

GERMANY'S FINANCIAL TANGLE—WHAT NEXT?

With the Appointment of a Committee to Examine Her "Capacity to Pay," a Decision Must Be Made Concerning the Triple Problem of Reparations, Private Loans and the Inter-Governmental Debts

By CHARLES MERZ.
GERMANY went to her creditors last week with a formal plea for a re-examination of her capacity to pay reparations.

Her creditors have assented and a committee appointed by the Bank for International Settlements will begin work at once.

The stage was set for this appeal by the dramatic series of events which began last Spring with the flight of foreign capital from Germany and ended in October with the conference between President Hoover and Premier Laval in Washington.

We have now reached a point at which some decision concerning Germany's financial future must be made. Germany faces the problem of paying two sets of creditors. Under the terms of the Young Plan, which superseded the Dawes Plan in 1929, she is due to pay an average of \$473,000,000 a year in reparations. At the same time she owes \$4,046,000,000 in private debts to foreign bankers and individual investors.

For the moment payment of reparations has been suspended by the Hoover moratorium. Also for the moment foreign bankers have agreed to leave in Germany the short-term funds which they have lent to that country. This is the "standstill" agreement recommended last August by the Wiggins committee, consisting of ten bankers and economists appointed by the International Bank to inquire into Germany's immediate credit needs.

The Hoover moratorium ends next July. The "standstill" agreement ends in February. The question with which the new committee of investigation must deal is the question of what will happen next.

Where Opinion Differs.
On this question a sharp difference of opinion is at once apparent in different countries and in different groups. With his authority as leader of the Conservative party in Great Britain, Stanley Baldwin insists that Germany must give priority to payments on private loans rather than to payments on reparations. French opinion is equally insistent upon the opposing thesis that reparations must have precedence over private debts.

In Germany, the Hitlerites are at this moment celebrating a victory in Hesse on a platform favoring repudiation of all reparations. In the United States the argument that world recovery would be advanced by a reduction of war debts owed to the United States, in return for a corresponding reduction of reparations, has been met by the warning that such logic is merely bait in a steel trap set by bankers.

The problem of reparations, private loans to Germany and war debts owed to the United States is a problem involving the interests of many millions of people. In order to weigh these interests it is necessary to note:

(1) The factors entering into Germany's financial position.
(2) The present extent and distribution of her private loans.
(3) The relation of these loans to reparations.
(4) The relation of both loans and reparations to war debts due to the United States.

I. GERMANY'S LEDGER.
The best approach to the question of loans and reparations is to consider the factors which enter into Germany's balance of international payments. Nations, like governments and like individuals, must balance their books from time to time. If their income exceeds their outgo they are fortunate enough to have a surplus. If their outgo exceeds their income they must borrow.

The chart at the top of the page illustrates Germany's balance of payments from 1924, when the Dawes Plan took effect, until 1930. Seven items appear in this equation, summing up the receipts and expenditures of Germany as completely as a similar statement of income from salary, interest on bank deposits, payment of grocery bills, cost of life insurance, payment of taxes, payment of rent and "miscellaneous expenditures," covering everything from club dues to laundry bills and bad debts to moving-picture entertainment, might sum up the income and the outgo of an individual. These seven items are:

loss of gold amounting to 310 million; and an unfavorable trade balance of 429 million. The total of these three items is 810 million.

What balances this figure on the other side of the line? There is an income of 71 million from services, an income of 48 million in the form of interest payments and a miscellaneous income of 96 million. This totals 215 million—but falls 595 million short of equaling the 810 million on the other side of the ledger.

How was this additional 595 provided? By borrowing from foreign banks.

With the aid of the chart, certain shifts in the balance of payments from one year to another may be noted. Gold, for example, flowed out of Germany in 1924, 1925 and 1926; flowed in in 1927; flowed out again in 1928; and flowed in again in 1929 and 1930. Balance of trade appears on the debit side in 1924, 1925, 1927 and 1928; appears on the credit side in 1926 and 1930; and disappears entirely in 1929, when Germany's exports precisely matched her imports.

