NEW PROSPECTS FOR AMERICAN CAPITAL—I

BY C. REINOLD NOYES

It will be difficult for the historian of the twenty-first century to exaggerate the sensational character of the changes in the world situation which were brought about by the Great War. The development of civilization seems to proceed through long periods of comparative quiescence, during which the incubation of new forms of human growth takes place, and the rearrangement of the stresses and strains of the human conglomerate accumulates statically; until in a sudden dynamic catastrophe the old shell cracks and bursts and, with all the labor and pains of birth, a new era is introduced to the light of day.

The catastrophe of the four years, 1914 to 1918, has had consequences as radical as were the combined effects of the great movements at the close of the eighteenth and the beginning of the nineteenth centuries, when the French Revolution, the Industrial Revolution and the Napoleonic era remade Europe, politically and industrially, in a period of twenty years. Perhaps it would be necessary to go back to the fifteenth and sixteenth centuries, and to the effects of the discovery of the new road to the Old World and the road to the New World, to find a parallel for the rise and fall of empires and the complete upsetting of trade relations and routes that have recently occurred.

But changes equivalent to those that occupied the greater part of the fifteenth and sixteenth centuries, and more than two decades one hundred years ago, have in our time been condensed into four years.

It is little wonder then that we have not been able to grasp the significance of the revolution that has occurred; that we have not adjusted ourselves to changed conditions; and that we still talk, work and govern our affairs, public and private, largely according to policies which were derived from the experience of the last century under circumstances which have passed not to return.

Out of the throes of this upheaval the United States has been thrust into a position of preëminence. It is now the great Power, financially, industrially, and perhaps even commercially. The period of European preëminence has closed. That of North America has opened. We are no longer a debtor nation, but the world's greatest creditor. We are no longer a seller of food and a buyer of manufactures, a frontier, colonial people. Our status in the world at large and our relations with other nations have been suddenly and completely changed.

Among the most radical changes that our new position as a financial creditor and an industrial exporter has brought about is in the field of the investment of capital. Not only has the future supply of domestic capital for investment been greatly enhanced, but also the channels into which these funds will or should flow have been fundamentally modified. If a proper appreciation of these new ruling factors does not become common, it is likely that much capital will be dissipated in ventures which might have been successful under the old auspices, but which will now have the stars in the heavens set against them.

Before the war it was commonly estimated that about two billion dollars of new capital was available for investment each year. As soon as we have recovered from the temporary ills of our surprisingly rapid and radical deflation and liquidation, it is reasonable to expect that the savings of the people will again yield about this annual increment. The price level may remain somewhat higher for a time, which would tend to make this figure proportionately greater. But to offset this influence there will be the counteracting effect of the lessened share which goes to the capitalist—the saver—in a time of gradually declining prices. The high taxes will have little effect in diminishing savings, because as soon as there is a settled and permanent fiscal policy the business world will, as always, adjust itself, and taxation will be absorbed into cost of production. In this particular instance, since practically the whole industrial world is equally debt-ridden, there will be no competition to speak of which will be enabled to undersell our producers because of a lower tax rate. In former cases foreign competition sometimes forced the capitalist to pay the taxes out of his current savings. But now such a necessity is practically eliminated. In view of all these considerations it is safe to assume that our normal savings will at least equal our figures before the war.

During the next twenty-five or fifty years there will be an additional increment of investible capital from two new sources which will greatly increase the total funds available each year. I allude to the retirement of our national debt and the liquidation of foreign indebtedness to the Government and people of the United States.

It seems not to be generally recognized that taxation for the purpose of retiring national debt is a form of compulsory savings, when it is looked at from the point of view of the whole people. Liberty bonds were originally paid for out of the current savings of the nation over a period of three years, and out of the credits issued to individuals on pledges of savings not yet accomplished. This latter fund of frozen credit is rapidly being liquidated and most of the outstanding national securities are now owned outright by the investor. The proceeds of this financing have been spent or lent, not invested, by the Government. Deducting the loans made to foreign Governments, about fifteen billion dollars of the savings of the people have been used up in current expenditures. There are no assets to speak of to counter this liability, for the credit of the Government lies in its power to tax the individual proprietors of the country, not in its owned assets. Though the individual naturally regards his Government bonds as a part of his capital, the aggregate of the bonds is not a part of the national capital, but represents property used up with nothing permanent or tangible to show for it.

To retire such a debt, the people must produce each year additional savings over and above their personal expenditures and pay them over to the Government in the form of taxes. The Government in turn will indemnify the original lenders of capital until the whole account is settled. To the lender the cash received at maturity appears to be merely the repayment of his principal, formerly advanced, and there is therefore a strong tendency to retain it as capital and to re-invest it. What was at first largely a paper lien against non-existent savings becomes, as the bonds are retired, a real enhancement of the national capital fund, and is an additional increment available for productive investment as long as the process lasts.

