vagaries of foreign loans had a valuable stabilizing influence. The flow of funds was much steadier through changing conditions. There was not, in general, the same extreme rush to take part in booms, nor so great an eagerness to withdraw, nor a complete refusal to lend, when business was poor and conditions uncertain. As a result, the violent fluctuations in the flow of capital to other regions, which characterized earlier British investment and which have been typical of American investment in recent years, were avoided.

With the turn of the century there came a period of general confidence. Political conditions seemed more stable. The influx of gold from South Africa caused rising prices, with their beneficial effect on business turnover. Foreign investment, together with International Trade, made extremely rapid strides. These conditions existed until ended abruptly in 1914.

The chief creditor nations during the period 1875-1914 were France, Germany, and Great Britain. Some mention should be made of the part which the foreign investments of each of these countries played in the economic life of the world

FRANCE

TABLE II

FRENCH FOREIGN INVESTMENT, 1876-1914 (1)

YEARS	AVERAGE INVESTMENT PER YEAR (IN MILLIONS OF DOLLARS)
1876-1880	10 to -10 (2)
1881-1885	0 to very little
1886-1890	95
1891-1896	110
1897-1902	230
1903-1908	280
1909-1913	250

By 1914 the total French foreign investment was estimated at $8,600,000,000 as compared with $2,500,000,000 at the beginning of this period.[3] The numerous small investors of France, had helped to make good the lack of capital in Eastern Europe, especially being of aid to Russia.

1, Feis "Europe the World's Banker, 1875-1914. p.44
2, This means that some observers believe that France was ~~not~~ an importer of capital during this period.
3, Feis, op.cit. p.4.

To a large extent French foreign investment was still inspired by political motives. While in many cases an attempt was made to further French trade by clauses in the loan stipulating purchases in France, in general, the prime motive was to further alliances and cement existing political friendships. The results were sometimes economically unfortunate. The Czar of Russia was ennabled to fight reform, and the Balkan States to arm themselves, but all too little economic development occurred, in proportion to the debt with which these countries were saddled. Yet we should not deny the part played by French capital in the economic growth of Central and Eastern Europe, as well as its furtherance of development elsewhere.

GERMANY

From 1875 to 1914, Germany financed, within her own borders, the needs of a thirty million increase in population; a mechanization of her industry; the up-to-date equipment of her coal fields; the launching of a merchant marine; a large expenditure for public works and large expenditures for social, as well as for military purposes. Interest rates reflected this, and were consistently high. Yet, although a few firms did obtain foreign financial assistance, and there was at times a

Ref. F Feis

movement of short term capital to the country, Germany played a very considerable part, as a source of capital for other nations.

Why was this, and how was it done? The answer is, that with Germany, investing abroad, in the right quarters, was a primary part of her foreign policy. She was enabled to do it, because her banks were equipped especially for this purpose. The four great banks combined with their other functions the activities of security originators, promoting syndicates, and investment trusts. At the same time they co-operated, and with the big private houses (for example, Rothschild's), handled all foreign demands for capital without wasteful competition. They all had overseas branches, partnerships, and subsidiaries, located wherever they could help German commerce, and judiciously offered loans whenever these would further German interests. This investment abroad was sometimes carried on against unfavorable opinion in large sections of the country.

While both French and German foreign investment was dominated by political motives, there were important differences. France was engaged in financing foreign governments which would be helpful to her; Germany was financing her foreign trade, and her commercial and economic influence abroad. For example, France loaned to Russia to cement the Franco-Russian alliance,

but Germany loaned to Turkey, to further the building of the Bagdad railway, and thus to facilitate German commercial influence and German prestige in the East.

TABLE III

GERMAN INVESTMENT ABROAD, 1875-1914 (1)

YEAR	TOTAL GERMAN FOREIGN INVESTMENT (est.) (IN MILLIONS OF DOLLARS)
1883	1200 (2)
1905	3600 to 4200
1914	5200 to 6000

BRITAIN

As indicated, a considerable part of the world's effective demand for capital was satisfied by France and Germany. Small nations, such as Belgium and Holland were also investing abroad, though on a correspondingly small scale. In addition, by 1914 the United States had considerable amounts invested in the neighboring countries, Canada, Mexico, and Cuba. Nevertheless, the chief market

(1) Feis, op.cit. p.71.

(2) This figure is much lower than that given on p.22 for German investments in 1872. While there was little new investment during the interval, there are no other indications of any return of capital to Germany. The disparity may be explained partly by the rough nature of both estimates, partly by the fact that in 1872 German holdings of foreign securites were swollen by the French indemnity payments, which were largely in the form of the transfer of foreign security holdings to Germany.

for nations, and for corporations within those nations who desired outside capital was still London. Estimates show the total British foreign investment to be larger than all other foreign investments put together.[1] The most generally accepted of these estimates are, for 1907, £3,000,000,000[2] and for 1913, £4,000,000,000.[3]

Throughout this period, Britain's industrial and natural resources did not offer as great opportunities for gain, differences of risk and circumstances considered, as did those of foreign lands, especially those to which people of British stock were moving. British commerce was growing rapidly, and trade growth and foreign investment went hand in hand. Some of the overseas countries, notably the United States, but also to some extent Canada and other countries such as Japan, were, as they developed industrially, building up capital resources of their own. With industrial growth, they were not as good markets in many lines as formerly, and were even competing with

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1. Compare the British figure for 1913, c.$19,500,000,000 with the maximum figures of $8,600,000,000 and $6,000,000,000 dollars given previously for France and Germany, and the estimate of $2,500,000,000 for American foreign investment (given in "International Movements of Capital", Harris Foundation Lectures, 1928. p.196)

2. Originally in Article by Sir George Paish, Journal Royal Statistical Society, Sept. 1909.

3. Originally in Statist. Supplement, Feb. 14, 1914.

British trade abroad. But this must not be over-emphasized at this time. As long as there was confidence, and a reasonable degree of prosperity, active demand for capital grew as fast as its accummulation, while needs filled by home production were more than replaced by increased demand for other products, and the buying of new and additional commodities.

TABLE IV

BRITISH FOREIGN INVESTMENT 1860-1913 (1)

YEAR	AVERAGE INVESTMENT PER YEAR (IN MILLIONS OF DOLLARS)
1860-1876	201
1875-1879	8
1880-1884	116
1885-1889	297
1890-1894	221
1895-1899	130
1900-1904	104
1905-1909	532
1910-1913	898

1. Feis, op.cit. p.11.

In conclusion, one point should be stressed; namely, the large growth and the great amount of British income from abroad. Despite inadequate data, it seems definitely indicated, that since, at the latest, 1875, with at most one or two exceptions (1907 and 1912), British income from abroad exceeded every year her new exports of capital.

That is all that need be said about the creditor nations. A table showing the geographical distribution of British, French and German investments will illustrate who were the leading debtor countries. Remembering in addition the countries of the American continent, particularly Canada, Mexico and Cuba, were receiving capital from the United States, this table gives a fairly complete picture of the situation in 1914.

TABLE V

DISTRIBUTION OF THE FOREIGN INVESTMENTS OF GREAT BRITAIN, FRANCE, AND GERMANY IN 1914[1]

COUNTRY	INVESTMENT IN THAT COUNTRY (IN MILLIONS OF DOLLARS)			
	British	French	Germany	Total
Europe				
Russia	530	2180	430	3140
Spain	90)	750	405	1285
Portugal	40)			
Austria-Hungary	40	425	715	1180
Turkey	115	635	430	1180
The Balkans	75	480	405	960
Italy	60	250	(2)	310[3]
Other two creditor countries	70	(2)	310	380[3]
Rest of Europe	145[4]	580[5]	285	1010
America				
United States	3670)	400[6]	880	7450
Canada	2500)			
Argentine	1550			
Brazil	720			
Mexico	480			
Chile	295	1340	900	5910
Uruguay	175			
Peru	165			
Cuba	160			
Rest of Latin America	125			
	9840	1740[6]	1780	13360
Asia				
India and Ceylon	1840			
China	215			
Japan	305			
Rest of Asia	175+[8] [3]	425	230	3015[3]
	2535			
Africa				
Egypt	220)			
South Africa	1800)	635)	230	4155[3]
Rest of Africa	180+[8] [3]	775)		
	2200	1410		
Australia, New Zealand and Islands of the Pacific	2100	(7)	110	2210[3]

FOOTNOTES TO TABLE V

(1) Compounded from figures in Feis. op.cit.

(2) Included in "Rest of Europe".

(3) Incomplete total.

(4) Chiefly Denmark.

(5) Chiefly Belgium, Switzerland and the Netherlands.

(6) Includes small amount for French investment in Australia.

(7) Included in figure for the United States and Canada.

(8) Figures for "Other Colonies" (other than W. Africa, Br. Borneo, Straits Settlements and Hong Kong), and for "rest of foreign World", being $130,000,000 and $380,000,000 respectively, have not been placed. Outside of an unknown, but small amount in the Br. West Indies, they would come under one of these two headings.

III. CAPITAL MOVEMENTS AND POST WAR ECONOMIC CONDITIONS TO 1930

(1) The War, and International Financial Equilibrium.

As could be expected, the outbreak of World War caused a terrific shock to credit, and an immediate cessation of the outward flow of capital from Europe. Instead there was a demand for the repayment of all matured obligations. There was no further investment in foreign securities, but rather, an attempt to dispose of, and realize on, those already held. For a short period the debtor nations were in a precarious position. This was shown by the moving of exchange rates against them, for example, the pound sterling was quoted as high as $7.00 in New York.

Before long, however, a reverse current set in. The belligerents began to make great purchases of food and raw materials from the debtor nations, whose financial situation responded accordingly. These purchases were so large, that some countries wiped out a considerable portion of their foreign debt with the proceeds, while one country, the United States of America, became in a very few years a great world creditor. Excluding the debtor nations of Europe directly involved in the War, the other countries practically all managed to finance themselves without further external indebtedness.

So much for actual events during the war. But, before discussing the fundamental changes brought about by this conflict, something should be said concerning the basis upon which Pre-War equilibrium rested. Roughly the situation was this: The industrial countries of Western Europe made loans to countries elsewhere. For these industrial nations the loans both provided a future income, and opened up markets for their surplus of manufactured goods. The other areas benefited by this in that it meant a supply of capital for economic development which could not otherwise have been undertaken, at least for some time. As these loans continued, there came into being a reverse flow covering interest and maturities. This flow financed the excess imports of Western Europe, providing the countries there with cheap raw materials and food-stuffs for their urban population, and giving the other countries a market for the sale of their primary products. The whole process was thus a circular one, and a breakdown at any one point meant a collapse of the entire system.

(2) The Economic changes brought About by the War.

Such a collapse has been brought about as a result of the financial changes and the dislocation caused by the war. Further, the inability of the nations of the world either to restore this or a similar system, or to devise a better one, is one of the root causes of the present depression.

Some knowledge of what the changes were and why they brought about this breakdown is thus necessary. They may be broadly grouped under four headings. (a) The impoverishment of the former leading creditor nations, with a consequent reduction in their ability to provide capital for the rest of the world. (b) An increased productive capacity in many parts of the world. (c) The emergence of the United States as a leading creditor nation. (d) An increase in the world's total short-term indebtedness. While this division of changes is made it must be remembered that all are interwoven and that no one change can be entirely separated from another.

(a) The Impoverishment of European Creditor Nations

While the changes which have taken place in Britain, France, and Germany are different enough to warrant a separate account of happenings in each country, the war left all three with one common burden, that of War Debts and Reparations. These were a straight addition to the debit payments of all three nations, as well as

many other countries of Europe, without their contributing anything to wealth or production capacity, or setting in motion any forces which would aid in their repayment. That is obvious as far as Reparations go, but it is equally true of the War Debts. These debts were incurred almost entirely for the purchase of consumers' goods, and for non-productive articles such as munitions. The funds raised were very largely spent in the country of their origin. Purchases were made at inflated prices. In no way did the debts incurred contribute to the permanent wealth of the borrowing countries.

The effect of these Reparations and War Debts was a decrease in the ability of these countries to invest abroad (and in the case of Germany, a rapid movement of foreign funds into the country), and an increase in the creditor position of the United States with consequent further effects which will be discussed later.

Again, to the extent to which the political aspects of War Debts and Reparations brought about a state of fear and insecurity in the world, they put a check on all foreign investment, as well as causing financial dislocation in other ways.

Other changes which occurred were as follows: Britain bore a large part of the financing of the War, not only on her own account, but also for that of her allies. To do so, she realized heavily on her foreign credits. This was done (1) by selling abroad her holdings

of foreign securities. (2) by borrowing abroad on the market. (3) by borrowing from foreign and Dominion governments.

The details of immediate post-war finance need not be traced at this time. By the time that relative stability was reached, Britain found herself still a creditor nation. On paper, the sum total of her foreign investments was not greatly reduced, but when the higher prices prevailing are taken into account, their value to her is seen to have been considerably lower. There is no doubt that her financial position was strained. The general view seems to be that her national income throughout this period was reduced. This reduction would help to account for the falling off in her foreign investment.