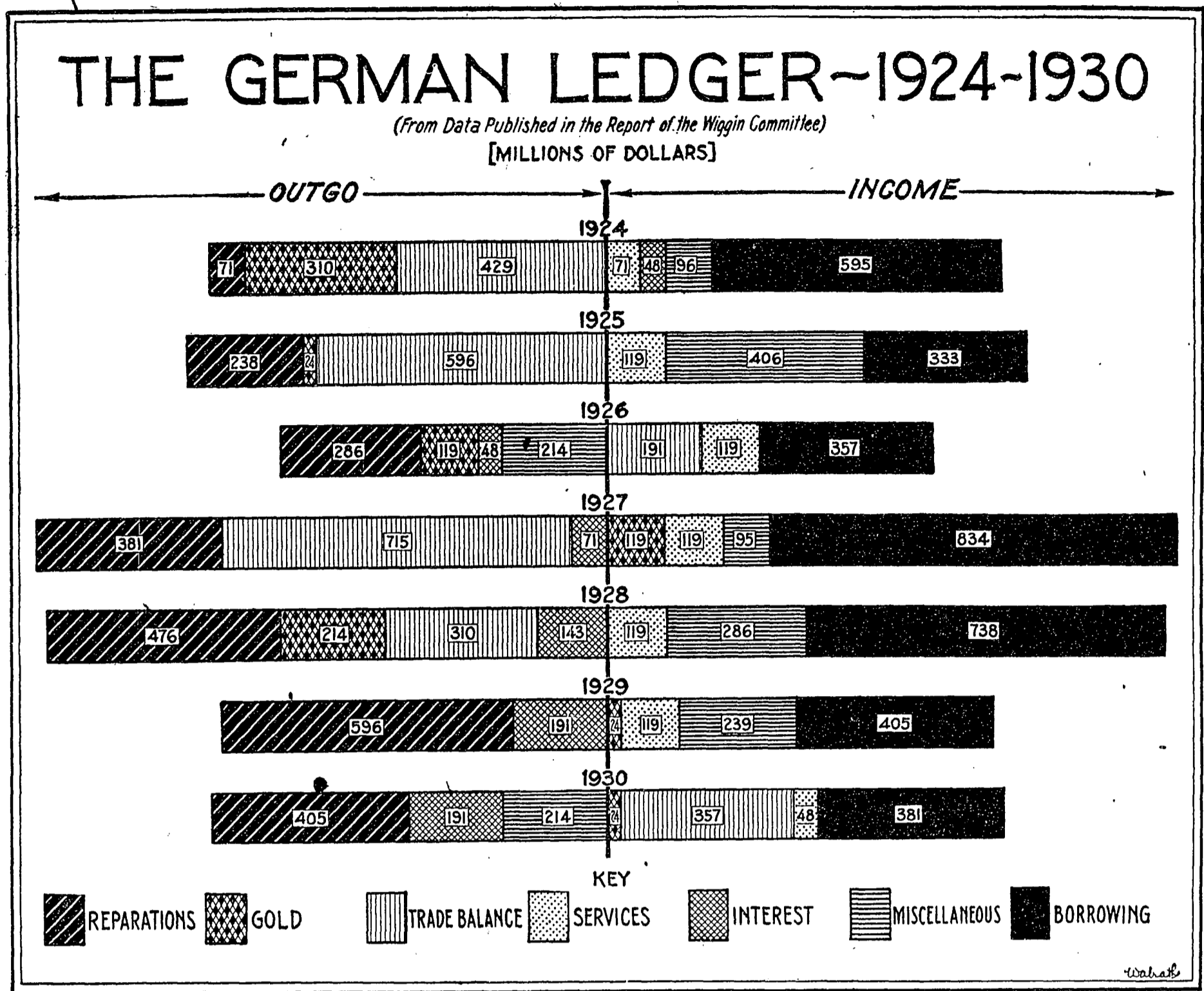
What never changes in the chart, however, is the presence, on the left, of a large striped block representing reparations and the presence, on the right, of a large black block representing borrowing from private bankers. Roughly, in recent years, these two blocks tend to offset each other.

