WEALTH THAT MELTED

TRAGIC EXPERIENCES OF EUROPE

DANGER OF TALKING INFLATION

HOW AMERICA DRAINED OLD WORLD

In the second instalment of Professor Gregory's Fisher lecture on International finance, which is published below, some of the problems worrying the financier are explained. In 1923, a single Minister in Great Britain suggested in a speech that a little inflation might not be harmful. Within 24 hours every international banking firm in the world was withdrawing deposits from London. Professor Gregory cites this and other instances to show how intricate and delicate the financial fabric is. The first instalment of the lecture was published yesterday.

I hope I have made it quite clear that money is a very much more important element in modern economic life than is thought at first sight, and than was thought by all those middle Victorian economists who lived in a period of great peace and prosperity, and used to say that money was only the disturbing value which hid the realities from mankind. Money is more than that. It has an extraordinarily potent tendency both for good and evil in the national life of any particular country and in the international life of all countries taken together.

That brings me more directly to the problem I have to discuss ultimately this evening. Why is it that international finance is in such a difficult position to-day? There are certain people in my country, and in yours, whose conception of an international financier is that of a gentleman with a considerable waist protuberance, always smoking a very fat cigar, and wearing nothing but white waistcoats and diamond studs. That is not the international financier as you actually know him, or as you actually meet him. The international financier as you actually meet him is a very worried gentleman, who sits in an office with twenty-five telephones around him, receiving depressing telegrams from every part of the world. What is wrong with international finance at present? In the first place it is suffering from the economical and psychological effects of the periods of extreme instability, which came to an end in Europe, and the rest of the world, roughly about 1925. I want to describe what these psychological and economic effects are and have been.

When Money Melts

In the first place there is the problem of the liquidation of the accumulated balances in the international short loan fund. That seems very terrifying. It is, in fact, a very simple thing to grasp. In the period in which the German mark, the Belgian franc, the French franc, the Italian lira, the Hungarian crown, the Austrian crown, and the currencies of all the other European countries were melting before the eyes of the miserable population of those countries, a few people began to realise earlier than the rest that they were melting. What did they do? They tried to escape from the consequences of the falling value of their currency by buying something which did not fall in value; and the simplest thing to buy, apart from attache cases and other things which they could buy in their local shops, but which they could not go on buying because the shopkeepers frankly refused to go on selling them, was a dollar note, the ordinary notes of the Federal reserve system. In 1926 and 1927, for instance the Federal reserve system suddenly discovered millions upon millions of small notes returning as physical entities from the interior of Poland, Czecho-Slovakia, parts of Germany, and other parts of Europe. There took place what is nowadays popularly called a flight from the currency, and, in the particular case of the London money market, a flight from the currency was especially important in the case of our nearest neighbor, France. Between 1924 and 1926 the French escaped the consequences of their local inflation by refusing to return to France the proceeds of their exports to England and to other countries. They left these sums—very large sums—on deposit in London banks. The same thing had taken place in Holland and in Switzerland in the case of Germany. All of these countries had also accumulated large balances in New York.

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rates of interest, one of the most difficult problems which German and French bankers have to face at the present time. This difference, this distortion of the rates for money in one department and in another, is entirely the consequence of psychological disturbances created by inflation in the past.

Sensitive Money Markets

The third consequence of inflation is this:—Nobody in Europe has forgotten the war; still less has anyone forgotten the period from about 1919 to 1925. What is the consequence? The consequence is that people are liable to be very panicky when anybody suggests that a little dose of inflation would not do us any harm. I remember the situation in Great Britain on the eve of the general election of 1923, when a certain Conservative Minister suggested that the situation was so desperate that it might be as well to see what the effects of a little inflation would be. What was the consequence? The consequence was that within 24 hours of the making of that speech every international banking firm in the world was beginning to withdraw deposits from London. They said, in effect, "If you are going to inflate we shall take time by the forelock." That is not only true of bankers, who ought to know their business. Over large parts of the Continent it is true of the average man and the average woman, who has been through the period when local money literally would not buy the same amount from hour to hour. The result is that the European money markets, and all the money markets affected by Europe, are very sensitive to any suggestion of a movement intended to reduce the value of money; that is, to raise prices.

Investments in America

The fourth consequence of the inflationist period in Europe was one which was hardly suspected until it came to an end. The fourth consequence was to make very popular among European investors the idea that at all costs they had to invest their money in something which had a real value. The business men's way of expressing that was to say that they wanted to invest their money in something which gave them an equity in an actually existing enterprise. The most prosperous country in the world in the last few years has undoubtedly been the United States of America, and therefore the tendency has been for European investors to refuse to invest in the long-dated bonds of their own enterprises and their own loans, and to put all their money into those American enterprises which seemed to yield an endless prospect of expansion and profitability. The New York Wall-street boom of 1926-29, which came to a very sudden and very disastrous end last October, was fed by the fears of the European investor, and by his desire to invest his money in a way which gave him a real, aliquot part of the ownership of some definite industrial enterprise. The Wall-street boom—you probably never heard of it in Australia, because you had one of your own—was not only caused in part by European conditions, in part it was caused by American conditions; but however it was caused, it has in itself been a factor in creating some very serious problems, both for the money markets of Europe, and for the money markets of the rest of the world. In the first place, it accentuated the problem of the flow of international balances. There was a time in the early part of 1929 when anybody, by which I mean any bank, any investment trust, any insurance company, having an amount of over 100,000 dollars, that is to say, £20,000, could earn with perfect safety 12 per cent. per annum by putting its money at the disposal of Wall-street. The New York Stock Exchange has always said with perfect truth that no investor in call