During the next quarter to half-century twenty-five billion dollars of paper assets will in this way be converted into real assets in the hands of our people. And since no one will regard his share of this national accumulation as a part of his individual accumulation during the period, there will be little or no tendency for the process to diminish or replace normal savings.

The second of the new sources of supply of investible capital will arise from the repayment of the world's indebtedness to the United States. Europe is the principal debtor, and probably through the ramifications of international trade the repayment of the entire amount will devolve upon Europe; therefore I shall refer hereafter to this debt as the European debt. While a greater or less part of this debt may be refunded at maturity, the necessity now exists that this collection of obligations must be paid off during the next twenty-five to fifty years, for the option to refund lies with the creditor, not the debtor. Reinvestment of the proceeds of these foreign loans in the same form will be considered in connection with the other possible fields of investment. Suffice it to say at this point that a sum variously estimated at from fifteen to twenty billions is now owing us. As it is paid it will constitute an addition to our normal supply of new capital. Nearly ten billions of this is owing to our own Government and will therefore be paid to our capitalists as a part of the retirement of our own national debt in the way already described. But there is between five and ten billions besides which exists in the form of credits of short or long term to foreign Governments and foreign individuals, extended by private interests in this country. The unfunded debt of foreign buyers which now rests in our banks, in the form of frozen loans, is estimated to be about four and one-half billions. In addition to this there is the funded debt in the form of external bonds of foreign Governments, municipalities and private concerns, owned by our investors and corporations; the credits granted by the United States Food Corporation and other official bodies; the purchase of foreign drafts by speculators in foreign exchange, which classification seems to cover all the male citizens of voting age and some others; and finally the speculative purchase of foreign internal securities. No reliable estimates of the aggregate amount of these credits is available, but the figure must be a large one, and the end is not yet. The score is still mounting and will continue to mount until international trade is restored to its normal equilibrium.

Setting aside the rather remote possibility of any number of our debtors becoming permanently bankrupt, either fiscally or commercially, somewhere between fifteen and twenty billions must be paid back to us, the floating portion first and rapidly, the funded portion gradually over a period of from twenty-five to fifty years. What are the forms which this payment will take? There are six possible mediums in which international settlements may be made.

The first is gold, the international money. The reasons why gold cannot effect any considerable portion of these settlements are so obvious that it is not necessary to discuss them.

The second medium is the transfer of titles to tangible permanent property located outside our borders. This covers securities representing actual ownerships, such as stocks, titles to real estate, etc.

The third medium is new funding or refunding operations upon the indebtedness itself. This represents merely a postponement of the payments, although by constant renewals there may be set up what will, in effect, constitute a revolving fund which will provide for a part of the debt with more or less permanence.

The fourth medium is services, such as freight, insurance, etc. What this will amount to depends very largely upon the successful development of our own merchant marine. To the extent that our exports and imports move in our own bottoms, our acceptance of bills for freight, etc., will be reduced. It is not impossible that this item may become an element of invisible export instead of invisible import as it has been in the past.

The fifth medium consists of remittances to travelers and nonresidents, and remittances from immigrants to their families in Europe. It has been estimated that before the war our tourists alone carried across the water $250,000,000 a year. Therefore this is an item of considerable importance.

The sixth form of payment lies in an excess of imports over exports. This constitutes what is known as an adverse balance of trade, for the reports of exports and imports cover only the movement of visible raw materials and manufactured products.

Whatever part of the annual payment of principal and interest upon Europe's fifteen or twenty billion dollar debt to us is not accepted by our investors in the form of titles to property or new evidences of indebtedness, and whatever part conditions prevent our receiving in the form of services or counterbalancing with remittances to Europe, must of necessity appear in the form of an unfavorable balance of trade.

It will be a shock to America when this occurs. We have grown up with the idea, correct under then existing conditions, that a favorable balance of trade spells prosperity. That is the reason it has been called "favorable". Now, however, we have changed from a debtor to a creditor nation. From a condition in which we balanced invisible imports with surplus visible exports, we now have a flow of invisible exports which must be balanced with surplus visible imports. As a result we must adapt our ideas of prosperity to an adverse balance of trade, for this condition is now coming as inevitably and inflexibly as the change of seasons. And the combined efforts of Congress, bankers and business men cannot stop it.

The pressure of international settlements seeking a level is a force beyond the control of man. Contrivances may postpone its action, may divert its courses, but the dams of tariff walls cannot hold back its flows. When we dam it up in one or many spots the pressure will vent itself all the more violently at some other point.

The gold point in most of the foreign exchanges will doubtless be a fiction or a fond memory for many years. The international balances are too far from equilibrium to be adjusted by minor shipments of gold, and for a period of many years adjustments will be effected through a medium of greater and more flexible proportions, namely, variations in the relative price levels, corresponding variations in the exchange rate, and the consequent movement of goods. For the present, at least, the rates of exchange will remain abnormal—far from the gold point for currencies that are far from the gold basis—and will be free to register as a gauge the pressure of settlements due and payable on a scale which will make the fluctuations of normal times seem diminutive by comparison.