The plain fact is that since 1924 private bankers in the United States, England, France and other nations have supplied the entire fund which has been used for reparations payments.

In effect, the bankers have advanced money to their own governments and sent the bill to Germany.

II. THE PRIVATE LOANS.
How extensive has been the practice of private borrowing by Germany, in order to pay reparations, meet interest charges on her private debts, add to her gold holdings and compensate for an adverse balance of trade in four of the seven years from 1924 to 1930, may be seen by referring once more to the chart and by adding the various sums borrowed in each of these seven years. The total is 3,643 million dollars.

In addition, the Wiggins committee created by the Bank for International Settlements last Summer has pointed out that under the item described in the chart as "miscellaneous" there have been certain movements of capital into Germany. The total amount of Germany's indebtedness to private creditors at the end of last July is estimated by the Wiggins committee at 4,046 million dollars—a sum approximately equal to the total expenditures of our own Federal Government in 1930-31. How is this sum divided and from what sources has it come?



interest of different nations in the long-term debt of Germany. Certain facts stand out as unmistakable.

(B) The Short-Term Loans—No similarly comprehensive data are available with respect to short-term loans to Germany. The best figures are those supplied by the Wiggins committee, covering about 65 per cent of the short-term indebtedness of German banks and about half of the total short-term indebtedness of all public and private German interests estimated by the committee as outstanding at the end of last July. In terms of millions of dollars, these figures show the following results:

	Loans of Total	Per Cent
United States	287.7	37.1
Great Britain	230.1	29.7
Holland	80.0	10.3
France	70.7	9.1
Sweden	18.3	2.3
Switzerland	13.3	1.7
Others	54.7	7.0
Total	1,065.5	100.0

In this case the geographical distribution of the German debt is somewhat different from that which we have noted in the case of long-term loans. The United States is again first, but with a percentage reduced from 55.2 to 37.1. Great Britain, rather than Holland, is second; Switzerland is third, and Holland fourth. France, which has advanced an even 5 per cent of Germany's long-term loans, is shown by the present table to have advanced 6.8 per cent of the short-term indebtedness. In both cases the French stake is relatively slight.

These figures represent, as we have said, the status of approximately one-half of the total short-term debt of Germany in July. If a count had been taken six months earlier it would have shown far larger figures. The Wiggins committee estimates, in fact, that between Jan. 1, and mid-July, the enormous sum of \$890,000,000 in short-term loans was withdrawn from Germany. This was the famous "flight of foreign capital," brought about by a series of circumstances which included the collapse of the chief bank in near-by Austria, the political uncertainty resulting from Communist and Fascist gains in the German elections of September, 1930; the bad business conditions existing in Germany and generally throughout the world, and the increasing caution of bankers in all of the important lending countries.

Once under way, the flight gained pace with rapidly accelerating speed. To the withdrawal of short-term funds was added a large amount of selling by foreigners of long-term investments in Germany, mortgage bonds, etc., and of purchasing by Germans (for safe-keeping of their funds) of long and short term investments in foreign countries. All told, the drain on Germany's credit resources amounted to more than \$800,000,000. Gold left the country. The situation approached a panic.

It was in these circumstances that President Hoover proposed his plan for a moratorium and that foreign bankers agreed upon their "standstill" plan. The moratorium provides that nonpostponable reparations due before June 30 of next year shall be paid into the Bank for International Settlements, but shall then be reloaned immediately to Germany, while postponable reparations due before July 15 shall be suspended and paid later.

The "standstill" plan is an agreement by the foreign bankers to continue for a period of six months their short-term credit to German debtors, up to the total outstanding at the end of August. The agreement ends on Feb. 29.

III. LOANS vs. REPARATIONS.

With these facts in hand we are now in a position to consider the rôle that will be played by the chief protagonists in the new drama on which the curtain is about to rise, as the nations involved in the tangled plot of loans, debts and reparations face the question of what will happen when the moratorium and the "standstill" plan expire.

