THE CRUX OF THE REPARATIONS PROBLEM

BY PROFESSOR M. J. BONN

[*The outstanding incident in Europe at present writing is the collapse of German and Austrian exchange, which the Paris correspondent of the* Westminster Gazette *believes portends Germany's speedy bankruptcy. That fear is shared in most financial circles of Europe. Professor Bonn, of Munich, is a distinguished economist who has been associated with the German commission dealing with this question.*]

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THE international economic situation is characterized to-day by the fact that the war has greatly increased the industrial productive capacity of the world, while at the same time power of consumption has greatly diminished. The balance between the production of agricultural foodstuffs and raw materials, already seriously disturbed since the beginning of the century, has been completely overturned; to mention Russia is sufficient.

This great reduction of purchasing power is aggravated by the depreciation of the exchanges. A depreciating exchange is in the long run equivalent to reduced purchasing power of the country suffering from it; it is offset to a limited extent by the stimulus it is giving to exports. This being so, a balance might be reached automatically by a nation's foreign commitments being reduced and her foreign assets being increased; and a stabilization of the foreign exchanges might be brought about, if at the same time inflation were to come to a standstill.

As far as Germany is concerned, the Reparations obligations make this automatic settlement impossible. The settling of a Reparations debt is, broadly speaking, equivalent to an adverse balance of payment. The country concerned must pay more to other countries than she receives from them. This can only be done if she has a favorable balance of trade, or considerable invisible exports. Germany has neither to-day. She has an adverse balance of trade, and no invisible exports. Quite the contrary, she is indebted to foreign countries, quite apart from her Reparations obligations. There are great obstacles blocking the way to a favorable balance of trade. Most debtor countries — and a country paying Reparations is a debtor country which has not had the use of the capital it is debited with for productive purposes — have been so-called young countries, *i.e.*, agricultural countries, with great possibilities for development. They could easily reduce their imports by diminishing their consumption of manufactured goods, and quite as easily increase their exports, consisting of foodstuffs and raw materials.

Germany is an old industrial country. She cannot reduce her imports to any great extent, for she can only live and produce when receiving grain, fat, rubber, cotton, wool, and so on. She cannot even exclude 'articles de luxe,' because France does not want to lose her market. She can scarcely increase her exports on the scale needed, as her exports are mainly competitive. Her falling exchange, among other causes, enables her to undercut her competitors; her competitors are her creditors. They insist on payment, but prevent her from making it. They block her markets by tariffs, anti-dumping legislation, and exclusion. They refuse her the most-favored-nation treatment, insisting rightly that a depreciating currency is unfair competition, and they force her to make unfair competition by depreciating her currency.

The fall of the exchanges, it is said, is due merely to inflation, brought about by unsound financial methods. But there is no strict parallel between the issue of bank notes and the present rate of exchange. The dollar cost 100 marks early in 1920, when 40 billion notes were issued; it fell to nearly 40 in the following months, though the note issue increased steadily; it stood between 50 and 80 in spring 1921, when the note issue had gone up to 70 billions, and it rose to 100 and more when the effects of the payments of the first billion for Reparations were felt. And it went down from about 125 to 195 inside a week, when the German public realized the gravity of the League of Nations' decision about Upper Silesia. No doubt there is a close connection between Reparations payments and note issue. As things are at present, the German Government must issue Treasury bills to finance Reparations. These Treasury bills are bought by the Reichsbank with newly issued notes. With these notes Government has to buy the foreign bills needed for Reparations payment.

These Reparations payments bring about an increased *primary* demand for foreign exchange. This unsettles the exchange, and immediately a *secondary* demand sets in. For the high cost of the foreign exchanges increases the demand for foreign bills instead of diminishing it. Every German business man indebted abroad buys gold exchange for fear of a higher rise later on, when his payment falls due; every importer of raw material or foodstuffs lays in foreign currencies in some form or other, so as to be quite sure to be able to get his goods at a price no higher than that ruling to-day. These are followed by the flock of speculators, many of them mere exchange gamblers, but others frightened investors, who want to save some of their money from the depreciation of the mark. The flight from the mark sets in, *i.e.*, the desire of German investors to provide against further shrinkage of their capital; it is due to-day mainly to the fall of the exchange, and through its vehemence it brings about a further depreciation.

Until lately, this tendency was somewhat balanced by a strong counteracting movement. Foreigners bought German stocks and shares and German real estate. They purchased huge quantities of German bank notes, and opened considerable accounts with German banks. These people prevented the decline of the mark for a long time; they offered, so to speak, gold credits to Germany, being willing to run the risk of being paid back in paper marks later on, when the mark has recovered; and they acted quite unconsciously as the saviors of international economics.

Since the payment of the first milliard for Reparations has thoroughly broken the resistance of the market, this movement has come to a kind of standstill. New investments are not sufficient to absorb the German offers of marks; there is even a danger that these old investments may be withdrawn as their owners get frightened. Large quantities of 'frozen' marks are 'thawed' and are flooding the market. The panic following the Upper Silesia decision has shown clearly that there is no further strong resistance on that account to the downgrade movement.