In any case since the war, Britain has not been the open source of capital for the less developed regions of the world, that she previously was. Connected with this decline in investment has been a decline in her foreign trade, especially her export trade. In so far as this has been due to a shortage of capital in other areas wherewith to purchase British goods, particularly the products of the heavy industries, it is one of the effects of the falling off in foreign investment. The most striking illustrations of this are given in Mr. Gustav Cassel's work on Foreign Investment,[1] where he gives figures showing

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[1] "Foreign Investment". Harris Foundation Lectures 1928. Columbia University Press, Chapt. II of Cassel's contribution.

the drastic falling-off since the War in the exports of locomotives, power machinery, and agricultural machines, from Britain and Germany, which falling-off he directly connects with the reduced rate of foreign investment. But the reverse is equally true. In as much as the decline in Britain's export trade checked national income and saving, and affected views on the wisdom of foreign investment, it has been partly responsible for the decline in capital movements. It was the marked decline in Britain's favorable balance of indebtedness due to the falling-off in commodity exports, the decline in income from abroad, and the restricted payments received for services rendered which convinced many that Britain was over-lending. For, while loaning was on a decidedly lessened scale,[2], particularly bearing in mind the inflation of prices which followed the war, the fall in the favorable balance of indebtedness was even greater. In fact, the figures would indicate that, for some of the period, Britain was borrowing on short term to lend on long term. The inclusion of sinking fund payments, and the deduction of the foreign subscription to loans floated in London, somewhat lessens the validity of the conclusion, but, at that, there is no doubt that there

[2], Harris Foundation Lectures, 1928. T. E. Gregory, in Foreign Investment. Foreign issues floated in London 1920-1927 were equal to c.$4,600,000,000.

has been little margin for new investment. This falling off in national income might not have checked investment to the extent that it did, but for other changes wrought by the War. The Post-War period has seen an anormous increase of the tax burden in Great Britain. While affecting all alike it fell proportionately heavier on the larger incomes. The full effect of this both in home and foreign investment is uncertain, but it must have had something to do with its decline. Probably more important in its effects on foreign investment was the accentuation due to the War of the growing trend towards governmental interference. This meant that checks could be put on the free movement of capital to an extent that would never have been possible in Pre-War days. Three instances of this changing viewpoint, all taken from the period before 1930, should make this point clear.

One is the unofficial embargo by the Bank of England on foreign loans, during the period in 1925 when Britain was returning to the gold standard. This incident is important in that it established a precedent. If loans could be restricted in the interests of the gold standard, why not for other purposes as well? A second instance, is the outspoken views of a man of such repute as Mr. John Maynard Keynes. "What is wanted is systematic discouragement of the issuance of large

foreign, including colonial, loans.[3] Thirdly, there is such a consensus of opinion of a representative body of leading men, as that given in the "Report of the Liberal Industrial Inquiry."[4] This report, while in favor of freedom of loans for industrial, agricultural, and mining enterprises overseas, reports in favor of control over, and a check on, loans to public bodies and for public utilities abroad. In short, the right of the government to interfere with the freedom of foreign investment has come to be recognized.

France

The war reduced the foreign assets of France to a far greater degree than it did those of Britain, due to the extent of French investment in Russia, Austria-Hungary and the Balkans, which investment was largely wiped out. In addition, France herself incurred foreign indebtedness during the War. Finally, for a few years after the War, the rebuilding of the devastated areas of Northern France required all available capital. Nevertheless, even before the stabilization of the franc in 1928, there was a considerable flow of French capital to other areas. Most of this, however, took the form of short term capital,

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3. Keynes, in "The Nation". April 25, 1925

4. "Britain's Industrial Future". London 1925. P.110.

either in flight from the franc, or seeking participation in the American stock market boom. Prior to 1928, the extent of French long term investment was limited. Most of this investment went to aid France's allies in Eastern Europe. In view of the prevailing shortage of capital there, and the check put on investment by insecurity, this was a valuable service.

Germany

The foreign assets of this country were entirely dissipated by the War. Russian and other defaults; unrepayable loans to her allies; the sale of her holdings of foreign securities to the neutrals of Europe to provide exchange for war imports; seizure by her foes, including the loss of her colonies and the investment therein; all these consumed her credits established in previous years. Finally, the inflation of the mark culminating in 1923, droveabroad or made worthless, much of her internal accumulation of capital.

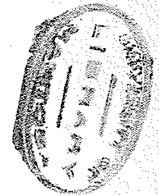
It is no wonder, when themark was stabilized, and some degree of economic and political security restored, that Germany and German industries borrowed abroad to the extent of their ability. As this period coincided with that of American willingness to invest abroad, all was, on the surface, well. But it was an unstable equilibrium. The Pre-War German income from abroad, which financed

Germany's excess imports, and was replaced by German borrowing. But the reverse, balancing movement was checked. The country in whose favor the income from investment in Germany was piling up would not take German goods. Coupled with this, Germany had no means of aiding would-be purchasers of her goods, in other areas, with capital, as she had formerly done.

In Germany's changed situation lay one of the main causes for the world depression.

(b) The Increased Productive Capacity of Many Parts of the World.

The War increased the productive capacity of the world in many ways. It stimulated scientific research. Though such research was directed toward the arts of war, the results have since been utilized in aiding production for more peaceful ends. While most of the present day technical progress would have come with time, there is no doubt of the stimulating effect of the War upon it. Such technical development has always caused some dislocation. Plants and equipment are rendered obsolete; differential advantages due to situation are wiped out by new means of transportation or new sources of power; certain products are less needed than formerly. However, if economic conditions are good, and the change not too sudden, the land, labor, and capital involved can be switched into then, the newer lines of production.



But, during the war, the suspension of the free play of economic forces postponed such changes and left them all to come at once. At the same time, the war, with its need for munitions, armaments, and so on, brought about a great increase in the demand for the products of the heavy industries. All over the world the capital sunk,in the plant and equipment of such industries, was greatly increased. Again, in many lines of production, both of primary and secondary products, there had been an urgent demand for increased outside production to replace that of the warring nations of Europe.

With the end of the War, these nations of Europe gradually returned to production; the demand for war materials practically disappeared (for the time being); and a short but sharp deflation, joined with the cessation of American loans to Europe to cause a great falling-off in purchasing power. The result was an over-supply of many goods in relation to effective demand. In the face of this oversupply practically all of the nations of the world threw up tariff barriers to protect their own industries from outside competition.

How was it that the full effects of all this dislocation were not felt until after 1929? For one thing, it took the nations of Europe some time to

restore their production to its old level and to repair the ravages of war. Competition from Russian production was practically entirely removed. Again, new industries had arisen whose products stimulated demand wherever there was any degree of confidence. The automobile industry, with all its subsidiaries, and with its demand for the products of the heavy industries; the radio industry; the aeroplane industry; great road building programs; all these absorbed surplus agents of production displaced from other lines of activity. But the real reason why these full effects were not felt, lay in the fact that the nations of the world realized that the breakdown of financial equilibrium was at least partly due to the reduced purchasing power of Europe. Acting on this realization, meant that loans were extended, first to the most needy countries, for example Austria, then, as confidence was restored, to other nations. Finally, in 1924, even Germany was given help. Besides the actually purchasing power created by these loans, renewed confidence put an end to deflation.

With the proceeds of these loans the European nations made their necessary purchases from abroad. Other nations could thus find a market in Europe, but there was still no provision made for the purchase by these other countries of European goods. The income from the loans to Europe went to America, which country,

on account of its great industrial development did not want further manufactured goods to any extent. Further, most other countries, in their efforts to protect their home industries, also checked European exports.

However, loans by the United States to Latin America did help somewhat, and with general confidence in most new European countries, the total volume of trade did increase considerably, and so, with the aid of the loans to Europe, equilibrium was maintained for a time. But this equilibrium was only maintained at the expense of the increasing indebtedness of Europe to America. There was no real progress in Europe, and deflation soon set in again there.

Thus American loans kept a temporary equilibrium , but nothing had been done to remedy the causes of disequilibrium set out above, and since the stopping of loans and the return of deflation in 1930, their full effects have been evident.

(e) The Emergence of the United States as a Creditor Nation.

The war caused a rapid reversal in the international financial position of the United States. Not only in magnitude, but relatively as well, the change was as great as any that has yet occurred in history. As in her case, other countries have changed fairly

rapidly from debtor to creditor status. But, in five years she changed from being the nation with the largest foreign debt,[5] into the second biggest creditor, the amounts owing to her from abroad being only less great than Britain's foreign credits, which credits, had been built up during a period of over a century. The magnitude of the change can be best grasped from the actual figures.

TABLE VI

CHANGES IN THE FOREIGN INVESTMENT OF UNITED STATES

1914-1918[(1)]

Year	Foreign Investment in America	American Foreign Investment
1914	$5,000,000,000	$ 2,500,000,000
1918	3,000,000,000[(2)]	11,500,000,000

For a short period after the War there was relatively little new American investment abroad. With the return of prosperity to America and some measure of stability in most regions of the earth there was a fresh burst of American loans. However, before this,

5. See Table V, P.31.
(1) H. K. Norton in "Foreign Investments" Harris Foundation Lectures, 1928. p.196.
(2) "Capital, Export of--" Encyclopaedia Britannica, 14th Edition, Volume V, p.801.

the placing of the War Debt and Reparations problem on a seemingly firm footing, loans made to Austria and Central Europe, and the promise of aid to Germany (The Dawes Loan) had done much to bring about this stability. From 1924 to 1930 America pursued a liberal foreign investment policy.

TABLE VII

FLOTATIONS OF FOREIGN BONDS AND STOCKS IN THE UNITED STATES 1920-1933[1]

(IN MILLIONS OF DOLLARS)

Year	Total Foreign Issues	Issues on Behalf of other areas than Canada
1920	602.9	379.8
1921	692.4	514.3
1922	863.0	621.8
1923	497.6	413.1
1924	1,217.2	977.7
1925	1,316.2	1,097.7
1926	1,288.4	966.5
1927	1,577.4	1,277.1
1928	1,489.4	1,271.6
1929	705.8	446.6
1930	1,087.6	723.1
1931	282.5	127.0
1932	87.9	6.7
1933	65.1	5.1

(1) "The Canadian Economy and its Problems". Innis and Plumptre. P.234.

This American investment can be divided into three groups; loans to Europe, to Latin America, and to Canada. Each class of loan deserves separate notice.

Loans to Europe.

The total American portfolio investment in Europe, at the end of 1930 was $3,460,529,000.[6] By far the largest individual portion of this was in the form of German securities. The following table shows the total American investment in Germany at the end of this period. By that time, the short term indebtedness at least, had already been somewhat reduced from its high point.

TABLE VIII

AMERICAN INVESTMENT IN GERMANY (1)

(IN MILLIONS OF DOLLARS)

Holdings of German foreign issues (Sept. 1931).....	1177
Short term commercial loans (Dec. 1931)............	(450)
Total short term loans (Dec. 1931)..................	700
Holdings of shares, real estate, and other values in Germany (1930).............................	243
	2,120

6. Sale of Foreign Bonds in Securities in the United States. Hearings before the Committee on Finance, United States Senate. 72nd Congress. U.S. Govt. printing office. Washington, 1932. p.64.
(1) ib. p.409

Something has already been said as to the effects of these European loans. They contributed towards the period of prosperity in America, by furthering the export of American goods, and they aided in the reconstruction of Germany and the rest of Europe. American capital must receive credit for the part it played in putting Europe on its feet after the destruction of the war and immediate post-war period. Even though it is now seen that this capital served as a palliative, and a dangerous one at that, not a cure, the help furnished should not be forgotten. Britain and France took a large share of various governmental loans, such as those sponsored by the League of Nations; for example; those to Austria, Hungary, Greece, and the loans to Germany under the Dawes and Young plans. But, for aid in municipal and corporation finance, Europe had to rely practically entirely on America. The following figures bring out this contrast. Only $9,000,000 of the $70,000,000 League of Nations loan to Hungary and $6,000,000 of the $48,600,000 joint loan to Greece were floated in America.[7] America supplied $208,000,000 out of the $500,000,000 advanced to Germany under the Dawes and Young plans, that is, about 40 per cent. But, of

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7. ib. pp. 613 to 621

the total German loans floated abroad between 1924 and 1928, (including the Dawes, but not the Young loan,) 65 per cent were American. The figures are: Total loans, $1,546,000,000; American loans, $1,039,000,000.[8] Furthermore, those of the next largest investor, Holland, ($190,000,000) were largely loans to small bodies, and for small amounts, loans which could not be floated at a reasonable rate in New York because of over-head costs.

The following words of Mr. Gustav Cassel, noted Swedish economist, spoken in 1928,[9] might well apply to American loans to Europe. After speaking of the evil results of placing obstacles in the way of free communication between the nations, he says "In this dark picture the only illuminating point is the relative freedom that has been given to the international movement of capital. In fact, the amount of reconstruction that has been accomplished is, in an essential degree, due to the liberal supply of capital from the better situated nations to those that were in need of it."

Unfortunately, the picture has also a darker side. The instability of the equilibrium established by these loans has been mentioned. America, and other areas also, either would not, or could not, take European goods, in sufficient quantities to cover Europe's indebt-

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9. Cassel in op.cit. on Foreign Investments, On p. 71

8. T. E. Gregory in Foreign Investments. Harris Foundation Lectures, 1928. p.186.

edness. Fresh loans could not forever conceal this fact. In the end they aggravated it. Under the stimulus of prosperity America overloaned, just as since the depression she swung to the other extreme, greatly exaggerating the violence of the collapse. By America overloaning, is meant that the flotation of loans there became too easy, building up a sense of false security in many of the borrowers, and tempting them to unsound financing. In Europe, such unsound finance was particularly true of many of the German states and municipalities.[10.]

Loans to Canada

The largest American investment in any one country was not, however, in Germany, but in Canada. The total of Canadian loans of all descriptions, (including a few for Newfoundland) floated in the United States between 1914 and 1930 was no less than $3,592,727,000.[11.] Of this indebtedness, $1,891,900,000, or just over half, was incurred between 1924 and 1930.[12.]

