

# The transfer problem and its importance to the United States : Speech made ...

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# THE TRANSFER PROBLEM

AND ITS IMPORTANCE TO  
THE UNITED STATES

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*Speech made by*  
*I V A R K R E U G E R*  
*at the meeting of*  
*The Chicago Industrial Club*  
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*T*HE CHICAGO INDUSTRIAL CLUB has been kind enough to invite me to make a short address on some subject of my own choice and I wish to tell you how much I appreciate this opportunity to meet so many of Chicago's prominent business people.

I have chosen as the subject of my address the transfer problem and its importance to the United States and I have done so because I consider that this problem holds a special position among the large problems now occupying the world. I do not know of any other problem which, if neglected, can cause such rapid and universal distress and at the same time I feel that there is no other problem for which we are so justified in hoping for a rapid and permanent solution. If you consider other important problems of a similar scope, such as, for instance, the question of universal free trade or the question of disarmament, you will generally find that there are serious obstacles in the way of accomplishing anything of importance towards a solution of these problems, obstacles depending upon national prejudices or deep-rooted public opinion which cannot be altered except gradually and very slowly. Similar obstacles do not seem to exist to nearly the same extent with regard to the transfer problem. It is therefore to my mind of greater value to try to stimulate the interest of the business



world in the transfer problem than in any other question that I know of.

Before the War, not even the most cautious banker or the most theoretical professor of economy attached any great importance to the transfer problem, and I do not believe that even the expression itself ever existed until during the War. Not even the War, however, made us realize the full significance of the transfer problem. The Versailles treaty and many other international treaties from the same period give ample evidence of the truth of this statement. There are two main reasons why the transfer problem did not make itself felt as vigorously during the War as later. The one reason is that during the War the foreign commerce in practically all countries was under efficient control and the imports of every country were therefore restricted to such amounts as the transfer and exchange situation would permit. Even today we can see how in the case of Soviet Russia, thanks to the complete control of the foreign commerce, it has been possible for the Russian Government to keep the exchange situation comparatively well in hand, in spite of the extremely bad economic conditions in the country. The second reason is that during the whole War a constant and relatively uniform inflation took place in practically all countries and it is natural that an inflation of this kind must minimize the transfer difficulties, as the burden of all debts is constantly decreased. It may also be assumed that it was the inflation during the two years immediately following the War which prevented the transfer and exchange problems, which are practically identical, assuming too serious proportions during this period. As a matter of fact, I consider that it is the

general deflation movement inaugurated during 1920 which marks the appearance of the transfer problem in its most serious form. The immediate effect of this deflation was a serious increase in the burden of all debts expressed in gold value, the restraint of international trade and general lack of confidence, all factors tending to seriously aggravate the exchange and transfer problems. In the following years, 1921, 1922 and 1923, the transfer problem became more difficult than ever, and during 1923 particularly, the year of the Ruhr occupation, the exchange conditions in certain European countries, particularly Germany, became perfectly chaotic. The lack of confidence everywhere in Europe was so great that all securities issued in dollars were eagerly sought in Europe and this to the extent that it is estimated that during 1923 more American securities were bought by Europe than the total amount of European securities placed in America. At the same time a considerable number of dollar bills were used in circulation in many of the countries where the inflation had gone so far as to make the domestic currency practically useless, which of course meant an export of capital from Europe to the United States, naturally tending to make the situation still worse. It was not until 1924, when a change in the money policy inaugurated by the Federal Reserve Board opened the American market for foreign securities on a larger scale than previously, that a marked improvement in the exchange situation could be noticed, and the effect on the European exchanges and international commerce was striking. The year 1924 can undoubtedly be considered as the outstanding year for the re-establishment of normal conditions in international

commerce and finance. Among the noteworthy events during the year may be mentioned the settlement of the War debts to the United States by Great Britain and some other countries, the re-establishment of the gold basis in Great Britain, Holland and Switzerland, and finally the creation of the Dawes Plan, which to my mind is the most important achievement accomplished since the War. From the year 1924 it may be said that constant progress towards the solution of the transfer problem has been made, though naturally occasional relapses have occurred. As one of the most serious of these relapses must be considered the threatened collapse of the French exchange during 1926, though this occurrence has ultimately proved to be of great benefit to the world by hastening the financial reconstruction of France. A serious relapse also occurred during the year 1929, caused by a sudden restriction in the foreign lending by the large creditor nations, and the consequences of this relapse have been very harmful to the economic life both in the United States and in other countries. Even in this case I believe, however, that some benefit has followed, as I think it is very doubtful if the Young Plan would have come into existence except under the heavy economic pressure which was caused by the international financial situation during 1929. In my opinion it is first through the inauguration of the Young Plan, by which so many elements of uncertainty have been removed from the economical and political life of Europe, that peace can be said to have been fully re-established in Europe, and in regard to the transfer question particularly I consider the Young Plan to be of decisive importance. It seems to me that the transfer problem can now for the first time be