This downward movement cannot

come to a standstill, for whenever things have settled down somehow, a new Reparations installment falls due, and exchange tends to a new lower level. A big — transitory — premium is given to German exports; valuta-dumping begins afresh, disturbing foreign markets; tariff legislation is introduced, anti-dumping Bills are passed, or if already in existence are being applied. German imports are forbidden. Prices rise in Germany, and another step in the social revolution, destroying the old-established society in Central Europe, is reached.

Is there a way out of it?

The stabilization of the exchange has often been mentioned as such. However, stabilization is not yet needed. There is no necessity to fix the relation of the German mark to gold at the present low level; but there is the necessity of preventing it from falling to a still lower level. It ought to be steadied; minimalization of the mark might be the right word. It ought not to fall below a certain level, but it ought to have a chance to rise above it. If such a level could be found, an international banking agreement would be needed to maintain it, so that a sufficient amount of dollars or pounds could always be had at the price fixed. If that could be done, there would no longer be any bear speculation. There would be no further valuta-dumping, and consequently no need for anti-dumping legislation, and no further violent fluctuations in prices in Germany.

Many experts doubt the efficiency of such a measure. Inflation, they say, must stop first, and this can be only done if no more notes are printed to make up the deficit. In my humble opinion they are putting the cart before the horse. As long as there is no 'minimalization,' no German Budget will ever balance. When the dollar is at 42 marks, it costs 10 billion marks paper to pay one billion marks gold; when it rises to 126 it costs 30, at 170 it will be 40. Under these conditions, the deficit in Germany is almost an automatic function of the fluctuations of the exchange, for the cost of the Services must rise parallel to them, while the revenue does not increase at the same rate. How on earth is a Chancellor of the Exchequer to budget for such fluctuations? He can scarcely reduce expenses by strict economy. The most important item, Reparations, cannot be reduced; and its payment forcing on inflation must depreciate money and swell the account.

Sound finance is impossible without the fixing of a minimum. As long as the paper currency goes on depreciating, no long term loans can be placed in Germany, for the investor who, when the dollar costs 50 marks, lends the Government 1000 marks or 20 dollars, is sure to lose the purchasing power of 10 dollars when the dollar goes up to 100 marks. There is ample paper money looking for investment in Germany, the boom on the Stock Exchange shows that clearly enough. But no one will invest in long term Government securities; the deficit must be met by Treasury bills, and Treasury bills are paid by the issue of new notes. When there is no risk of a further fall of the mark, — but the chance of a rise, — long term annuities could be floated, preparatory means for the balancing of the Budget could be carried, and this aim could be ultimately achieved. But this can be done only if the heavy list of the German payments is adjusted. Stabilization or minimalization is impossible as long as the balance of payment is getting more adverse every month. You cannot adjust the balance of a pair of scales by adding new weight to the one already overcharged. The empty scale must either be filled or the other scale must be lightened.

There are two ways of doing this. The yearly Reparations payments might simply be reduced so as to be within the limits of Germany's capacity to pay. I am not going to discuss this question. The Allies, especially France and Belgium, are depending on their payments. Moreover, it is almost impossible to state Germany's real capacity, things being as they are. But there is not the slightest doubt that the present payment is far beyond her present strength. This being so, the further spreading of economic anarchy arising from Reparations can only be prevented by a part of the payments of Germany being deferred. In the language of finance, they must be 'funded' and added to the capital to be paid later on. If this were done, the effect on Germany's present balance of payment and on her exchange would be very remarkable. It is just such a measure as the United States Treasury applied toward their Allies when postponing the payment of interest until after April 1922. It did not settle the question of indebtedness, but it did save the exchange for the time being.

But the nations entitled to German payments, especially France, are not in a position to postpone their demands and to become deferred creditors. They want the money immediately. If the German exchange is to have a chance of recovery, somebody else must advance the cash with which she can pay France. Now the only country in a position to do this is the United States. But the United States is not likely to do it. In fact, they are now asking for the payment of interest from their Allies, which so far has been deferred. They are simply sick of Europe just now, and not inclined to throw good money after bad. Their leading men realize the seriousness of the situation, but they tell us that public opinion in the United States is not ripe for such an active policy. I am sure that they are right, but I know, too, that Europe is over-ripe and cannot stand much more maturing. Moreover, postponement can only settle the problem if the debtor's recovery is such as to enable him at a future day to pay his original debt plus accrued interest. Will such day ever come for Germany and will it come soon?

France cannot be satisfied with annual payments; she wants their capitalized value. The German annuity is supposed to be sufficient at present to pay 5 per cent interest and 1 per cent sinking-fund on about 50 billion gold marks. These 50 billion 5 per cent gold bonds have been handed to the Allies. France would like to place her share on the stock market. It is not very easy to do so at present. The rate of interest for all loans is very high; and the credit of Germany under the present circumstances is not very good. If the Allies succeeded at all, the bonds could only be placed very much below par; or, in other words, Germany has to pay a very high rate of interest, while France gets only a very moderate amount of capital. On a 10 per cent basis the market value of the 50 billions is probably only 25 billions. Germany is crushed, and France is not saved. Apart from all political complications, the high rate of interest is the crux of the Reparations problem. There has been such an enormous destruction of capital that the tangible savings of the world are inadequate for the regular expansion of business and for floating the capitalized value of the Reparations payments.