The loans furthered an increased development of Canada's productive equipment as well as being the basis for a considerable credit inflation, which at the time, aided in giving a temporary prosperity to the country. With them Canada financed her excess imports

10. See: Memorandum of Mr. Gilbert Parker, Agent General for Reparations in, op.cit. on "Sale of Foreign Bonds and Securities in U.S. p.889-898.
11. ib. p.340.
12. Canadian Economy and Its Problems. Innis and Plumptre. p.234.

from the United States and carried her indebtedness from previous loans. Finally a fair proportion of this capital was being turned back into Canadian foreign investment, Large sums remained in the United States, in the form of short term loans, such as money on call in New York. In August 1930, the foreign assets of the Canadian banks, amounted to $574,000,000.[13.] In addition there was a large Canadian investment in American stocks and bonds, as well as Canadian participation in foreign issues floated there.

The loans to Canada did not themselves propagate an unstable position, as did those to Europe. Canada was, in any case, a debtor nation, and had already built up an export trade to pay for the interest on previous loans. Further, after the War she had established markets for her goods, while Europe had either to re-establish lost markets, or find new ones. Finally, industrial development after the War meant that on a short run view, Canada was not so vitally dependent upon foreign imports. When America crippled Canadian trade with her tariffs, Canada proved able to curtail American imports in proportion. Unfortunately, the whole situation depended upon an excess of Canadian exports to non-American countries, especially Europe. When this became no longer

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13. Ib. p.251

possible on any scale, (Canadian attempts to keep this excess by further restricting her imports from Europe only serving to aggravate the situation,) the effects of these loans proved less beneficial. Credit inflation was followed by deflation, increasing indebtedness; the great volume of the loans contracted when prices were higher left an extremely heavy foreign interest burden; above all, the increased productive capacity of the country, entailing as it has done, in the main, in Canada high overhead costs and rigid charges of various sorts, necessitating large volume in order to be more efficient, has been ill suited and not easily adjustable to the great falling off both in volume and price of exports. Railway deficits, bankruptcy in the pulp and paper industry, the plight of the Western farmer, crushed between relatively fixed charges and costs and drastically reduced income, are all symptoms of this. The value of some of the industrial development can also be questioned. There are too many artificially high costs due to Canadian industries which need tariff protection.

TABLE IX

AMERICAN LOANS TO LATIN AMERICA 1914-1930[1]

Country	Governmental Loans	Corporate Loans	Total
Costa Rica	$ 10,820,000	....	$ 10,820,000
Cuba......	137,300,000	$472,092,000	609,392,000
Dominion Republic..	17,300,000	2,250,000	19,550,000
Guatemala..	550,000	18,900,000	19,450,000
Haiti......	16,000,000	21,765,600	37,765,000
Honduras...	500,000	13,192,500	13,692,000
Mexico.....	5,796,288	44,082,900	49,879,000
Nicaragua...............		1,000,000	1,000,000
Panama.....	26,800,000	940,000	27,740,000
Salvador...	7,520,000	....	7,520,000
Argentina..	824,421,000	100,313,000	924,730,000
Bolivia....	63,230,000	9,700,000	72,930,000
Brazil.....	423,682,000	24,985,000	448,667,000
Chile......	325,692,000	189,000,000	514,692,000
Colombia...	172,588,000	47,186,000	219,774,000
Paraguay................		2,272,249	2,272,000
Peru.......	95,710,000	8,000,000	103,710,000
Uruguay....	53,918,000	....	53,918,000
Venezuela...............		31,928,750	31,923,000
	$2,181,837,000	$987,602,000	$3,169,439,000

(1) op.cit. on Sale of Foreign Bonds or Securities in U.S. p.340.

Though these figures are for the full period 1914 to 1930, most of those loans were floated from 1924 on. Out of 122 "dollar" loans to South America, only 16 were floated before 1924, and 10 of those were Brazilian.(2) These figures give no indication of the vast sums tied up in direct investments in Latin America, for example in the oil fields of Mexico, Peru, Venezuela, Bolivia, and so on. To the extent that these Latin American loans were well handled and the proceeds carefully used (which was by no means always the case), they were the most beneficial of all American loans. In general these countries and the United States were complementary rather than competitive in the character of their production. As a result, there have been relatively few artificial barriers to restrict Latin American exports to the United States. Payment for these loans in the form of goods has been generally possible. Equally important, a good proportion of the dollar exchange created by this investment ultimately found its way to Europe, in the form of income from previous European investment in Latin America. In view of Europe's difficulty in obtaining sufficient American exchange, except through additional loans and further indebtedness, this proved very valuable.

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(2) ib. p.228-230.

Fundamentally, American investment in Central and South America was sound. Many of the individual loans were not. While most of the larger American investment houses were relatively conservative, some, particularly the smaller ones, were far from it. There was a great deal of unwise competition, questionable commissions, and so on.[14] Coupled with this over-readiness to loan were political instability and inexperience in most of the borrowing countries. The results have been the obvious ones; a great deal of unwise public expenditure, and governments living constantly beyond their means. "This observation is made merely to point out that no direct enhancement of the economic capacity of the country can be shown to have resulted from the Government's expenditure, in anything like the amount of such expenditures."[15]

As a result of this extravagance and unwisdom many of the Latin American countries did become over-borrowed. There is evidence that before 1929, officials of the American Department of Commerce, as well as others, saw that this was the case, and warnings were issued to proceed cautiously, for example, circular 305 concerning

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(14) This is brought out in various parts of op.cit. on the Sale of Foreign Bonds in U.S. See eg. pp.1323ff.

(15) From a letter re. the Peruvian situation April, 1929. ib. p.1594.

the foreign loans and public finances of Colombia.[16.]

But, in general, the best account of the situation in the Latin American countries, is the description of Chile's position, given in a report on her public debt policy.[17.] The following are significant extracts: "For many years in the future Chile will be a borrower of money in foreign markets. A country so rich in natural resources needs large amounts of capital for its economic development, and for some time, it will be wise public policy to obtain much of this capital by foreign borrowing. .....It is to the advantage of any country with great undeveloped resources to obtain capital in those countries where the rate of interest, due to the great accumulations of capital , is lower than it is in the borrowing country. .....The development of the country will to no small extent depend upon the wisdom with which foreign loans are floated and the purposes for which they are used....."

To sum up. Despite some unwise loans due to inexperience and over-optimism, American foreign investments contributed greatly to Post War recovery and economic progress. But, because of America's refusal to increase

16. ib. p.728.

17. ib. p.1695.

her imports and her drive to increase exports, an impossible situation was built up. As long as internal conditions were booming, and American people felt free to invest in foreign bonds, to travel and spend freely abroad, the day of reckoning was postponed. When the boom collapsed in the stock market crash, the unstable Post-War equilibrium went down with it.

If America could have accepted her position as a mature creditor, and allowed payments to be made in goods, she might have been the saviour of the world. Instead, all her loans proved at best but a temporary stop-gap, and in so far as they contributed to an excess of false security, an ultimate aggravation of the world's economic illness. The further evils caused by the abrupt way in which this flow of funds has been cut off form part of the immediate situation and will be discussed in the situation dealing with it.

(d) The increase in the world's total short term indebtedness and its effects.

The useful, and necessary, part played by short term capital movements in international finance, and the value of having floating funds abroad, will be set forth in the chapter on the theory of capital movements. It is not sufficient to say here that, with the breakdown of the pre-war gold standard, this role has become of much greater importance. As a result, most nations of the

world have increased their holdings of foreign short term indebtedness.

This section is concerned with but one aspect of this, namely, that, in times of uncertainty, the large amount of floating capital, easily moved from country to country, proved too mobile and caused sudden and additional stains on the equilibrium of international payments. The rise of New York as an international financial centre, and the increased relative strength of Paris as compared to London, greatly increased this mobility and added to the danger of sudden movements. For, with any financial change, such as a rise or fall in interest rates, or even the expectancy of such a change, vast amounts of capital could be readily moved to or from one of the other centres on very short notice.

By some, the existence of so much floating capital has been regarded as a positive danger, one of the most disturbing factors in the whole situation. It is true that short term capital movements have, on occasion, accentuated rather than mitigated fluctuations in the exchange rates, and added to, rather than evened up, discrepancies in the balance of payments. Extreme cases of this have been the flight from the mark, in 1923, and the flight from the franc in 1928. What happened was that practically all available liquid capital was transferred into foreign short term indebtedness. As a rule, when there seems ultimate hope of adjustment, short term capital movement aids in some way, smoothing out fluctuations, but when there

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is complete uncertainty, the reverse happens and panicky movements of short term capital, by accentuating the financial difficulties of the country in question, retard whatever chances there are for recovery, and have even, in some cases, themselves brought to pass the very situation which was feared.

Mention has been made of Canadian short term investment in the United States, at the same time that this country was floating large loans there. But Canada was not the only country doing this. In 1927 there was an increase of $1,005,000,000 in American short term foreign indebtedness,[18] that is, an amount equal to practically two-thirds of her total long term investment for the year, and that at a time when American long term investment was at its peak. The presence of this extra foreign capital cannot but help to have contributed to the excesses of the boom, as did its withdrawal to the boom's collapse.

Again, the period of world trade on a large scale, saw a great extension of short term commercial credits. With the great drop in world trade, many of these credits became frozen, due to transfer difficulties. As other transactions have dwindled in volume this mass of international short term indebtedness has become proportionately larger and increasingly dangerous. The

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18. League of Nations Statistical Year Book, 1933-1934.p.196.

result has been that many countries have had to take steps towards regulating its movements, that is, have adopted some method of exchange control. Most of this has happened in the years since 1930, but the large mass of short term indebtedness was built up prior to that date, being one of the legacies of this War period.

In short, capital movements, or the lack of them, and the causes of the present depression, have been closely linked. There remains the question, what part have capital movements to play in world economic recovery? More particularly, how will they affect the Canadian situation? But, before answering that question, something must be said concerning the theory of capital movements, and the general effects of changes in their volume.

IV. THE INTERNATIONAL BALANCE OF PAYMENTS

In the previous chapters there have been numerous references to the relation between capital movements and trade. Before discussing the present-day situation and its problems, an explanation is in order, as to the manner in which capital movements and trade are connected, and how they interact on each other.

To start with, both create international payments, and any change in their volume disturbs the equilibrium of such payments, and changes the debit and credit position of the nations. This being the case, a knowledge of the various transactions which cause international payments, and also of how their equibilbrium is maintained, is necessary. Only thus can the effects of a change in the volume of capital movements on trade and world conditions be traced.

A great deal is heard concerning the International Balance of Payments. As here used, the term means the whole system of debits and credits between any one nation and the rest of the world. Thus, a statement showing the International Balance of Payments of any nation, is simply a balance sheet of that nation's accounts with all other countries.[1] In such a statement it is usual to distinguish

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1. Examples of this are "Canada's Balance of International Payments" published at Ottawa in 1933, and Taylor's annual publication of the United States Balance of Payments.

between payment in respect of current or income transaction, and payment re capital account. In some cases (for example, the British), the lending and repayment of capital are omitted altogether. It is only when this is done that it is possible to speak of a deficit in the Balance of Payments. It is usually referred to us as the Balance of Indebtedness.

It is only recently that much stress has been laid on the Balance of Payments, in the sense used herein. In so far as this conception replaces that of a Balance of Trade, or that of considering payments between any two nations as a separate entity, it is a forward step. Both the Balance of Trade, and the so-called Balance of Payments between two nations, are but parts of a whole, and surpluses in either must be reflected by deficits elsewhere. This fact has been all too frequently forgotten. Sometimes with dire consequences. Even yet it is not too well understood.

Consider the Balance of Payments as it is usually presented.[2.] Such a presentation in any detailed form has been of necessity but a recent development, for only lately have sufficiently adequate statistics become available. There are still many cases in which more accurate information is needed. Too many of the figures given, are found, on examination, to contain a large degree of conjecture.

2. A standard form of statement has been drawn up by the Economic and Financial Organization of the League of Nations. (cont'd. on p.63.)

Tables showing the Balance of Payments of the different countries vary considerably in their classification, but all retain the distinction between payments on account of the movements of goods and services, and those on capital account. In order to understand the effects of changes in the latter type of payments, something must be said of the former transactions.

(1) Non Capital Transactions which cause Payment Between Nations.

Here again there is always a division into two parts, visible and invisible items.

Under the first heading of visible items, falls the Balance of Commodity Trade, representing the difference between the value of exports and imports of goods. Because these figures are relatively easy to obtain, and because the physical movement of goods is a tangible transaction, such a movement of goods alone has often assumed undue importance. A 'favorable' or 'unfavorable' balance of trade is considered as being paramount of itself. The

2(Cont'd) Such a form is presented in "International Trade" by Barrett Whale pp.34-39. It was felt that no purpose could be served by setting forth such a table in this work.

effect of other transactions is minimized. Some attempt is now being made to remedy this, for example, the greater attention now being given in Canada to the income obtained from foreign tourists. At that, it is doubtful how many Canadians realize, that in one year, 1930, for example, the net income to Canada on Tourist account was $166,000,000,[3], over half as much again as the greatly deplored excess of commodity imports over exports.[4]

Though the figures for the movement of goods between countries seem to be exact, there is a danger of misusing or misunderstanding them. Factors which must be taken into account are: (a) The inclusion or exclusion of movements of coin and bullion. (b) The method of valueing imports; f.o.b. or C.I.F. If the latter is used, the balance sheet, to be accurate, must contain compensatory assets, showing shipping and insurance charges paid to that country's own national; and payments to foreign shipping must not be duplicated. (c) Inclusiveness of the figures (for example, are re-exports included?) (d) Arbitrary valuation of imports for customs purposes. Canadian statistics, for example, have in recent years made,

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3. Canada Year Book, 1933. p.501, or Canada's Balance of International Payments 1926-1932. (Ottawa)

4. ib. $103,000,000 incl. gold movements, or $88,000,000 exclusive of them.