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What was the result? As soon as these currencies became stabilised again local populations started drawing some of these sums back, and, owing to the peculiar organisations of money markets, you cannot withdraw immense sums from one money market to another without actually, if you have fixed rates of interest, taking part of the proceeds in gold. It would take me too long to explain why, but it is so. Consequently the London money market in 1927, 1928, and particularly in 1929, when other things were happening as well, which I intend to explain, was faced with the enormous problem of the French balances, the so-called bad money, about which you will find every English banker complaining and grumbling at the present time. In other words, the first of the consequences of inflation from the standpoint of the London money market (I make no apology for mentioning London, because, after all, it is the centre of international financial machinery), was the presenting to the London money market of a very difficult and serious problem, namely, what the central bank was to do if a single country had it within its power, as France certainly had it within her power, to withdraw something between a moderate £50,000,000 and £100,000,000 in gold at any particular moment. That is the problem of withdrawal, the liquidation of accumulated balances—balances which had largely accumulated as a result of previous inflation, and as a result, therefore, of an attempt to escape from the consequences of that inflation.

Disparity in Interest Rates

The second consequence of this period of extreme instability all over the world is something which I can describe only in technical language. The second consequence has been an exaggerated spread, as a technical banker would say, between short and long period rates of interest. All over Europe you earn relatively little if you leave your money on deposit at a bank; but if you take your courage in both hands, and invest in a long term bond, you get proportionately more than you would have got in comparison with deposit rates of interest before the war. In other words, the margin between the deposit rates of interest paid by banks, and long period rates of interest paid by various Governments, municipalities, and business enterprises has increased considerably over the last ten years. Why is that? It is a remarkable thing. It presents many grave difficulties to the financing of long period enterprises; but the fact remains that the spread between long period and short period rates of interest is much greater than it was before the war. That is a direct consequence of the psychological effects of inflation. Everybody in Europe outside the Scandinavian block, Holland, Switzerland, and Great Britain, has witnessed—actually physically witnessed—the savings of the community being literally wiped out so far as those savings were expressed in terms of money. Naturally the temptation to anyone who has seen that is to say, "I will put my savings into such a form that I can convert it from money into something else at a moment's notice." Now, a deposit payable within seven or fourteen days is the most liquid form of investment known to mankind, and consequently all the nervous investors of Central Europe have been deliberately piling up their savings in the form of deposits, and have been refusing to take up on the normal scale the long-dated, interest-bearing bonds of Governments and municipalities, and other enterprises. If you read the reports of that highly gifted officer, the Agent-General for Reparations Payments, an American, you will find that he is constantly pointing out the spread, the difference, between long period and short period perfect truth that no investor in call money to the New York Stock Exchange has ever lost a cent. In other words, you could at that time earn 12 per cent. and get your principal back without any difficulty by simply calling it. What was the consequence? It was perfectly simple. Instead of the European investment trust, or the European insurance company, taking up, I shall not say Australian securities, but the securities of the Argentine, or of Brazil, or of some West Indian island, which was risky, they put their money into Wall-street, which was not at all risky.

Draining Gold from Europe

Consequently the whole equilibrium of international investments, which was already being effected by the peculiar mentality of the European investor as regards short or long investments, was being further accentuated by this enormous drain on the funds of the New York Stock Exchange. How it worked out was briefly this:—All the time the American banks and American issue houses were taking up long-dated securities in various parts of the world; it really makes no difference to the net result if J. P. Morgan lends 50 million dollars to Canada, and Canadian banks and insurance companies lend 50 million dollars to Wall-street, for in the end no money is being lent to Canada at all; but in consequence of the enormous outburst of speculative activity in the United States the total quantity of money invested in sustaining the industry and the governmental equipment of the newly developing countries of the world fell off, and fell off very sharply. What consequences this had there I need not enlarge upon at this meeting. Let me go further into the question. From the standpoint of the banking systems the flow of funds to Wall-street had the effect of causing a drain of gold to the United States; and, when central banks lose more than a certain amount of gold, they are almost inevitably driven, under central banking practice, to put up their bank rates. What is the consequence of that?

When the Banks Squeezed

It can be very simply described. In the years 1927, 1928, and the early part of 1929, all over the world raw materials of one kind or the other, such as copper, zinc, spelter, wheat, and cotton, were being financed by means of bank credits, &c. As soon as the money market rates rose, as soon as the banks were short of funds, they began to put a squeeze on all the various instrumentalities, which were preventing the prices of raw materials from being depressed by keeping a certain proportion of the aggregate world output of those things off the market, therefore producing the slump of raw material prices of all kinds, which has been a characteristic feature of the world in the last twelve months.

I come back to 1929, as being directly and inevitably associated with the reactions of the money markets of the world, to the great spectacular boom in New York in those three years. The consequences of the fall in the prices of raw materials is again a matter on which I need not enlarge to this audience. I may mention, however, that the fall in the price of raw material has been accentuated by the fact that various countries—I shall not mention them—thought that they could keep up the prices of these things by valorization schemes of one kind or the other. Rubber producers, for example, thought that if they could only keep rubber off the market they would keep the price up, and copper producers thought the same thing. That sort of game is all very well so long as banks are willing to finance the pools, but, as soon as the banks are not willing to do so, the whole structure comes down with a tremendous thump. As every-

one knows, the whole structure has come down with a tremendous thump during the last few years. Of course, that does not end the matter, as banks all over the world have been advancing to producers in anticipation of those prices being maintained. So you see that, just as when you throw a stone into a pond, the resulting disturbance stretches out in an endless series of ripples, so a stone thrown into the international monetary organisation, in the shape of the immense Wall-street boom, has had repercussions of a most difficult and far-reaching character.