GERMANY—In the opinion of Germany, the relation between private loans and reparations is close and inescapable. It was only by means of private loans that Germany paid reparations in the seven years from 1924 to 1930. In the opinion of the German Government, it is only by means of additional private loans that reparations can be paid when the moratorium ends.

In these circumstances, Germany has been urging that the commission appointed under the Young Plan to re-examine her "capacity to pay" deal with this question in the light of her present indebtedness to private creditors and of her future ability to borrow. In any choice between payment on reparations and payment on private debts the German position naturally favors priority for private debts, in order to conserve the credit not only of the central government but also of the States, municipalities, banks, public

utilities and private businesses which owe the long-term German debt.

FRANCE—On the question of priority the French position is directly opposed to that of Germany. The reason is not hard to find. France, as we have noted, has a small stake in the private indebtedness of Germany, her share of the long-term loans amounting to 5 per cent and of the short-term loans to 6.8 per cent. On the other side, France is destined under the Young Plan to receive 52.7

per cent of the total payment of reparations. French loans to Germany amount to less than 250 million dollars. French receipts from Germany in the form of reparations will amount in the end to 13,262 million if the whole reparations bill is paid.

France has accordingly insisted that Germany's plea for a re-examination of her capacity to pay must be made strictly according to the letter of the Young Plan and without reference to the question of private loans.

GREAT BRITAIN—Under the Young Plan Great Britain receives 20.6 per cent of the reparations paid by Germany, compared with 52.7 per cent for France. If the Young Plan survives the fifty-seven years for

which it was created and if Germany continues unflinchingly from 1932 to 1988 to make the payments charged against her, Great Britain will receive the large sum of 5,594 million dollars.

All British Governments, however, have shown a skeptical attitude concerning the permanency of any reparations settlement and a disposition to collect from Germany and their other debtors only what is required to meet their obligations to the United States.

Admittedly this proposal would require the American people to pay in larger measure for the cost of the war by compelling them to make up through taxation part or all of the loss of an average annual payment of 350 million dollars which would be made to us, at least in theory, by debtor nations during the next six decades. The argument for and against revision of the debts turns upon the question of whether such a policy is justified by the experience of Germany, her European creditors and the United States itself, in the twelve years since the signing of the Treaty of Versailles.

On this point opinion in the United States is divided, and the immediate interests of two groups of Americans are brought into conflict. There is one group, consisting of all holders of German securities or notes, which stands to gain more by any action tending to strengthen German credit than by any payment on the war debts. There is a second, larger group which lacks this personal incentive in favor of revision unless the issue is framed in terms of national policy.

To point out the conflict between these groups is not necessarily to argue that a decision will be reached solely in the light of the immediate interests of the two factions. There will be people on both sides of the approaching argument who will take a position opposed to their immediate interests, for the sake of a public policy which seems to them of more importance.