~~volume~~, an allowance for this. (e) The inclusion of settler's effects in the figures for imports. While these, in large volume, are a valuable source of wealth to the country, they cause no payments to be made, and they must be deducted from import figures.

The above covers payments on account of the international movement in goods. There remain the <u>invisible items</u>. Under this heading falls payment for services. That is, payment tendered to people of any nation, on account of services rendered to the inhabitants of other countries. These payments fall into various groups; payment for freight, payment on account of insurance held in other countries, commissions of all sorts, foreign tourist expenditure, accounts of Government officials abroad, and interest payments, including dividends and business profits receivable abroad. Under the same heading fall what are known as non-commercial items which enter into the balance of payments. Thie term covers capital brought in by immigrants, remittances of such immigrants to their homeland, any other postal notes and remittances, and donations to foreign charities and missions (other than in kind). While a gift, for example, is as much a movement of capital as a loan, these non-commercial items are distinct from all other capital movements by the fact that the single payment discharges all obligations. No new obligation to pay at a later date is created. The importance of these non-commercial

items as one means of balancing other transactions is considerable. In the immediate Post-War years, immigrant remittances, American donations to relief in the Near East, and so forth, were the means of supplying a by-no-means negligible portion of the funds required to meet the huge obligations of other nations in America, built up by her excess of commodity exports. Even in Canada, as recently as 1930, immigrant remittances were estimated as $37,000,000.[5.]

Little more need be said concerning Service Payments. To a far greater extent than in the case of commodity trade, figures as to the volume of such payments are difficult to obtain.[6.] More important, figures used are subject to a large margin of error. In drawing any conclusions from a nations'Balance of Payments' this fact must always be borne in mind.

A little more should be said about one item-- interest payments. They are here considered as service charges for the use of capital. However, they differ from other service charges in several ways. For one thing, they are frequently for services rendered to a

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5. Canada's Balance of International Indebtedness. 1926-1932.

6. How such figures are obtained for Canada, is adequately discussed in Viner "Canada's Balance of International Indebtedness. 1900-1913. The obtaining of such figures for Britain is dealt with in Hobson. "Export of Capital."

previous generation, quite possibly for projects of which the present government or people do not approve. But, the main distinction, between interest and other types of payment, is that the former is far more rigidly fixed in amount. In consequence, when times are prosperous, and payments on other accounts more frequent, interest payments form a smaller proportion of the total volume, than in times of depression when trade and capital movements have dwindled, and other services have been curtailed. Governmental actions usually adopted at such times further hinder the free movement of goods and services, which give rise to the other payments, and generally make the whole burden of interest charges worse. That is the situation in Canada, as well as many other parts of the world, today. The removal of this pressing burden of international debt is one of the primary problems waiting to be solved. The importance of changes in the various payments, including capital movements, which serve to balance interest charges, is thus obvious.

Can a restoration of capital movements, either directly, or by bringing about changes in the volume of payments on other account, lessen the burden of international indebtedness? On the reply to this question depends a good deal of the answer to the larger question, will a restoration of capital movements aid in conquering the depression? This whole matter is of particular importance to Canada, at this time.

(2) Capital Movements and the International Balance of Payments

Capital movements fall into two distinct classes--movements on long term and on short term account. These two types of capital movement play widely different parts in international finance. Their effects on trade and on the various other transactions causing international payment are quite distinct.

(a) Short Term Capital Movements.

Short term capital is that represented by bank balances, bills of exchange, temporary advances, overdrafts, call-money, and the like. The movement of such capital between countries, is, roughly, of four types. These are: (a) Changes in the deposits of banks of one in those of another;(b) Changes in the holdings of foreign bills of exchange; (c) Temporary loans to foreign customers. For example, bank advances and overdrafts; (d) Investment of temporary surpluses abroad. For example, money loaned on call in foreign centres. Movements of the first three types are normally brought about in the course of trade. However, movements of all four types may occur for various other reasons;--for example, higher interest rates in one country may call forth a holding, by other nationals, of its bills of exchange, as an investment.

Because of their relative liquidity short term capital investments can be easily shifted in response to changes in the other items of payment, and it is chiefly their movement which evens up temporary inequalities of payments caused by such changes. By balancing these inequalities, exchange rates are kept stable, without rising and falling with every shift in the immediate volume of payments. When the gold standard is in operation this balancing of payments is done by gold movements, but even in this case, the movement of short term capital supplements the shipment of gold. (For further details on this see the next section of this work.)

As short term capital movements occur in the regular course of trade, and as they are responsive to temporary changes of various sorts, it is not surprising to see that there is a constant flow of such capital in every direction. Thus, short term capital will move both ways between two countries, regardless of which is creditor or debtor nation, and with little or no connection with long term investment. The most outstanding illustration of this is the large movement of short term capital into the United States during the years prior to 1929, at the time when America was lending abroad, on long term, on an extensive scale.

In the years after the War, the volume of international short term capital increased enormously. The effects of this have already been dealt with. What must be done here, is to set forth the regular functions

of this type of movement and to show why they have become more important of late years. One function, that of supplementing gold movements to even up temporary dis-equilibria of payments has just been mentioned. An historical illustration of this has been furnished in a study of Canadian international payments.[7.] This study shows conclusively, that during the period when she was borrowing extensively abroad, Canada was building up foreign short term assets. That is, the temporary surplus of payments to Canada was removed from the immediate supply by being lent on short term elsewhere. Later, as changes in other items of payment were brought about, these short term assets were liquidated and brought into Canada.

Even with the gold standard in operation, most countries find it convenient to have some reserves of foreign assets. There are some international long term securities which can be sold readily on different markets, but in general such reserves of foreign assets must be made up of short term obligations to be of much use in maintaining balance. With the suspension of gold movements, the need for such a reserve of short term foreign obligations becomes infinitely greater.

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7. Vines "Canada's Balance of International Indebtendess. 1900-1913. Chapter VIII.

As no country can have adequate reserves of claims on every other country, the method adopted has been for the smaller countries, to hold short term obligations payable either in one of the gold standard countries, or in some country whose currency is relatively stable, and widely used. When a country evens up its international payments by drawing on or adding to, its short term capital in gold standard countries, it is said to be in the gold exchange standard. Similarly, other countries may be said to be in the sterling exchange, or the dollar exchange standard.

That is the general function of short term capital movements, but there are also more specialized ones. Short term capital can be moved quickly to take advantage of exchange quotations which are out of line with similar quotations elsewhere. Thus wide spreads between rates on different exchange markets are eliminated. Similarly, temporary differences in interest rates (beyond the normal spreads due to risk) are evened up.

Another important function of short term capital movements is to smooth out inequalities of payment due to the seasonal movement of goods. In many countries, producing raw materials, there is a large seasonal export of goods following the harvest and a slack period at other times, whereas imports of manufactured goods usually proceed steadily throughout the year. Due to an increased storage facility, this is not so true in some cases as it formerly was, for example,

the movement of Canadian wheat is comparatively steady throughout the year. The largest scale example of seasonal inequalities of payment occurred in the Pre-War trade between Britain and the United States. Regularly, the United States had a surplus of imports early in the year, and a large surplus of exports following the harvesting of wheat, cotton, and so on in the summer and fall. Every spring, to increase the supply of exchange and prevent gold movements, the American banks drew on their balances in the British and European banks, and where necessary through temporary loans and advances increased these balances to permit further drafts. In the fall, the reverse procedure was followed.

(b) Long Term Capital Movements.

Before setting forth the relationship between long term capital investment and the other items which enter into the balance of payments, something should be said concerning the reasons for the investment abroad of capital on long term.

The first and most important reason, especially over the long time period, is national difference in interest rates. This is the fundamental reason for the flow of capital across national boundaries, and so long as the private investor has any say in the matter, will continue to be so. Its importance is so evident that little more need be said. One point to be noted, is that the spread in interest rates necessary to call forth foreign

investment varies considerably with economic conditions. In prosperous times, a very small spread may be sufficient, but in times of great uncertainty like the present, the risk of loss is so great as to make only the widest spreads tempting.

Rather more should be said concerning the other motives which cause capital movements. Interest rates establish the general trend of capital movements, but other motives cause the fluctuations above or below the trend line. As this section deals with the effects of changes in the volume of capital movements, these other motives require a little more explanation.

The most important effect is "political considerations". There are many examples of this. The most noteworthy case is French loans to Russia, prior to 1914. There have been other cases where political advantage outweighed economic considerations to a greater degree. But for time and amounts involved, this is the most striking. Interest rates were higher in Russia than in France, but by no means enough, in comparison to other areas, to account for the extent of the movement. The machinery of French investment was definitely geared so as to favor Russia. With the consent and approval of the government, the banks, who largely controlled investment, spread extensive propaganda in favor of Russian bonds.

Political motives were also bahind the placing of other French, and of most German, loans. The fact

that the banks very largely controlled foreign investment in these two countries greatly facilitated the putting over of such loans.

In Britain political considerations have played a much smaller part. But, even there, as far back as 1900, the Colonial Stock Act was passed which made Dominion bonds trusted securities in the United Kingdom. This act undoubtedly gave investment in the Dominions a decided preference over other foreign investment.

Since the War, political considerations have generally worked to restrict rather than to encourage loans. Sometimes there has been direct political action. Italy restricts the import of foreign capital; France has laid heavy stamp duties on foreign issues in Paris; the United States by the Johnson Act of 1933, forbade the flotation of issues of countries in default to her, and as default included suspension of war debt payments, this excluded most countries; even Britain has placed temporary embargoes on foreign loans.

The political motives at work aiding capital investment in particular regions, or restricting it, have been many and varied. The more important ones are: (a) The desire to strengthen foreign alliances; (b) Eagerness for foreign exploitation; (c) The desire to encourage export trade by direct methods; (d) The desire for independence from foreign obligations; (e) Fear of building up potential enemies or competitors; (f) The

desire to guarantee a steady supply of raw materials from abroad. Instances of all these are common. The first three have already been illustrated in connection with French and German Pre-War loans. The actions of Hitler and Mussolini are illustrative of the fourth. The fifth is one which works strongly in the United States. It is reflected in certain sections of the American press. A letter from the President of the Chemical Foundation admirably illustrates this viewpoint.[8] Here is an extract. Speaking of foreign loans, he says "I ask your committee to exert its full powers of subpoena and cross-examination to expose this menace to our people. If not exposed and checked, it threatens our national defence, our public health, and our standard of living."

Finally, there are numerous instances of the sixth motive at work, namely the guaranteeing of a steady supply of foreign raw materials. There is British investment in Persian oil fields, British investment in Malayan rubber plantations, American investment in the Canadian pulp and paper industry, and numerous other instances.

Besides the lure of higher interest rates, and what are broadly speaking, political motives, there are other reasons, which lead to the investment of long term

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8. op.cit. on Sale of Foreign Bonds and Securities in the United States. pp. 527. - 531.

capital abroad. The more important of these are: (1) The policy of establishing branch offices and factories abroad, usually financed by home capital. While this policy may be adopted for various reasons, the most common one is to avoid tariff barriers. (2) The preference of capitalists for diversity of investment, geographical as well as otherwise. (3) The chance for a direct profit on the investment may make differences in interest rates of relatively little importance, for example, when there is a possibility of rapid development in a country, with the likelihood that the investment will grow in value. (4) Foreign investment may be due to internal monetary conditions, for example, the flight of capital abroad to escape a feared inflation or high domestic taxation.

These are the chief reasons for long term foreign investment. The question is, when the main motive grows stronger or weaker, or when any of the other motives come into play, or lose their force, and, _when, consequently, the rate of new investment in any country changes, what happens to the equilibrium of international payments?_ From the wording of this question, it can be seen that there is an essential difference in the viewpoint from which long term and short term capital movements are regarded, for with short term movements, the question asked was, how they responded to changes in the other transactions. Long term capital movements

are, generally speaking, classified as more of a disturbing than a steadying element in the international balance of payments. However, there have been exceptions to this, especially in very recent years. The following quotation, applying to events since 1929, clearly places all capital movements among the modifying elements, not the causes of the disturbance. "The table on balances of payment brings out recent disturbances in the equilibria of international business transactions and the accompanying abnormal movements of gold and capital..."[9.] There is no doubt that with increased rigidity of trade, and a great diminution of payments on other accounts, any further changes that have occurred, have had their repercussions on long term capital movements. Even bearing this in mind, "basic changes which primarily affect imports and exports seldom call forth secondary adjustment with regard to long term lending, while the reverse always happens."[10.] For each and every position of a country with regard to its capital obligations, there is a fixed and definite relationship of the payments on non-capital account. There are four such positions. The following is a description of them with the corresponding situation with regard to other payments.

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9. Interdependence. October 1934. Review of the Statistical Year Book of the League of Nations. 1933-1934. p.149.

10. Bertil Ohlin. "Inter-regional and International Trade". Chapter XVIII, Section 2.

1. When capital is being invested in a country in excess of its current capital indebtedness, the country is called an Immature Debtor. Canada was in this position before the Great War. Such a country always has an excess of imports. (Throughout this section the terms export and import cover invisible as well as visible trade)

2. When interest and sinking fund obligations come to be in excess of the new investment in the country, that country is called a Mature Debtor. Such is the position of Canada today, although her situation is close to the border line between this and the next one. The United States in Pre-War days, was in this position, as are The Argentine, and Australia today. Such a country must have an excess of exports.