Exchange rates are determined by the balance of trade and by the relative purchasing power of the currencies. Yet each of these factors has a great influence over the other, and the normal reaction to exchange rates which do not represent gold parity is that a stimulus is set up toward the automatic rectification of these variations. Gold parity cannot be secured by freedom to ship gold. The balances and the inflations are too great to permit the condition to be corrected in this way. It can and will be reached when the world is paying us for our exports and for its debts in goods, and when through deflation the price levels of these goods in foreign markets decline to a point where they can compete in our markets at prices based on gold parity.

Until this deflation of foreign currencies is achieved, exchange rates will fluctuate to whatever extent is necessary to bring the foreign price level in terms of our currency to a point where we can import a sufficient quantity of some materials and goods each year to cover our exports and add whatever excess is necessary to balance the principal and interest of the indebtedness due and payable to us that year and not cared for otherwise.

Natural imports under normal conditions consist of those materials or products which we cannot produce, or which can be better produced, or produced more cheaply, elsewhere. Natural exports are those materials or products of which we have a monopoly, or which can be better or more cheaply produced here than elsewhere. Through the breakdown of foreign productive ability, the effects of which will doubtless last many years, we will, for some time to come, be able to produce in general better and, in terms of gold, cheaper than will our old competitors. There will then exist a situation in which natural exports will tend to exceed natural imports. Yet this result cannot follow, because the force of compulsory invisible exports, acting through the exchange rate, must necessarily compel an unfavorable balance of trade. What will occur is that materials and products which we are able to produce better and more cheaply than other countries in terms of the nominal values of currencies will be enabled to flow into this country in spite of all handicaps, because of the automatic variation in the exchange rates of those currencies or of the comparative price levels in terms of those currencies. And such adverse exchange rates will, of course, put our exports at a corresponding disadvantage and thereby effect a marked reduction in all but those upon which we have a practical monopoly.

The effect of a tariff evenly distributed over all commodities entering into international trade would then be nil. For such an *ad valorem* tariff would immediately and automatically be reflected in an adjustment of exchange rates to absorb the duty. Tariffs, however, are not usually constructed on this basis. Protective tariffs are intended to protect those producers who are most likely to suffer from foreign competition and to leave unprotected the stronger industries, extractive and manufacturing, which, because of their efficiency or advantages, seem not to need it. The result of such a protective system under present conditions will be to inhibit or prevent imports in those commodities which it would be to our advantage to import; to raise the barrier of exchange rates against us; and thereby to encourage imports and discourage exports of those commodities of which we naturally have an exportable surplus. Such a tariff, by which we protect our weak industries at the expense of our strong industries, in the forlorn hope of preventing the inevitable payment of debts due us in the form in which such payments must to a great extent exist, is the paradoxical remedy for industrial depression still advocated by many who adhere to principles politically successful and therefore deemed economically sound half a century ago.

While such unsound expedients may radically alter the character of our imports and radically curtail our natural exports, neither a tariff nor any other system will prevent the foreign debt from being liquidated in due course. As a creditor nation we will see to it that what is owing us is paid, and the judgment of our investors will determine to what extent we are paid in securities and how largely in an adverse balance of trade.

C. Reinold Noyes.

THE RETURN OF A NATIVE

BY P. W. WILSON

To revisit England after an absence of three years—and especially three years of the social turmoil that has followed the armistice—could not but be for an Englishman an experience at once fascinating and poignant. About the landscapes, so familiar, there was now a strange unfamiliarity, as if something—or someone—had changed—a change, not indeed in those fields, by comparison with the prairies so curiously green, or in the hedges that enclosed them, but in the eye itself which for the first time views them, as it were, from a distance, objectively. One realized why it is that Englishmen, after domicile abroad, whether in Asia, Africa or America,—for in this respect it makes no difference,—can never again be quite at home in England. These nomads have seen with their eyes what their people at home have not troubled as yet to imagine. They have looked over the hedges to the horizons beyond, and in their gaze these far horizons must ever be reflected. For every pilgrim who goes forth, the New World is a discovery, but for the American of seventy times seven generations the Old World remains, as Rome remained to the Celts of Cornwall, a sub-conscious memory—like a child's sense of the mother who died at his birth. The Old World can never know the New World as well as the New World knows the Old.

Take Fleet Street, the proverbial haunt of the press. Of her newspapers, dignified, accurate, and restrained, Britain has been justly proud. But in Fleet Street to-day there is a crisis. While the price of paper in the open market has fallen, many journals are tied to war contracts which have still a period to run. Labor is costly and the coal strike slumped advertisements, which source of revenue is only beginning to recover. All this means that newspapers are apt to be smaller than their normal size and that there is room for an ampler interpretation