surveyed in its entire width without too many disturbing factors and I feel that an analysis of the problem will bear out the view that the difficulty of solving the transfer problem is at the present time highly overestimated. In putting forth this view it is, however, necessary to define what I really understand the transfer problem to be.

I believe that here in the U. S. A. you have been used to consider the transfer problem as referring specifically to the War debts. But the question of the war debts is only a part, and not a very big part, of the transfer problem. If we take the case of the United States for instance, the yearly interest payments on the War debts to the United States are only a small part of the new debts created every year through the large export surplus of the United States.

The most primitive view of the transfer problem would undoubtedly be that all international debts have to be fulfilled by payments in gold, but such a view would be entirely absurd. On the contrary, one may say that the basis for the gold system is a general understanding that gold should be used for payments only in very exceptional cases. Of all monetary gold existing in the world today, the bulk is already owned by the creditor nations and the remaining quantity could not cover more than a small part of the international debts. Moreover, the loss of any large quantity of gold by any debtor country would seriously disorganize the monetary system of the country in question. The total yearly production of gold in the world is only a fraction of the yearly interest and dividend payments which have to be made by the debtor countries to the creditor countries. It must,

under these conditions, be evident that any international debts which have been contracted have not been intended either by the debtors or by the creditors to be paid in gold, but the term "gold" has been used only as a measurement of a quantity of goods to be delivered in payment of the debt. Long time tradition is in this respect equally as binding as any written contract. Another view of the transfer problem, which in my opinion is equally erroneous, is that, in order to fulfil the conditions of sound financing, full interest and a certain amortization on all international debts should be paid yearly so that the total debts could be completely amortized within a measurable time. While such a view might be perfectly sound in the case of an individual debt, it would, if applied to the total international debts or even to the total debts of a single country, make the solution of the transfer problem impossible. The real obstacle to such a procedure is not the unwillingness or the inability of the debtor nations to make sufficiently large payments, but it is the unwillingness of the creditor nations to accept sufficiently large payments in the only form which has ever been contracted for, that is, with goods. I believe a creditor nation should be looked upon very much as a banking institution. While a bank likes to see individual credits amortized and paid, it nevertheless always wants to see the total amount of its outstanding loans increasing and what a banking institution has to look out for is only that the credits are protected by sufficient assets and that they are sufficiently liquid. As I understand the transfer problem, a solution should involve the creation in the main creditor countries of a sufficiently broad and reliable market for international

securities to make it possible for any country with sound finances to be able always to depend upon getting a deficit in the yearly balance of payments transferred into long term loans at a reasonable rate of interest. To solve the transfer problem on these lines would not be to achieve anything very new and wonderful; it would only be to re-establish the conditions which existed before the War. As long as the transfer problem has not been solved, it will not cease to cause severe disturbances in the economic life of the creditor nations as well as of the debtor nations.

Let us in this connection compare the present situation with that existing immediately before the War. At that time, the important creditor countries were Great Britain, France, Switzerland, Holland, Germany and Belgium, and it is estimated that these countries together had a yearly income from interest and dividends from the rest of the world amounting to  $2\frac{1}{2}$  billion dollars. In order to make possible the payment of these dividends and interest, the creditor countries were yearly making new loans or investments to a total amount of 2 billion dollars. The borrowing countries thus paid yearly 20% of the interest and dividend charges, while 80% were added to the capital of the debt. At the present time it is estimated that the yearly interest and dividend payments in favor of the creditor countries amount to  $2\frac{3}{4}$  billion dollars and that, in order to make these payments possible, it is necessary for the creditor countries to lend 2 billion dollars yearly to the rest of the world. It seems therefore that at present a larger percentage of the interests on the debts is actually paid than was the case before the War.