3. When a nation begins to loan abroad more than it borrows it becomes an Immature Creditor. Again, it must have an excess of exports. Of recent years Canadian balance of payments figures have sometimes shown a net export of capital. However, if maturities and redemptions be taken into account, Canada still remains an importer of capital,[11.] that is, Canada has hardly yet reached the stage of immature creditor.

11.
eg. See "Canada's Balance of International Indebtedness." (Ottawa) 1926-1932. p.5.

4. Where a country's investments abroad become so extensive that its income from them exceeds its new investments, such a country is called a Mature Creditor. This position must be accompanied by an excess of imports. Britain reached this stage about the beginning of the last quarter of the nineteenth century. She had an import balance of commodity trade approximately a quarter of a century earlier, but not an excess of total imports, due to her receipts on account of shipping, banking and other services. The events of the War and immediate Post-War years brought the United States into the same position, though her fresh loans between 1924 and 1930 staved off the effects until then. Further, in that country, the forced adjustment from an excess of exports to an excess of imports was brought about very largely by a change, not in the visible, but in the invisible items. In these is included loss of income from abroad due to defaults.

It has been stated that for each position of a country in regard to its foreign debts and credits there is a corresponding position of its respective volume of exports and imports. This is a corollary of the fact that a nation's income and outgo must balance. How often that fact is completely ignored! It is perfectly true that the manner in which the balance of payments is obtained is important. For instance, it is unsound policy for a nation to continually drain itself of capital, while home industries could well use it profitably, or to allow the balance of payments to be made up by unnecessarily adding

to its foreign obligations. But, a policy which takes this into account is a long way from a policy of building up a surplus of payments on any one account, while wholly ignoring the fact that another source of payments, (equally or more profitable to the nation) may be badly affected in the process. Yet, this latter policy has been followed by many governments.

A specific case of definitely conflicting policies adopted by one government is worth some notice. After the Was, the United States became a mature creditor nation. The normal reaction would have been an increase in imports, and an at least relative decrease in exports. This was not acceptable to the great majority of the American people. They strove to keep down imports and export sales they pushed vigorously. For a while this policy seemed to work very successfully, resulting in a large "favorable" Balance of Trade. Many of the other changes which occurred to make this policy successful for a time have already been mentioned (for example, further American loans, tourist expenditure abroad.) It is in connection with one of these, American foreign loans, and two balancing items not previously mentioned, payments for ocean freight and passenger transportation, and the inflow of gold, that the conflict of policies came. Of course the fundamental conflict was due to the fact that America desired to be a creditor nation, and would not accept the excess of imports accompanying such a position. But certain policies

she adopted in connection with the three previously mentioned items, aggravated the situation.

Payment to foreign shipping, for the carriage of the bulk of her large commodity trade, and her numerous tourists, could have formed a large item in America's out-payments and provided funds for a great deal of the surplus payments due her. But instead, large amounts were spent on attempts to build up a Mercantile Marine. In itself the attempt was uneconomic, without allowing for the fact that by so doing, America kept herself from receiving payments due to her, and helped to undermine her large "favorable" Balance of Trade position which she was trying so hard to hold.

Again, America welcomed the movement of gold into the country. Yet, the fact that she received such a large proportion of the world's gold drove many other countries off the gold standard. The resulting exchange depreciation hindered American sales abroad, and forced America to raise her tariffs, or to see them less useful in keeping out foreign goods.

Finally, throughout the period of American loans abroad there was pressure against them by those who feared that they were building up industries in other lands, whose products would compete with home manufactures. Finally this view prevailed and American foreign investment ceased. The consequences were the very thing feared, namely an increased foreign competition, due to foreign inability to buy and further exchange depreciation.

Eventually the whole Post-War equilibrium collapsed. The results have been interesting. In the collapse America has largely lost both things she desired. Her favorable balance of trade decreased from $738,000,000 in 1928 to $87,000,000 (gold dollars) in 1933.[12] Her creditor position, already weakened by numerous defaults, has been further impaired by the devaluation of the dollar. She is still a creditor on a large scale, but her position of world dominance has been definitely weakened. No longer is there talk of New York supplanting London as the financial centre of the world.

All of the above section of this work has been telling of the various items comprising the balance of payments. An attemtp has been made to show in what manner changes in the capital items affect, and are affected by, other payments. But, as yet, nothing has been said as to the way in which such changes are brought about. It has been said repeatedly that total payments must balance, and that changes in any one item of payment must cause changes in the others. It is now time to show how, in actual practice, these changes are made to happen.

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12. League of Nations, Statistical Year Book. 1933-1934.

V. THE THEORY OF CAPITAL MOVEMENTS

To deal with the theory of capital movements, is to tread on dangerous ground. For, in their views on this subject the most eminent of economists differ widely. The problem is to ascertain whether the Classical theory, with certain necessary adjustments, has held true, or whether a totally new conception of the way in which capital movements bring about change in other causes for international payment, is necessary. The following views are mainly those of the modified Classical Theory.

An attempt will be made to trace what happens when a loan is floated in one country for the benefit of another. Such a study falls naturally into two parts. (1) The situation while the loan, and the immediate adjustments necessary, are being made. (2) The long time effects of such a loan.

(1) The Primary Effects of a New Movement of Capital

The simplest form of capital movement is that where a loan is spent solely in the country of its origin, for example, a British loan to a Canadian shipping company, which the shipping company spends in purchasing ships from Britain. The Canadian claims on the British banks find their way into the hands of the British shipbuilders. There is no need to transfer funds from one country to the other. The movement will have no effects on the equilibrium of payments between the countries. Canada

imports the ships and pays for them with an export of bonds. There will be no further adjustments necessary.

Such cases rarely happen, and are of small importance. It is better to take a more typical example, say a loan for railways. Better yet, imagine a period of active railway construction in the borrowing country, and a series of such loans, for the amount of one loan is too insignificant in relation to the total volume of international payments. Several assumptions will first have to be made. The changes in theory that are necessary when these assumptions are removed, can be discussed later.

Imagine two countries, A and C, both on the gold standard, trading only with each other, and neither disposed to make any changes in existing tariffs or restrictive measures of any sort on trade. Suppose that C floats a loan in A. Part of the loan will surely be used in A. The actual proportion so spent outside of C will largely depend upon the state of economic development of the two countries. In the case imagined here, it would likely be fairly large, for a period of railway construction implies recent development and probably less industrial equipment. That being the case, most of the railway material will likely be purchased in A. But, in any case, part of the loan will be spent in A, with the same effects as in the first mentioned illustration. Some part of it, however, will be left to be spent in

C, for wages on the construction work, if nothing else. This raises the question of how this portion of the proceeds from the loan is transferred from A to C.

The agents who have floated the loan in A, after disposing of the bonds, and deducting their commission, will credit the funds raised to the account of the banks in C, which are handling the loan. These banks thus have claims on A. Meanwhile, in return for these claims, they will have paid off the firm or government for whom the loan was floated in their own currency. As far as the individual borrowers are concerned, the transaction is thus ended.

The banks, however, still have to realize on their claims on A. A portion of these claims may be left in A and invested there on short term. That is what Canada did on several occasions when she was borrowing. (See p.51) But some at least of these claims will be put on the foreign exchange market. That is, C will draw on its correspondents in A, and sell the draft. The consequent increased supply of drafts on A will cause the rates paid for them to fall. But these rates cannot fall far without it being more profitable to bring in gold from A to C than to sell a draft on A.

Even before this happens, other forces will have been set in motion. Speculators will become active. The banks in A soon find that by utilizing their balances in C, they can buy these claims on their own country at a lower rate, and so make a profit. Further, the banks

engage in arbitrage, that is, A's claims on other countries, to which C is a debtor are transferred to C, and from there to the other country, at a profit. By these means, (short term capital and gold movements) some of C's claims on A are realized upon, but it is the effects of these movements and the further changes which they cause, not the movements themselves, which enable most of the proceeds of the loan to be transferred.

What are these effects? Consider first the effects on C, then those on A. Credit has been increased in C. This was done when the banks paid off the original borrowers in their own currency. The inflow of gold and the increased reserves of foreign exchanges form the basis for further credit expansion. Part of this increased credit will likely result in further purchases in A; that is, there will be further imports from A to be paid for and a consequent lessening in the surplus credit to be accounted for. Most of C's increased purchasing power, however, will be spent on home market goods, and in purchasing goods which would otherwise be exported to A. The result will be an increased demand for home market goods. The production of these will then expand, far more than that of export goods or those competing with imports from A. That is particularly true, because, as will later be seen, imports from A tend to fall in price. In contrast to this, with the increase in credit, C's prices and costs of production tend to rise both in domestic and export

industries. Thus, more of A's industries will be able to compete successfully in C, while, due to their relative cheapness, any commodities previously imported from A, for which demand is in anyway elastic, will increase their sales. At the same time, due to higher production costs, export sales will be increasingly difficult. The result of all this will be a further increase in C's adverse trade balance, until finally all additional claims on A, as a result of the loan will be wiped out.

While this is happening, other events may be aiding in the process of absorbing these surplus claims. The increased imports may be brought in in A's ships, increasing payments to be made on this account. Cheaper prices in A than in C will check tourist traffic from A to C, and increase it from C to A. Higher wages in C may cause more to be sent to A in the way of Immigrant Remittances.

Meanwhile, what will have happened in A? The loan will have increased the indebtedness of the banks there. More important, as short term capital and gold have moved out of the country, the banking reserves will have decreased. This will have led to a restriction of credit, and if the gold movement is of any volums, a rise in bank rate. All of this will have tended to lower prices, the degree to which they fall depending upon the sensitiveness to gold movements of A's monetary structure, the ability of the banks to control credit, and many other

causes. But, in general, with the decrease in the volume of credit, there will be a fall in the demand for goods and services at home. A's exporting industries will force their sales abroad. Imports from C will have risen in price, and with the decrease in A's purchasing power, their sales will fall off. Ultimately, as has been mentioned, payments on other than capital account will be great enough to balance the proceeds of the loan.

It is necessary at this point to deal with the assumptions made. Does the fact that in actual practice there are not two, but many countries, all trading with each other, make any essential difference in the way capital movements are balanced? Observations seem to indicate that the necessary changes are brought about in essentially the same way, but with many variations in detail. The best example of such world wide adjustment that can be found to illustrate this point, is the case of British loans to Canada in the years 1900-1914.[13.]

During the period of these loans, prices rose in Canada, particularly those of home market and export goods, just as outlined above. But, unlike in the theoretical case above, most of Canada's imports came, not from Britain, but from the United States. Indeed, during all this period, Canada actually had a "favorable" balance

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13. For a full treatment of this see Viner. op.cit.

of trade with Great Britain. How, then, were Canada's increased claims on Britain balanced or taken care of? Why did British imports from Canada not fall off as according to the supposition above? It has been said that prices in Canada rose. In general, this was true, and certain Canadian exports did fall off in consequence. But the falling off in these exports was more than balanced by a great increase in the export of other commodities, an increase which in every case can be explained by the discovery or development of low cost resources, or cheaper methods of production. These factors prevented costs of production of these other commodities from keeping pace with the general upward price trend occurring in Canada.[14.]

That still leaves the question as to the manner in which Canada's claims on Britain were taken care of, to be answered. Higher prices in Canada led to an increase of imports, as the theory indicated. These imports were mostly from the United States. In payment for these imports the Canadian banks turned over their claims on Britain to the American banks. It was largely in this manner that Canada realized on the loans. But that still did not settle the claims on Britain transferred to America. Like Canada, the United States also had an excess of exports to, over imports from, Great Britain. Some of the claims were

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14. For figures for this see Viner, op.cit. p.261-274.

used, as Canada herself had used some of them, to pay interest charges on previous investments, to pay for carriage of goods in British shipping, to pay British commissions, and so on. But to finally settle these claims, a further triangular adjustment was necessary. America made large purchases from tropical countries. These countries in turn were heavy purchasers of manufactured goods from Britain. So America transferred her claims on Britain to them and they used them to settle their indebtedness to Great Britain.

One other question might be asked, in view of the theoretical case, did prices fall in Britain? As this occurred during a time of rising prices, the world over, they did not, but, they did not rise as fast as prices in Canada, United States, or the other countries undergoing rapid economic development at that time. Relatively speaking, there was a fall in British prices.

Modifications of the theory of capital movements caused by the abandonment of the gold standard. It was assumed in the theoretical example given, that both countries were on the gold standard. As, at present, that standard is only in operation in a very few countries, and even these countries may not continue on it for long, it is highly important that all differences caused by its abandonment be fully discussed.

Return to the theoretical case previously set forth, but with the assumption that both countries are

now off the gold standard. The most important difference is that there will be no automatic limit to the fall in the rates paid for drafts on A. There will be no gold movements. Further, the knowledge that the exchanges may move widely will lessen the chances of buying these surplus drafts, for there can be no guarantee that exchange rates will return, to their old level. It may even happen, that, for a time, speculation will cause the exchanges to shift more rapidly than they otherwise would. While eventually speculation and the other forces called into play will tend to stabilize the rates of exchange, at first these rates may fluctuate over a wide range.

What further differences will this cause? Before proceeding, still another assumption must be made, namely, that both countries are following a fairly stable monetary policy, that is, they are not actively pursuing either inflationary or deflationary policies. This being the case, there will be the same increase of credit in C with the same effects as previously. However, there will be less likelihood of a contraction of credit in A, for there will not be the same drain on its currency reserves, and these will not, in any case, be considered as so important. However, if there is much of a fall in the exchange rates, the banks may tighten credit there, as before.