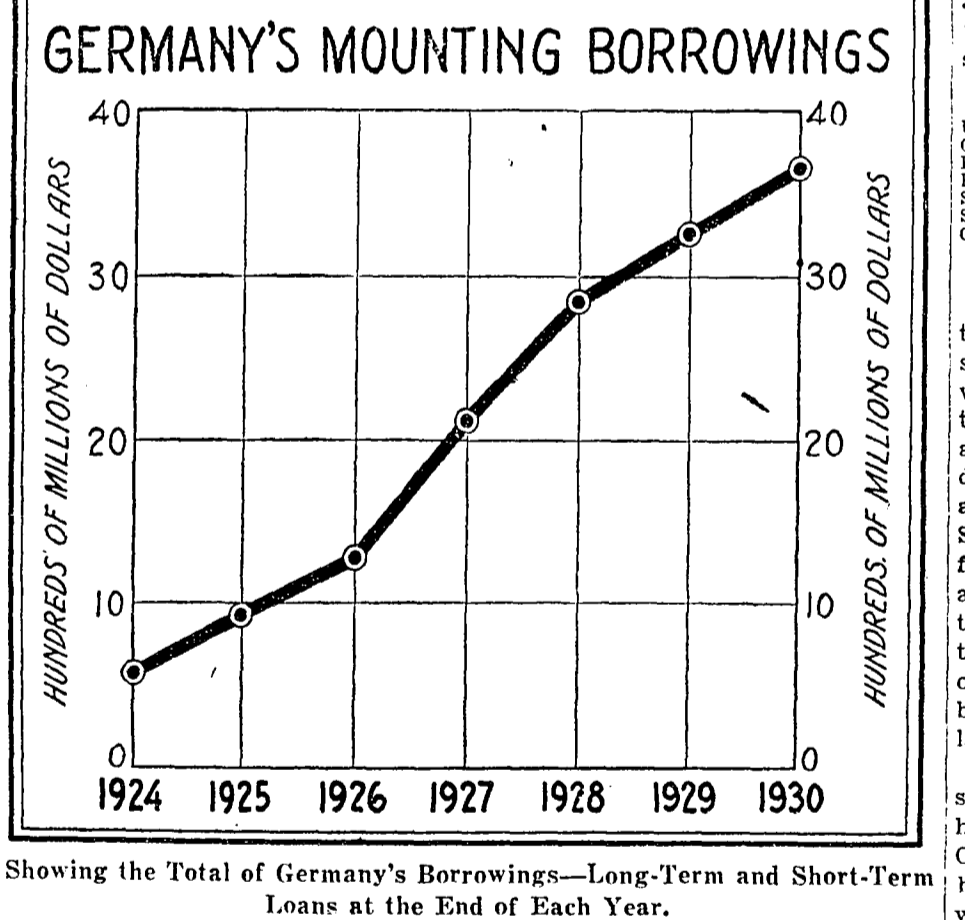
Whether the new committee of investigation will pose the question of revision of the intergovernmental debts, or whether this question will arise automatically when it adjourns, is a matter for the future to determine. It is possible that the committee will find a precedent in the report of the Wiggins committee, created by the Bank for International Settlements for the purpose of examining the same fundamental problem.

The Wiggins committee went back to the balance of international payments with which this summary began. It pointed out that Germany, thus far, had paid reparations solely by means of foreign borrowing. It predicted that future reparations could be paid only by means of continued borrowing, unless the present schedule of reparations is scaled down. It argued that continued borrowing would "pile Pelion on Ossa," creating a steadily increasing interest charge on private loans which would offset ability to pay reparations.

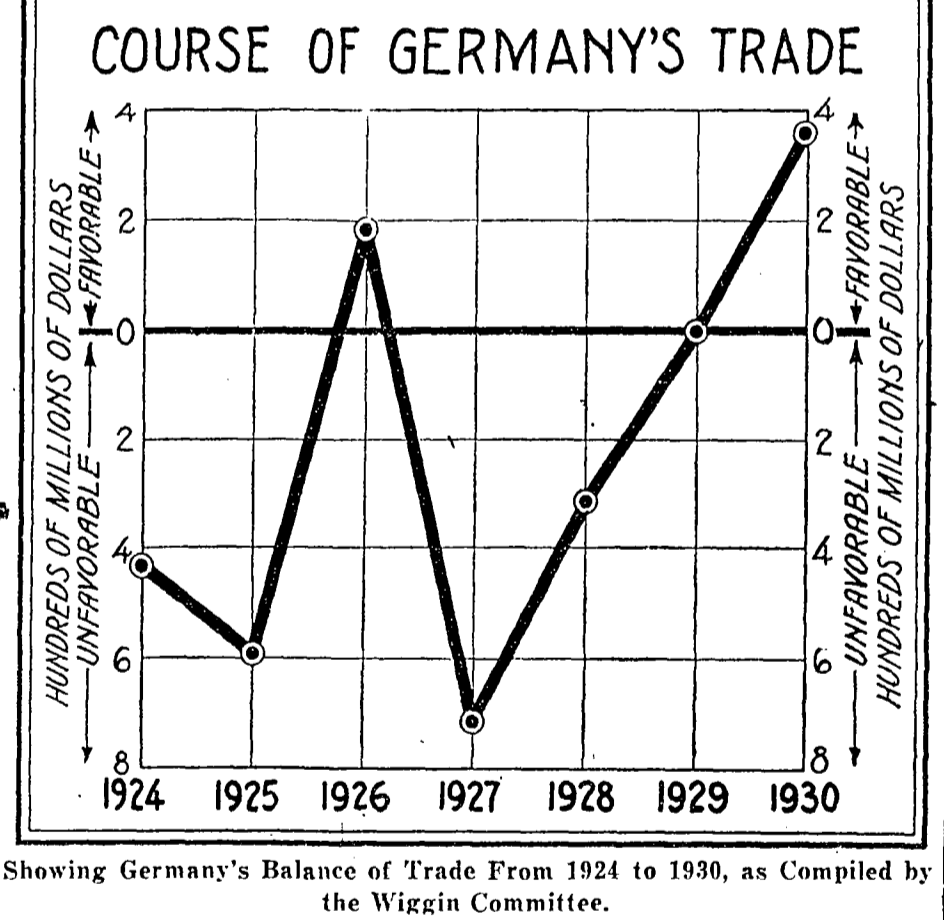
The Wiggins Recommendations.
In these circumstances, the committee recommended that action be taken to place Germany's finances on a sounder basis than they have been since 1924. "We believe that this can be accomplished," the committee said, "but only if the governments of the world will realize the responsibility that rests upon them and will take prompt measures to re-establish confidence. Their action alone can restore it."