Using another standard, we find that the total export of all the countries in the world was estimated for the year 1913 at approximately 18 billion dollars, and for 1928 at approximately 33 billion dollars. Thus it will be seen that, while the yearly balance to be covered by international loans during 1913 amounted to approximately 11% of the total world export, the corresponding figure for 1928 is only 6%. I do not claim that these figures are absolutely correct, but they are sufficiently accurate to justify the statement that international debts today are not sufficiently large in themselves to explain the serious difficulties which the transfer problem has caused during the past years. What, then, are the causes of these difficulties? The great devastation of capital, the disorganization of the financial systems of many countries, the creation of many new tariff territories and the political unrest caused by the War, are, together with the great wave of deflation commencing in 1920, sufficient to explain all the exchange and transfer difficulties up to now. All these causes are, however, of a temporary nature and should at the present time not play any important role with regard to the transfer problem. A cause of more permanent nature is the change in the position of different countries as creditor or debtor nations. It is particularly the fact that Germany has changed into a heavy debtor nation and the United States into an important creditor nation that is of interest in this connection. I am perfectly convinced that Germany with her great productive capacity and her thrifty and well-educated population will relatively soon regain her financial stability. The war debts of Germany will undoubtedly, for a long time to come, be a heavy burden on

the German economic life, but the fact that through the Young Plan the amount of the German war debts has been fixed cannot fail to exercise a beneficial influence on the development of Germany. The yearly amount of external payments imposed on Germany by the Young Plan is approximately 500 million dollars. It corresponds to 3% of the national income of Germany and to 15% of the German export during 1928. The development of the German export trade during the last two years is very encouraging. While during 1927 there was an import surplus of about 700 million dollars, the year 1929 showed a small export surplus. I therefore feel that if not too many obstacles are created for the International Trade we have a right to be quite hopeful regarding the possibility of Germany to fulfil her obligations.

Of great importance to the transfer question is also, in my opinion, the fact that the United States has become an important creditor nation. It seems reasonably certain that since France has now regained her full financial power and since political conditions in Europe have become more stabilized, the European creditor nations will resume their foreign lending on such a scale as is necessary to cover the surplus in the yearly balances of any European creditor country. This only means re-establishing on a smaller scale the lending activity existing in these countries before the War. As far as the United States is concerned, the case is somewhat different, as foreign lending is a comparatively new development for that country.

It has taken generations to accustom the many million investors in Europe to foreign securities, and it cannot, therefore, be expected that it should be possible to create

in a few years a demand for foreign securities in the United States equally as broad and dependable as in Europe. Moreover, the types of securities mainly used for international financing have been established largely with regard to European conditions, and it is natural that these cannot fully meet the demands of American investors. To insure regularity in American lending, it may therefore be necessary to develop additional types of securities better suited to the conditions in the United States.

I am, however, convinced that American bankers and business men, who have already done a remarkable work in developing the American market for foreign securities, will be able to solve any problems which may come up in this connection. It is, however, essential, that in their work the American bankers are also supported in a whole-hearted and broad-minded manner by the Federal banking system, and too much weight cannot be given to this side of the question. The role of the Federal Reserve Banks has increased in importance in a way that is not generally understood, through certain changes which have taken place in the application of the gold system, compared to what was customary before the War. At that period, practically all the central banks in the world were governed by strict rules regarding the proportion of the note circulation to the stock of gold, and any acquisition of gold by a central bank of a given country was certain to exercise an immediate influence on the monetary conditions and interest rates of the country. The practice as now followed in some countries is to make the note circulation and interest policy more independent of the stock of gold. This is a change of

far-reaching importance. It places an immense power in the hands of the central banks of the creditor countries and removes to a great extent one of the chief advantages always claimed for the gold system, — that of being fool-proof. It cannot be doubted that today any one of the three creditor countries, United States, Great Britain or France, could by an extreme policy of gold import quickly disorganize international commerce and finance, and this without affecting its own economic life nearly so directly or quickly as that of foreign countries. The country importing gold will, in the long run, suffer just as severely as the countries losing the gold, but the fact that nowadays the immediate effect of any gold import may show itself quickest and most directly in countries far away and only indirectly and slowly make itself felt in the country importing gold constitutes in itself a great danger for the world, which should not be overlooked.

What has happened during 1929 is in this respect very instructive. Through the restriction in foreign lending which took place in all creditor countries during 1929, the gold movements were directed towards the two countries having the strongest active balance of payments, that is, the United States and France, with the result that these two countries together during 1929 imported about 533 million dollars in gold.