There is this big difference between this and the earlier example. In addition to the effects of price

changes withintthe country on exports and imports, trade and other transactions will also be affected by changes in the exchange rate. Because of C's excessive supply of claims on A, exchange rates will move against A. As a result, exporters in A, shipping to C, will receive more in return for their goods, since with each unit of C's currency they can purchase more of their own. They can thus lower their prices, and still make the same profit, thereby increasing their total sales. On the other hand, C's exporters receive less than previously for their claims on A and if the fall in rates is severe enough, will have to raise their prices in A's terms of currency, cutting down their sales there. C becomes a good country to sell to, and a poor one to buy in. Imports are stimulated and exports are checked. The effect is to increase C's adverse balance of trade and thus use up the surplus of that country's claims on A, restoring equilibrium just as in the case of the gold standard countries.

There is a distinction, however, between the equilibrium reached in the two cases. With the gold standard countries, exchange rates will return to par. With the paper standard countries, equilibrium will likely be established at a rate somewhat different than the old one. There will be a new parity of exchange. This new parity of exchange at which payments will balance is the purchasing power parity of economic theory.

All of the above is based on the assumption that the countries involved were pursuing a stable monetary

policy. When such is not the case, further modifications of theory are again necessary. Still using the same illustration, suppose that C is following an inflationary policy. The necessary adjustments will come very quickly. The credits granted by the banks following the loan will in turn be followed by further credits based on the increased foreign assets of the banks. Prices in C will rise more quickly and the changes in commodity trade, tourist traffic, , and so on, will occur that much sooner. If the inflation is rapid enough there may be a sufficient outflow of short term capital to balance the inflow due to the loan. Speculators will buy drafts on A with every fall in exchange rates, for they will expect the rates to ultimately move against C as the effects of the inflation are fully felt.

On the other hand, a strict credit policy on the part of C will hinder the necessary readjustments. However, a country which is pursuing such a policy, does not usually encourage borrowing so this rarely happens.

A tight credit policy, in A, however, will be of great aid in bringing about the necessary adjustments, while an inflationary policy pursued there may make adjustments exceedingly difficult. This is equally true for countries on or off the gold standard. In gold standard countries, lack of sensitiveness of the credit structure to gold movements takes the place of inflationary tendencies in the paper standard countries. The fact that a tight credit policy in the lending country aids readjust-

ment was well learnt by the Bank of England, after some bitter experiences in the nineteenth century. As long as England remained on the gold standard, when through excessive lending, or other wise, the exchanges moved against England, bank rate was raised and steps taken to see that other rates rose as well, so that credit was restricted, for it was found that delay only made the adjustments harder.

In case these statements should not seem to fit in with actual instances, it should be stressed that what has been outlined are the immediate effects of _new_ or _increasing_ loans only.

Capital Movements and barriers to Trade. One further assumption originally made, has not yet been dealt with, namely, the assumption that the impediment, natural or artificial, on trade, remained constant. If additional impediments to trade are raised by A without any retaliation by C, the adjustments will be made easier, but if C raises any further impediments to trade, the reverse is the case, for the flow of goods into C will be checked and there will not be as great an adverse trade balance to cover C's additional claims on A. A general raising of barriers will also serve to hinder adjustment. True, C's exports to A will be checked as well as its imports from A. But, as its imports from A will be the larger of the two items, they will decline most in absolute volume. A ten per cent excess of imports into C, on a large volume of trade, may be sufficient to use up the

surplus claims on A, but on a small volume of trade and a much greater percentage will be needed.

Mention of a general raising of barriers to trade brings to mind a further question. What effects have different conditions of trade at the time when the loan is made, on the ease of adjustment? The illustration used really implies that business conditions in C were at least normal. But suppose now that conditions in C are bad and that the loan is made to enable it to balance its budget, not for any programs of expansion. There will not likely be much increase of credit. Even supposing there is some increase in credit, there will not be the same rise in prices in the home industries. The assumption of hard times presupposes unemployed labor, idle plant and equipment, and so forth which can be called into use without any great rise in costs. Exporters will continue to push their sales abroad despite the increase in price, if any, and despite exchange rates unfavorable to them. For there will be no other line of activity into which any of the agents of production so used can be turned. There will not be the increased purchasing power to pay for imports from A, that there was in the previous illustration. Most important of all, any increase in competition from A will cause a great demand for, and a likely increase in, protective tariffs. By such tariffs, the increased flow of imports which normally would come into C will be checked.

If times are bad enough and restrictions severe enough exceedingly drastic changes may be necessary to bring about adjustment. The gold standard may break down, or exchange rates may vary to a striking degree, or defaults of payment may ensue. But this can be better explained after discussing the long term effects of foreign lending.

(2) The Long Time Effects of Foreign Lending

In general, it may be assumed that the balance of payments will adjust itself to fresh or new loans as previously illustrated. Payments between A and C will be ablanced so as to provide for C's excess claims on A, due to the loan. Suppose now that further loans are extended to C of the same volume as formerly. Each year the interest payments from C to A will increase. That is, there will be an increase in A's claims on C. But the balance of payments has already been adjusted to the excess of C's claims on A, caused by the loans. Therefore further adjustment, this time in the reverse direction, will be necessary. The situation will be exactly the same as if C were lending to A. If A continues to invest in C, these adjustments due to C's increased interest payments will be very gradual, and changes in the other payments will only have to come very slowly with a minimum of dislocation. But, unless

A continually increases its rate of investment in C, such changes must come. Eventually, as the interest payments due to A increase, they will surpass the fresh amounts invested by A. By the time this happens, A will have become an importer on balance, and C an exporter. The method by which this happens will be exactly the same as in the original case, except that the changes will be spread out over a longer period, and smaller shifts in exchange rates or price structure will be sufficient to bring them about.

Now suppose that A suddenly ceases to invest in C. Interest payments from C to A continue. The consequent adjustments necessary may evidently be quite large. The situation will be exactly the same as originally set forth, but with C and A in reverse positions. But, adjustment will in all probability be considerably harder. Why?

When business conditions are bad in C, A would not so likely extend any new or increasing loans. An increased volume of investment practically always occurs with good times and prosperity. But, bad business and trade conditions in A would likely lead to a cessation of loans from that country. And, as indicated, a sudden cessation has just the same effects as a loan from C to A. Practically all actual cases of difficult adjustment and extreme dislocation have occurred under such circumstances.

The reasons for these difficulties have been indicated on page 96. These difficulties may be made still worse. It has been stated that inflation in the lending country makes adjustments harder. In times of depression, C may find it necessary, due to financial difficulties, to print paper currency, thus covering inflation. Prices in C will rise, at least relatively to other prices, instead of falling. Again, prices in A will not necessarily rise--in any case there will not be any automatic adjustment. For example, from 1929 until the devaluation of the dollar, prices fell faster in the United States (in the position of A in the illustration) than in most of the countries which were in the position of C.

Extreme difficulties of adjustment have led, in many countries, to exchange control or default, that is, a wiping out of A's claims on C by the action of the government in C. One method of exchange control adopted has been that of payment in blocked accounts. A's surplus claims on C are settled by the payment of C's bonds to the claimants, that is, these claimants are given new claims on C, payable only in that country. These claims are thus available to settle any debts of A in C or can be used in payment for anything purchased there, but cannot themselves be transferred into A. In other words, the payments are balanced by means of what amounts to a forced loan from A to C.

Even without exchange control, and despite restrictions on trade, restrictions on gold movements, restrictions on the movement of exchange rates (pegging of exchange rates) and rigidity of price structure, payments have in actual practice been balanced in a way that admirably proves the soundness of the theory given above. Two instances of this will suffice, and will serve to close this section.

(1) Starting with 1929, the volume of American foreign investment which had been steadily increasing, suddenly declined and eventually fell away entirely. This left a large surplus of American claims on foreign nations for interest receivable. Following the stock market crash there was a period of very rapid deflation in America. The decrease in the credit extended to other nations was insignificant compared to the writing off in values which occurred. Figures are given in the next section, page 110, showing the falling off in America's national income. This fall between 1929 and 1932 was at least ten times the foreign credits extended by America in her most prosperous years. In consequence, prices did not rise in America, even relatively to those in the debtor nations. There were no changes in price structure to aid necessary adjustments in the balance of payments. Further, any decrease in American exports due to higher foreign tariffs was more than balanced by the increases in the American tariff under the Hawley-Smoot bill.

How was the adjustment brought about? The following were the four principal ways. (a) Short term capital movements. The years 1930, 1931, and 1932 witnessed large withdrawals of short term capital from the United States.[1] During her period of prosperity most nations had built up balances in that country which could now be realized on. (b) Most of the countries whose credits from America were stopped, either were already off, or soon were forced off the gold standard. Just as in the theoretical example these currencies depreciated rapidly and rates for bills on America rose sharply, while American claims on them depreciated correspondingly. This movement of the exchanges stimulated exports to, and hindered exports from, the United States, despite the operation of the tariffs. That is why in certain American magazines,[2] there were complaints about countries with depreciated currencies flooding the American market with their goods. (c) Changes occurred in the invisible items of trade. The loss of interest due to debt defaults might be included here. (d) With the devaluation of the dollar rapid deflation ceased, and instead, in many cases, prices rose until they were out of line with world prices. For example, American wheat and cotton prices

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1. League of Nations Statistical Year Book, 1933-1934. p.196.
2. For example, The Saturday Evening Post.

as compared to the world prices. The results have been a large falling off in American exports.

The other case to be cited, is that of Germany. It is true that that country has now undertaken rigid exchange control. But, how she managed to avoid such measures as long as she did in view of the magnitude of the adjustment necessary, is amazing. Despite restrictions on trade, there was a shift in the trade balance in close correlation with the changes in capital movements.

TABLE IX

GERMAN CAPITAL MOVEMENTS [1]
AND THE BALANCE OF TRADE
(IN MILLIONS OF R. M.)

Year	Capital Movements[2]	Balance of Trade[3]
1928	+2247	-3323
1929	+1462	-361
1930	-656	+988

The outflow of capital in 1930 was due to the withdrawal of short term funds from Germany. While the favorable balance of trade was largely achieved by a

(1) League of Nations Statistical Year Book, 1933-1934. pp. 187 & 196.
(2) + denotes an inflow of capital, - an outflow.
(3) + denotes a favorable balance of trade, - an unfavorable one.

curtailment of imports, exports did increase nearly 2,000,000,000 R.M. between 1928 and 1929.

From the whole of this section, it can be concluded that there is a very close connection between movements of capital, trade movements, fluctuations in exchange rates, price changes and tariff barriers, and that since capital movements affect all the others, they play a prominent part in determining economic conditions. The present day situation must thus be studied in the light of this conclusion.

VI THE PRESENT SITUATION AND THE FUTURE OF INTERNATIONAL CAPITAL MOVEMENTS

The final stage has been reached. Capital movements have been discussed historically and theoretically. Particular attention has been paid to their part in the background of the present economic distress. What the effects of capital movements have been, what the y should normally be, and the factors which checked or furthered such movements, or modified their effects, all these have been covered.

But, everything already described, while necessary, is really preliminary to the main question. What are the present effects of international capital movements (or rather the absence of such movements) and world economic recovery?

The background of the present situation, until 1930, has already been dealt with. To summarize it briefly: The nations who, before the War had made large foreign investments, were, after the War, both less able and less willing to invest abroad than formerly. Germany, instead of investing abroad, had absorbed large amounts of foreign capital. Nevertheless, capital movements, while by no means approaching the volume of Pre-War days, had been resumed on a considerable scale. France, and more particularly Britain, had not altogether ceased to lend, while capital was forthcoming from smaller countries, such as

Holland. More important, for a brief period, the United States loaned readily to many countries. From 1924 to 1928, and again in 1930, foreign loans floated there ran to over a billion dollars per year. But inherent in the situation lay the germs of a great collapse. The United States would not increase her imports of foreign goods, in fact, she added to her creditor position by pushing the sale of her exports abroad. High tariffs and other restrictions elsewhere, largely raised to protect industries created in the stress of wartime, and kept high by world insecurity and Nationalism further restricted the movement of goods from the debtor nations. The consequence was an ever-growing international indebtedness. High prices and further loans, bringing with them a sense of comparative security obscured the true situation for a time. But, it was inevitable that unless some means of paying the creditor nations were found, the burden of ever-increasing indebtedness must become top-heavy and a crash ensue.

Such a crash has occurred. The immediate cause was the collapse of stock market values in the United States which occurred in the latter part of 1929 and early in 1930 This collapse inaugurated a period of deflation in that country, and began a period of falling world prices. This increased pressure alone would no doubt have made the debt structure impossibly heavy in many countries.

Most of the debtor nations are primarily producers of raw materials and food stuffs. Even the more highly developed ones, such as Canada, depend largely on

the sale of primary products abroad. Prices of these products fell far more rapidly than those for manufactured goods. In consequence, most debtor countries saw a diminution in their favorable balance of trade, which balance was necessary to cover interest and other service charges. In their efforts to remedy this by restricting imports, they further reduced the exports of some other country, adding fuel to the fire. This restriction on imports did serve to cut down the huge sums due to America on account of her export surplus, but as it only served to intensify her desire to be self-sufficient, nothing was done to relieve the existing burden of indebtedness. Further, hard times in America meant a reduction in the vast sums spent by American tourists abroad. France, for example, suffered very greatly on this account.

But, to make the situation worse, with all this was an abrupt fall in the volume of new loans. Some countries, such as Canada, were fortunate enough to have built up large foreign assets to draw on and help to tide them over during the necessary period of readjustment.[3] Besides this, Canada has been one of the few nations still able to borrow, even if on a reduced scale.

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3. Between October 1930 and July 1932, the foreign assets of the Canadian banks fell from $563,000,000 to $379,000,000. Innis and Plumptre.op.cit. p.251.