With this end in view, the committee urged:
(1) That before the moratorium and the "standstill" agreement end, the creditor nations of the world "give assurance that international political relations are established on a basis of mutual confidence, which is the sine qua non of economic recovery, and that the international payments to be made by Germany will not be such as to imperil the maintenance of her financial stability."
(2) That the creditor nations also recognize the difficulty of "endeavoring to pursue two contradictory policies in permitting the development of an international financial system which involves the annual payment of large sums by debtor creditor countries, while at the same time putting obstacles in the way of the free movement of goods; financial remedies alone will be powerless to restore the world's economic prosperity until there is radical change in the policy of tariffs, and international commerce, on which depends the progress of civilization, is allowed to resume its natural development."

To this the Wiggins committee added its opinion that "the time is short—the body of the world's commerce, whose vitality is already low, has suffered a severe shock."
We therefore conclude by urging most earnestly upon all governments concerned that they lose no time in taking the necessary measures for bringing about such conditions as will allow financial operations to bring to Germany, and thereby to the world, assistance which is sorely needed.



Showing the Total of Germany's Borrowings—Long-Term and Short-Term Loans at the End of Each Year.



Showing Germany's Balance of Trade From 1924 to 1930, as Compiled by the Wiggins Committee.

DISTRIBUTION OF GERMAN LONG-TERM FOREIGN LOANS—1924-1931

(Nominal value in millions of dollars*—the totals are approximately the amounts now outstanding.)

	United States	Great Britain	Holland	Switzerland	Sweden	France	Belgium	Italy	Others	Total	Percentage
Dawes and Young loans	208.2	116.6	41.4	32.4	36.2	113.1	12.1	10.9	...	570.9	25.2
States, municipalities, etc.	204.7	50.0	60.9	12.6	126.2	...	...	...	2.5	456.9	20.1
Public utilities	255.4	11.4	27.4	27.1	.7	...	...	...	7.6	329.6	14.5
Municipal banks, etc.	44.7	1.5	7.1	1.9	1.0	...	...	...	3.3	59.5	2.6
Private borrowers	540.0	82.3	142.6	47.8	25.7	...	...	...	16.4	854.8	37.6
Total	1,253.0	261.8	279.4	121.8	189.8	113.1	12.1	10.9	29.8	2,271.7	100.0
Percentage distribution	55.2	11.5	12.3	5.4	8.3	5.0	0.5	0.5	1.3	100.0	

*Converted from Reichmarks to dollars at par of exchange, from figures in the report of the Wiggins Committee.