During the war, the capital needed for carrying on was largely provided by a policy of 'fiat money.' Loans were floated, not so much by the transfer of existing capital from its owners to the State, but by the creation of artificial credit. The result was inflation, with all its dire consequences. If the scarcity of capital alluded to above really exists, the international financial problem, according to my view, cannot be solved by applying to the stock market. The capitalists are not capable or not willing to provide the funds needed at reasonable terms, and the debtors, especially Germany, are unable to pay interest. Recourse must be had to the issue of some sort of paper money.

This money must, of course, be international. It must be accepted at its face value by all Governments or all central banks. It must be Government money only, *i.e.*, it ought not to be legal tender in private life. But it might be used as a special reserve against which the different Governments or the different banks could issue bank notes or certificates. Its total amount ought to be limited, and it would be redeemed at fixed dates. By the creation of such international money — it might be called gold certificates — the Reparations question might be solved.

A definite fixed sum — let us say the 50 billion marks gold of the Ultimatum — might be handed over to the Allied Governments in the proportion in which they are entitled to reparation. These certificates could be used for the paying off of foreign debts, for purchases or loans abroad, or as reserve for note issues at home. These might be called reconstruction notes. Germany would be bound to redeem annually a certain proportion of these gold certificates in gold marks, by handing in gold bills created by the sale of German goods. The amount due annually and the date of the payments could be settled in accordance with her capacity to pay, and with the inclination of the other nations to accept her commodities. The total sum could be issued in different slices, so that the amount of uncovered certificates would never be too great. France would receive cash, which she could use to clear off her international obligations, thereby easing and fixing her exchanges. England and the United States would be the ultimate receivers of the bulk of these certificates. In case they did not want to use them for payments or loans abroad or for the issue of corresponding currency at home, they would have to keep them in their vaults until redeemed. During that period they would get no interest on them, but they would get back their capital. They would thus incur some loss, but it would be much smaller than the loss arising from a scheme of canceling inter-allied debts which would deprive England and the United States of interest and capital as well. They would gain markets, for exchange would not decline any longer below a certain point, and they would get rid of German competition due to shocks of exchange. Germany's yearly payments could be greatly reduced. The payment to France of 10 billions on the Ultimatum plan necessitates the payment of about 1 billion a year for 30 years: the redemption of 10 billion certificates within 30 years could be done by a yearly payment of about 333 millions. The necessity of German exports, and with it the necessity of admitting German imports, would be reduced correspondingly. The further depreciation of the German exchange can be stopped, and the way to stabilization may be prepared.

I am very well aware of the crudity of the scheme outlined, and of the dangers of inflation. But the problem seems to me this: Shall we incur a certain amount of limited and regulated international inflation by the issue of international paper, which will be funded bye-and-bye as the resources of the world increase; or shall we continue — nay, even force on — national inflation, until the financial life of Central Europe is beyond recovery and until economic dissolution will follow financial anarchy?

If there is enough capital in the world to save the situation, some plan ought to be devised to solve the problem on the basis of existing capital; if there is not, the fiction of making money which has been used during the war for destructive national purposes ought to be used for constructive international aims. But something must be done, and that something must be done boldly; for the sands are running out with alarming rapidity.

EVASIVE TEUTONS

BY JOSEPH LOUSSERT

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The German Government resents the charge that its policy has been expressly designed to bring about a disastrous fall in the value of the mark, for the purpose of obtaining a revision of Reparations claims. I do not question the personal sincerity of Chancellor Wirth. But we have too good reason to know that public policies do not always follow the intentions of those who guide them, and that concessions must be made to powerful interests outside the Government. Six months have now elapsed since Germany yielded to our last ultimatum, and not a pfennig of new taxes has been voted by the Reichstag. Not a step has been taken toward providing for the new burdens on the treasury or even for meeting the enormous deficit which previously existed. Is it not suspicious that since the acceptance of that ultimatum by Germany, its Minister of Finance, who should have been a vigorous leader in devising means for complying with its provisions, has been practically deprived of his authority? When people cite the fact that the currency of Poland and of Austria is still more depreciated than that of Germany, they forget that neither of those countries has experienced the industrial prosperity which Germany has of late enjoyed. Neither have their business men been able to pile up millions and millions of deposits in foreign banks. And even were we inclined to attribute Germany's situation to mere inertia, and to the disposition of its public men to shirk responsibility, would we not be brought to a pause by the vociferous way in which certain interests in that country have proclaimed the 'mark at two pfennig' as the doom of the whole Reparations policy?

There is no escaping the fact that Germany is itself at fault for the collapse of the mark. Beyond all question a combination of private interests and of short-sighted Machiavellism has propagated the opinion in certain circles that, by ruining the currency, Germany might evade its Reparations debts. We should bear in mind, however, that the preponderant opinion in Germany is quite aware of the folly of such a course. Most Germans see clearly that the decline of the mark, instead of freeing their country from its bur-