While in 1928 Canadian issues formed but fifteen per cent of those floated in the United States, and in 1930, 33½ per cent, in 1932 and 1933 they formed over 90 per cent. In addition, Canada has been able to float several large loans in London. Even though most of these have been conversion loans, they have aided in preserving financial stability.

Many other countries have not been so fortunate, for example, those in South America. When, in addition to a deficit in their international payments caused by falling world prices, they had a further deficit to face due to the sudden cessation of loans, many were left with no alternative but straight default, or exchange control of some sort, with a freezing of foreign assets. Countries, such as Germany, which were not quite so dependent on the price of one or two primary products, also became involved, for with tariffs everywhere, there was no way in which they could sufficiently increase their exports to make up the difference in payments caused by the cessation of loans.

Some indication of the decrease in foreign investment in the last few years is given in the following table.

TABLE XI

FOREIGN LOANS FLOATED IN LEADING CREDITOR COUNTRIES [1]

1928-1933

(IN MILLIONS OF NATIONAL CURRENCY UNIT) [2]

Country	Loans Floated there						Currency Unit (Parity with $, December 1933)
	1928	1929	1930	1931	1932	1933	
Great Britain [3]							
Foreign.......	42.3	26.2	35.7	9.1	0.3	5.4	£= $5.11
Dominions and Colonies.....	63.2	61.0	61.4	38.5	25.5	29.2	
United States..	1319.	758	1009	254	26	1.6 [4]	....
France							
Foreign.............		517	2630	4161	1358	1407	Fr. = $ .06
Colonial......	72.	414	1343	2493	2252	2748	
Netherlands							Gulder= $.63
Foreign.......	242.	206	241	32	23	....	
Colonial................................					104	....	
Switzerland	91	110	305	103	145	....	Sw.fr.= $.30

To complete the picture, the following list is the sum total of all government loans floated in foreign countries from January to mid-summer 1934. [5]

London--£16,647,000. New S. Wales Conversion Loan

£10,000,000. Canadian government

£ 2,000,000. Palestine

Czecho Slovakia--4,000,000 gold schillings. Austria (Czecho Slovakia's share of the International loan to Austria arranged in 1933)

USSR--8,000,000 gold roubles credit to Turkey for purchases in the U.S.S.R.

(See p.108 for footnotes.)

To put it into words: By the end of 1933, for all practical purposes, France, and to a limited extent Britain, were the only countries making any further foreign investment. Since then France, which escaped the depression longer than most countries, has gone through a period of great economic distress. No later figures are available, but judging from all obtainable information, it would seem that french foreign investment (except possibly in her colonies) is now at a standstill.

Excepting a slow trickle to the British Dominions and colonies, and to certain other colonial areas, the flow of capital between national boundaries has completely dried up. What are the reasons for this, and are they still operating, or has their force been expended? If they are still operating, what are the chances for their ultimate removal? Finally, what is the connection between their removal and world recovery?

FOOTNOTES TO TABLE XI
(1) World Economic Survey, 1933-1934. p.303.
(2) Due to the wide fluctuations in the relative values of the different currencies, during the period in question, it was felt that reduction to any one currency would be both difficult and less useful.
(3) Conversion loans excluded.
(4) League of Nations Statistical Year Book, 1933-1934. p.226.

CAUSES OF THE CESSATION OF FOREIGN INVESTMENT

These causes fall under two distinct headings. (1) Those which have led to a falling off in all investment, home as well as foreign, and (2) those which have specifically affected foreign investment.

Before proceeding, it should be stressed that all that follows should be read in the light of what has previously been said. Capital movements cannot be viewed apart from the fundamental disequilibrium in international payments, brought about by the financial and economic changes which occurred during these times, that is, during the war and after it. When discussing these causes, it must be remembered that there already existed a heavy and growing burden of international indebtedness, and that the national policies adopted in the various countries gave little promise of relief.

(1) Causes for the decrease in all investments.

(a) The fall in national income. This falling off in the volume of national income occurred in every country and formed part of the process of world wide deflation. In 1921 there had been reaction from the high prices of the War period, but following that year the process of deflation was halted. In Britain, deflation began again with her return to the gold standard in 1925 and from then on prices slowly fell in many countries. But, in many other

countries, notably those of North and South America, prices remained high. The United States was riding on the crest of a boom, the effects of which spread to Canada and elsewhere. Loans from the United States to Canada and latin America were the basis for expanding credit in those countries. It was only after 1929 that deflation became world wide. The index numbers of Canadian prices illustrate this. The price of her export and import goods (being set in the world market) may be taken as roughly indicative of the general level of world prices.

TABLE XII

CANADIAN PRICE INDICES 1923-1931 (1)

Year	Retail Prices	Wholesale Prices	Export and Import Prices
1923	100	98	101.1
1928	100	100	100.0
1929	99.9	95.6	93.2
1931	89.6	72.2	68.0

Just as the boom was most spectacular in America, so was the deflation. The United States national income dropped at a great rate, from $81,040,000,000 in 1929 to

(1) Canada Year Book, 1932. pp.683,689,700.

$48,952,000,000 in 1932.[2] It has been estimated that Canada's national income dropped from $6,000,000,000 to $3,000,000,000 from 1929 to 1933.[3] In direct consequence the proportion of debt changes to national income skyrocketed.[4] Is there any wonder that, aside from any panic or uncertainty, there has been a falling off in investment?

(b) The fall in company profits. Deflation brought a period of great industrial uncertainty. No one desires to add to stocks in a time of falling prices, but rather all try to realize on them, thus forcing prices even lower. Wherever possible a hand to mouth buying policy is adopted. As a result forecasts as to necessary production become practically impossible. The practical collapse of world trade and growing political dangers in many countries added to the industrial uncertainty, and to the fear of making any long term commitments. But while production can be curtailed, overhead costs are relatively rigid. Interest rates, and fixed charges of all sorts are not easily reduced. Where labour is strong and well organized even wages may be too rigid. As a result, practically every country witnessed a falling off in company profits. There have been

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(2) World Economic Survey 1933-1934. p.283. Figures for 1930 and 1931 are $71,000,000,000 and $63,000,000,000, illustrating the progressive drop.

(3) Innis and Plumptre. op.cit. p.181

(4) 1929--U.S. internal debt = 55% of National Wealth. ib.p.234
1933--U.S. internal debt =107% of National Wealth.

innumerable instances of this in Canada. The passing of dividends by the Canadian Pacific Railway, the bankruptcy of many of the pulp and paper companies, the reduced yields on industrial stocks, and so on.

One effect has been to create an unwillingness either to invest or speculate in industrial, or public utility, stocks and bonds. But quite in addition to this the falling off in company profits has meant the destruction of one of the largest sources of further investment. Here is but one example of this.[4] In Germany, in 1929, the surplus of company earnings over and above the amount paid out as dividends was 882,000,000 R.M., out of a net amount from the country at large available for new investment of 6,083,000,000 R.M. By 1931 not only had this surplus disappeared, but earnings were no less than 1,000,000,000 R.M. less than were needed to keep the capital position of these companies intact, and by 1932, the shortage had increased to 1750,000,000 R.M. This glommy industrial situation all over the world, and the poor position of most individual companies, coupled with increased political insecurity, and general uncertainty as to how the position of many of the companies would be affected by governmental actions, caused most private investors to seek security above all else. There has been an increasing tendency to put savings into gold hoard-

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4. Taken from "World Economic Survey", 1933-1934. p.234.

dings (where that is possible) or in countries where the banks are strong, to build up idle bank deposits. On top of all this, financial difficulties in most countries have caused increased issues of home government securities. As government bonds always offer the greatest security of any type of investment, they have been taken up first, leaving less available for any other type of investment. The following table amply illustrates the falling off in all investment save in home government securities.

TABLE XIII

PUBLIC ISSUES OF LONG TERM SECURITIES 1929-1933 (1)

(MILLIONS OMITTED)

Country	Year 1929	1930	1931	1932	1933	Currency Unit
United States	10,183	7,023	3,116	1,192	716	Dollars
Britain	285.2	?	102.1	188.9	244.8	Pounds
Issues other than for public authorities.	209.8	?	59.1	62.4	64.5	
France	22,176	30,494	28,638	26,780	25,957	Francs
Issues other than for public authorities.	18,300	25,402	20,393	12,233	9,445	

A further table follows, showing the growth of investment in home government bonds at the expense of other types of investment.

(1) ib. p.286.

TABLE XIV

RELATIONSHIP BETWEEN GOVERNMENT LOANS AND ALL LONG TERM PUBLIC ISSUES

(FIGURES SHOW PERCENTAGE OF GOVERNMENT ISSUES TO TOTAL ISSUES)

Country	Year 1929	Year 1933
Netherlands	12	97
Spain	27	77
Great Britain	26	74
Belgium	8	70
Germany	15	66
France	17	64
Switzerland	5	60

In the face of this evidence that investors placed little confidence in anything save the security of their own government, and that national incomes fell rapidly, the lack of any investment in foreign securities is not surprising.

SPECIFIC REASONS FOR THE DECREASE IN FOREIGN AS COMPARED TO HOME INVESTMENT

There were forces operating which hindered foreign, as distinct from, home investment. In the years since 1929, there have been no less than four such causes, of major importance, at work. And, at that, no separate

account is taken of war scares and political troubles, which directly, as well as by their repercussions, serve to check international capital movements. The four major causes for the cessation of foreign investment were:
(a) Financial difficulties in many debtor countries.
(b) Transfer difficulties due to the decline in International Trade. (c) National Economic Policies. (d) Currency instability.

Each of these should be dealt with separately. When this is done, some estimate can then be made as to the present strength of these obstacles to renewed investment, and as to whether they can be eliminated. From these it should be possible to work back through the other causes and ultimately to find some clue as to whether capital movements can be restored.

(a) Financial difficulties in the debtor nations.

The depression meant falling government revenue in most countries. But, there was no corresponding fall in government expenditures. The question of how long governments could go on increasing their services without increasing their sources of revenue, was one that would have arisen sooner or later, in any case. Inability to balance budgets by external borrowing and demands for relief and relief works, coupled with falling revenues, made it of much greater importance. Most of the debtor nations in South America were especially affected since they depended very largely upon customs duties for their

revenues. With the fall in world trade, revenue from these duties fell to an alarming degree. But all countries witnessed some decline in revenue. The result was that many countries were obliged to default on their interest obligations. A list of the countries in default to London alone, between January 1, 1930 and May 31 1934, covers a goodly proportion of the nations of the world.[5.] It is no wonder that confidence in foreign investment was shaken. The Johnson Act, 1933, in the United States stands as a witness to this lack of confidence. This act prohibits flotation of loans in the United States on behalf of nations which are in default on interest or sinking fund payment to her. Even countries which did not default, or show signs of so doing, faced want of confidence in their guarantees, for though the government itself might be sound, difficulties of states, provinces or municipalities had their repercussions. The ~~very~~ effect on Canadian credit in London of the actions of Mr. McGeer in Vancouver, and Mr. Hepburn in Ontario, is a recent illustration of what happened in many instances previous in this matter.

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6. On May 31, 1934, the following countries were in default to London. Brazil, Bulgaria, Chile, China (in part) Colombia, Costa Rica, Ecuador, Germany, Greece, Hungary, Mexico, Paraguay, Peru, Rumania, U.S.S.R., Salvador (in part), Turkey, Uruguay, Yugo-Slavia, and that does not list countries in default solely on sinking fund payments. From "World Economic Survey, 1933-1934, p.303.

<u>(b) Transfer difficulties due to the decline in international trade.</u> Difficulties in maintaining the equilibrium of payments between nations, when changes in capital movements occur during times of depression, have already been discussed. The drop in investment in the debtor nations was sudden and interest charges were great, necessitating adjustments on a large scale in the balance of payments. But, due to the falling off in trade, while unfavorable balances of trade could be cut down, favorable balances could not be built up,--tourist earning, freight payments, commissions, as well as payments for commodities, declined in volume. Interest charges remained fixed, requiring an ever-increasing proportion of the available claims on foreign countries. In many instances, neither excessive currency depreciation nor deflation and price cutting, nor a curtailment of imports proved sufficient to balance payments, thanks to the continual shrinkage in trade.

By the time that Germany enforced measures of exchange control, her reserves of gold and foreign exchange had dwindled to practically nothing. The one country which managed to increase its exports sufficiently to balance its international payments was Japan--and this was only done by exchange depreciation, and internal deflation, with lowered standards of living. The furore caused by this increase in Japan's trades shows the rarity of such an event.

In the weaker countries, the fall in world trade has meant exchange control or default. And both act strongly to discourage any further investment.

(c) National Economic Policies.

It was shown in the introduction how the idea of national self-sufficiency, and any policy construed in that light worked towards reducing foreign investment. The revival of, and strengthening of, this ideal of self-sufficiency in the last half dozen years in itself partly explains the falling off in foreign investments. But, quite aside from this effect on the minds and viewpoints of people, national economic policies restrict capital movements in a more definite way.

The big indictment against all national economic policies is that they tend to make prices rigid. Actually, attempts to stabilize prices have not been successful, and schemes based on such attempts have all ended in failure. The "wheat agreements" were but one in a long line of such fiascoes. But, by various restrictive measures, the automatic responsiveness of prices to changed conditions has been destroyed. For example, trade restrictions which protect home industries against foreign competition have this effect. Vested interests are built up, which naturally resist change.