As France and the United States are the two countries having already the largest stock of gold, far in excess of what they need for the monetary circulation, this movement has in effect been equal to reducing the gold supply serving as basis for monetary circulation by a corresponding amount. Part of this reduction was covered by

production of new gold, but the net result has been that the central banks in all other countries but the United States and France lost about 255 million dollars in gold during 1929. This amount may not seem to be sufficiently large to exercise any great influence on world economy, but as a matter of fact, it has been quite sufficient to cause a world-wide deflation.

To understand this fully, one must realize that a deflation never takes place in a uniform manner. There is a great difference in the power of resistance of different countries and of different commodities against deflation. In general, it must be said that the new and comparatively undeveloped nations will feel most immediately and severely the effect of the restriction in foreign lending, and consequent gold movements, and it will be seen in this case that among the countries most severely hit by the financial situation during 1929 are Argentine, Australia and Canada. Of the total gold lost by central banks during 1929 not less than 178 million dollars was lost by Argentine, and all the three above-mentioned countries have during 1929 taken steps which are equal to suspension of the gold basis, or at least a preparation to suspend the gold basis.

The European countries have in this respect stood the test better, though even here the strain on some of the weaker exchanges has been considerable. In general, it may be said that in all countries depending upon borrowing abroad, the year 1929 has been characterized by acute lack of capital, very high rates of interest and general deflation. This deflation has in the first place affected all articles for which there exists a real international market, such as the great staple articles, — cotton, wheat and

farm products in general, colonial products, and raw materials of different kinds.

One of the reasons why articles of this kind are first affected by a general deflation movement is that they are to a large extent produced by new and undeveloped countries, but another equally important reason is that products of this kind are as a rule relatively uniform in their quality, and the sources of supply can therefore be changed without too much inconvenience to the buyer. The resistance against the depression of the price level is therefore much smaller for the large staple articles than for industrial products in general, for which the buyer would generally insist upon a special make and which, in addition, are often handled by an extensive and complicated sales organization. This is not a new observation. In all periods of severe deflation, agriculture has suffered very severely, and notably so after the Napoleonic Wars. It is this difference in resistance of different countries and different products against the deflation which makes it so difficult to calculate the exact effects on the price level of certain gold movements. Even comparatively unimportant gold movements can in this way cause drastic consequences for the price level of certain commodities.

While it may be very difficult to measure the exact effect of every special gold movement, the tendency in which a certain gold movement will affect the price level of the great commodities can generally be stated with a reasonable amount of accuracy. In a crude way it can be said that any import of gold into such countries as already have more gold than the money circulation in the country requires, will tend to depress the price level

of commodities in the whole world, and any export of gold from those countries into a free gold market like that of London will have a tendency to increase the price level of commodities. It is also certain that gold import by any country will in general tend to decrease the country's power of competition in foreign commerce. It is natural that under such conditions the money policy of the great nations must be governed to a large extent by international considerations rather than by local ones and any attempt of a large creditor country to treat its money policy as a purely local problem may lead to disastrous results for the country itself and particularly for its export trade. There can be no doubt that today the welfare of the whole world is largely dependent upon the fairness, moderation and wisdom of the leaders of the central banks in the great creditor countries, and this naturally places a great deal of responsibility on them not only towards their own countries but towards the world at large. What the world hopes for from the great creditor countries is no altruism but only enlightened selfishness. I am convinced, however, that the leaders of the great central banks are fully aware of their responsibility and that we have every reason to look toward the future with confidence.

There are many causes which tend to make the transfer problem in the future less difficult than it has been up to now. The gradual perfection of the machinery for international financing, to which I consider the formation of the international bank as an important contribution, must be a factor in this direction. The general increase in political stability which has constantly taken

place since the War should also help the transfer problem, and finally I think that the experience gained by the central banks during the past years will prove of great value for the future. Unless any great calamity like a war occurs, and if international commerce is allowed to develop in a normal way, I feel that we are justified in anticipating a solution of the transfer problem, so complete that it will soon have as little practical importance as before the War. I believe that if such a solution is arrived at it will largely be due to the valuable contributions made by citizens of the United States.

I only need to mention the names of General Dawes, Parker Gilbert, Owen Young, J. P. Morgan, Jackson Reynolds, Melville Traylor, Jeremiah Smith, Charles Dewey, Gates McGarrah, Leon Fraser and many others to make you realize how important the work done by individual Americans has been.

It is no mere coincidence that the two most constructive pieces of work accomplished since the War, the Dawes Plan and the Young Plan, have been named after Americans, and I particularly feel that the Citizens of Chicago have contributed more than their share to the solution of the transfer problem.

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