Unless the world is to become totally stagnant, there must be change. It is granted that the hardships of such change should, if possible, be modified by making

it as gradual as possible. But present national economic policies have the reverse effect. They stave off all change as long as possible, with the result that when it does come, the effects are far more violent than they would originally have been. Change, except as deliberately planned, might be held off indefinitely only if a nation could live completely unto itself--though that presupposes much greater intelligence than most leaders have hitherto shown. But, as yet, no nation has reached that stage. So long as there is international trade, or international movements of capital, changes in one country will have repercussions elsewhere. An international movement of capital bringing in its train the adjustments previously described, plays havoc with the best laid schemes. Is it any wonder that attempts have been made to restrict such movement?

Aside from all conscious hindrances to international capital movements, rigidity in price structures, barriers to trade, pegged exchange rates, and the like, do make adjustment of the balance of payments so difficult as to effectively check the movement of capital on any scale.

(d) Currency Instability

Currency instability brought a new element of risk into foreign investment. It meant that there was a possibility of change in the relative value of two currencies so great as to wipe out all gain on cap-

ital invested by one country in the other. In view of general conditions in the world since 1929, the last thing the ordinary investor was looking for, was increased risk. In practically all countries quotations on foreign bonds dropped away down in reflection of this risk, as well as of the risk of default.

That ends the account of the causes for the decline in international capital movements. From all that has been said, it seems evident that these causes are also the causes of the general economic depression. Political uncertainty, business uncertainty, the fall in the national income of most countries, financial difficulties caused by the strain of proportionally increased debt charges, uneconomic attempts at self-sufficiency, the decline in foreign trade, extreme fluctuations in exchange rates, all are causes for both the decline in international capital movements and the economic depression.

But, to the list of causes for the economic depression must be added one other factor of importance. That factor is the decline in capital movements. How this abrupt decline through its effects on the balance of payments contributed to the bringing about of higher tariffs, and made defaults necessary, need not be explained again. Aside, however, from the evil effects

due to the abruptness of the decline in investment, there are other ways in which the absence of international capital movements has been felt.

For many countries, the financing of necessary purchases of foreign articles has become difficult. There have been many times when judicious lending would have been many times more effectively led directly to a flow of goods. Slackness in the staple lines of production of the industrial countries is closely connected with the falling off in their exports which in turn is closly related to the decline in foreign investment.

Wise lending might have helped some of the debtor countries in their financial straights and prevented total default on their obligations. The results accomplished by Australia with the aid of the British investors, are an illustration of the type of thing that can be accomplished by wise foreign investment. Again, inability to obtain foreign funds at critical moments has added to the violence of fluctuations in exchange rates. Finally, wide divergences in interest rates between the various countries show that there are still many countries which would benefit economically from an inflow of foreign capital.

In short, while a restoration of economic prosperity to the world would probably automatically lead to a resumption of capital movements, it is also true that any resumption of the international movement

of capital will mean that a great forward step has been taken along the road to recovery.

THE POSSIBILITIES FOR A RESTORATION OF INTERNATIONAL MOVEMENTS OF CAPITAL

The procedure adopted here will be to go through the causes for the falling off in foreign investment, one by one, and endeavour to find out if they are still operative, and if so, what their present strength is and whether it is increasing or decreasing. From this it should be possible to determine whether the chaos of the depression has done anything to reduce the worlds burden of international indebtedness. To the extent that that has been the world can set out again to build upon a new, more stable equilibrium.

Possibilities of a general increase in investment.

In most countries, the long period of deflation has ceased and prices have started to rise again. The first check to world wide deflation came with Britain's abandonment of the gold standard in September 1931. With no necessity to restrict credit to protect its banking reserves that country was free to follow a more liberal credit policy. The external value of the pound was allowed to drift lower. Many countries followed Britain off the gold standard, and they too

became free to pursue easier credit policies. But the real end to world deflation came with the devaluation of the American dollar, in 1933. This devaluation of the American dollar has resulted in a considerable lowering of most countries' external debt. American exchange rates are no longer so decidedly against them, and they can purchase their necessary claims on America with less of their own currency. Many have been able to depreciate the internal value of their currency without fear of adding to their external debt burden. This has been done, in some cases by the lowering of the minimum currency reserve. In Canada this has resulted in the printing of over $50,000,000 in additional notes without any evil effects. Prices have risen and national income has been raised. On the whole, this process has been slow, and has not yet proceeded very far, but the reversal of the downward tendency in itself is of great moment.

TABLE XV

FARM PURCHASING POWER IN CANADA 1931-1934 [3]

(INDEX NUMBERS BASIS 1926=100)

Year	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
1931	73.89	71.93	58.36	59.32
1932	60.40	60.43	62.77	56.98
1933	57.12	59.45	61.05	63.45
1934	64.64	65.27	67.51	

These figures illustrate the progress being made in one of many quarters.

Along with the rise in national income, or at least the stop in its fall, has come a tendency towards increasing company profits in many countries. This tendency has been most striking in the case of Great Britain.[1] However, many other countries have witnessed a similar happening. Dividend payments in Canada were $196,039,411 in 1934 as compared with $141,327,826 in 1933, and $162,787,004 in 1932.[2] Even in the few countries still

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(1) The following figures show the increase or decrease (in %) of company profits over the same quarter of the previous year, 1933. 2nd. quarter +3.3%; 3rd. quarter -5.5%; 4th quarter +30.3%; 1934; 1st quarter +15.8%. 2nd quarter +18.2% World Economic Survey, 1933-1934. p.291

(2) Manitoba Free Press. December 31, 1934.

(3) Manitoba Free Press. October 15, 1934.

showing a decline in company profits, the rate of decline has been appreciably lower. A chart at the back of the League of Nations Statistical Survey 1933-1934 shows more adequately than can words, the steps towards internal recovery in the various nations. At the beginning of 1933 all but 8 out of the 39 listed countries were marked in black (indicating declining business conditions) while in the second quarter of 1934, all but 8 were marked in white (indicating improving business conditions). Further, most of those 8 were countries in the gold bloc, countries where deflation has not yet run its course and where trade has been crippled by the position of the exchange rates. Thus it would appear that conditions are favorable for some renewal of investment.

<u>The present and future situation in regard to the special obstacles to international capital movements.</u> Dealing with these one by one, as was done previously, the first question is: Has the financial position of the debtor nations improved sufficiently to warrant a renewed investment therein, and if not, what hope is there of such improvement? In general, where the above mentioned improvement in prices and profits has occurred in any of the debtor nations, or countries, their position has greatly improved. This improvement has been most marked in countries, such as the British Dominions, where the cost of government has been prevented from rising too rapidly. Many countries

have gone a considerable way towards scaling down their debt burdens, external and internal. The Canadian conversion loans in London, and at home, during the past few years, illustrate this. Many millions in interest changes have been thus saved. For many countries, depreciation, first of the pound, then of the dollar, has meant a great lessening of the burden of external debt. Even defaults have this advantage, that they make the position clear, and reasonableness on both sides is displayed and too much ill-feeling is not engendered, may eventually, by leaving clean slates, allow further investment on a moderate scale.

Most defaults are still too near in time for return of confidence in the defaulting countries. However, the boil of over-indebtedness has been broken, and the way is open to ultimate recovery. For instance, already there are few people but believe that the virtual end of the War Debts, achieved only by repudiation, has been a great help in relieving economic tension and financial strain.

The next question to be dealt with, is that of currency stability. During the period following the first rapid downswing in world economic conditions, as most debtor nations began to have difficulty in balancing their international payments, there was a great increase in the short term indebtedness of these countries. First, they realized on their own foreign assets, for example, the largest withdrawals of foreign short term capital from the United States occurred during 1929 and 1930. Then as con-

ditions became worse, they borrowed on short term, to the extent of their ability. Floating credits were fully utilized. Finally, however, most of these short term credits, including commercial as well as others, became unrepayable and were largely "frozen" by exchange control and arrangements of one sort and another. So long as these remained frozen there was little check on wild fluctuations in exchange rates. However, since the end of 1930, much has been done to reduce the volume of these debts. Short term debts in Europe and the United States decreased from 70,000,000 Swiss francs at the end of 1930 to 33,000,000 Swiss francs at the end of 1933.(3) Further, some of the smaller countries managed, by careful economy, aided by the rise in prices and increased trade in 1934, to build up short term assets abroad. All of this tends to make currency stabilization easier.

With the growing improvement in the economic condition of Great Britain, and renewed confidence in that country, and with the pound quoted at such a rate that, unlike a return to the gold standard, no great deflation is required by most countries to bring their exchange rates into line with it, there has been a growing tendency for foreign currencies to stabilize themselves in relation to the pound. Now that the American dollar has also depreciated, most countries outside of those in the gold bloc, could stabilize their exchange rates at the present level, without any great hardship. The future of the countries

(3) World Economic Survey, 1933-1934. p.306.

remaining in the gold bloc is still uncertain, but it seems safe to say that they too will eventually be forced to abandon the gold standard. When this happens, and present events [1] indicate that it may be fairly soon, a gold standard based on a new depreciated world value of gold might well be feasible.

The attitude of the United States towards any scheme of currency stabilization is still uncertain. There are a number of radical men in the present congress, with schemes for strong inflation. Should their views prevail, there is not much chance for currency stabilization as far as the dollar is concerned. However, directly opposed to their ideas, are the views of more and more moderate thinking people in that country. The following is but one example.[2] The Report of the Commission of Inquiry into International Relations, a report favorably received by the press and public of the United States, asks for international stabilization of currencies on a gold standard modified to meet present conditions. (It might also be noted that this report recommends the repeal of the Johnson Act, and the virtual cancellation of War Debts)

In brief, conditions for some degree of currency stabilization are brighter than for some time, and in so far as countries have already stabilized their exchange rates

1. The Devaluation of the belga, March 1935.
2. Manitoba Free Press, December 7, 1934.

with those for the pound, such stability has already been reached. The wholesome effect of this on international trade is evident. It is equally true that, by removing one ~~aid in any~~ of the largest risk elements, it will greatly aid in any resumption of capital movements.

Next, there is the question of national economic policies. Though little has as yet been done, evidence is accumulating the world over that the day of belief in high tariffs as an agent in restoring national prosperity, is on the wane. Tariffs have been little reduced, except in small countries, such as Newfoundland, but, in most countries, they seem to be at, or past, their peak. In Australia, in Canada, in the United States, to name but a few, sentiment in favor of some reduction in tariff is gaining ground. Even where a general lowering of tariff barriers is not contemplated, a variety of trade agreements are being negotiated, for example, the Franco-Canadian trade agreement towards the end of 1934. More than a few isolated trade agreements are necessary, while attempts to balance accounts between individual nations are, in general, economically unsound, but where either lead to any removal of barriers to trade, they are performing a useful service. Anything which makes the flow of goods between nations easier will certainly make for restoration of capital movements as well.

However, as long as there is political uncertainty, and danger of war, the nations will follow national economic

policies to a large extent, and international movements of capital will be on a small scale, at least between any countries which are fearful of each other. To the extent to which international tension can be relieved, to that extent only can there be any real increase in capital movements.

In the light of the facts just related, it might be expected that International Trade figures for 1934 would show some improvement, or at least a check in their precipitous decline.

TABLE XVI

WORLD TRADE 1932-1934 (1)

(INDEX FIGURES, BASE 1929=100. Each Quarter is Compared with the Similar Quarter in that Year)

Period		Quantum Relation	Value (3)
1932	1st quarter	76.2	41.9
	2nd quarter	73.0	39.8
	3rd quarter	67.9	35.3
	4th quarter (2)	78.4	39.2
1933	1st quarter	72.9	35.0
	2nd quarter	71.8	34.1
	3rd quarter	74.6	34.7
	4th quarter (2)	80.2	36.9
1934	1st quarter	74.5	33.9
	2nd quarter	74.6	33.2

(1) World Economic Survey, 1933-1934. p.309
(2) The increase in world trade has been mainly in raw materials, the bulk of which are shipped in the last quarter of the year.
(3) In terms of gold.

The table shows that the decline in international trade has ceased. But the table fails to bring out one significant fact. The values given are in terms of gold. But, during the period 1932-1934, most currencies declined in relation to gold. Therefore, stationary value of trade in terms of gold meant an increase of trade in terms of most currencies. And since indebtedness is fixed in such terms, it meant a lessening in the proportion of international indebtedness to total international payments. In 1934, Canada's trade increased, her imports by 29% and her exports by 25%,[3], and the trade of most other countries increased proportionally.

Conclusion

It is evident that the increasing vigor of the forces which together worked to virtually abolish the international movement of capital has been largely spent. In some cases, the reverse tendency has been so strong as to change the direction of these forces. To quote:[4]: "As-----the improvement-----continues, the way may be opened again to a gradual renewal of international lending, which would again promote trade, and facilitate agreements with regard to outstanding financial committments."

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3. Manitoba Free Press. December 31, 1934.

4. World Economic Survey, 1933-1934. p.307.

In addition, international indebtedness has been considerably reduced in actual volume, and any further increase in prices or in trade will serve to render payments on this account proportionately lighter. The creditor position of the United States is no longer such a stumbling block to world progress. There is a strong possibility that Britain will take the lead in any renewal of foreign investment. Since she is a necessary importer of raw materials and foodstuffs, and has had experience in foreign lending, any investment on her part should not lead to such disequilibrium as was caused by the American loans.

In many ways, the situation looks brighter than it has for some time. But, with many countries facing the problem which confronts the American government, how to satisfy the demands of the needy, yet keep down international debt; with still continued unemployment; with armament races; with still recent memories of default; will the possibility and the necessity for the free movement of capital be realized, or will the forces of economic nationalism still reign triumphant? If economic prosperity is to return, the former must be the answer. Do the financiers, the governments, and the people of the world fully realize that? Many do, and more can be, and ought to be, shown convincingly that such is the case. For, as long as the nations of the world have anything to do with each other, there must be international movements of capital.

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