Chapter V

INTERNATIONAL ECONOMIC RELATIONS.

BAD Money Embroils the Nations.—The system that has grown up could not have survived so long, or have remained so long camouflaged as the opposite of what it really is, but for the complication introduced into the problems by international economic transactions. Viewed from the standpoint of a single self-contained community, the gold-standard involves an almost self-evident contradiction. It is a system in which money was supposed to have been kept of constant value with reference to gold and in which the manner of issuing new money was such that it necessarily reduces in proportion the value of the rest. For since there are no more goods and services on sale than before the issue, what is on sale is divided among more money units, so that each becomes worth proportionally less, and the new issue merely dilutes the value of the old. In practice, this fundamental contradiction resolved itself into its two parts or phases—the inflationary period when the price-level was being forced up by new issues, and the deflationary period when it was being forced down again by the destruction

of money. The intermediate stage, the draining of gold out of the country as the one type of commodity arbitrarily prevented from rising in price, so reducing the "cash to credit" ratio, is the stage that brings in the international aspect of money. Bad money at home embroils the nation's affairs abroad.

International Banking.—As the inevitable inconsistency underlying their system became familiar to the banking profession in different countries, there grew up a corresponding system of international banking, working hand in glove with the internal banking systems, to the mutual benefit and security of both. They thus extended the area of their operations to that of the whole civilized world, and made it much easier for them to escape detection and punishment. Whereas internal banking plays off in turn the debtor and creditor classes within the community and keeps them in perpetual strife and poverty, international banking plays off the poorer country against the richer and, by reducing the latter to the level of the former, is the real agent fomenting and perpetuating the aggressive nationalism out of which international conflicts arise. *Money, the lenders say, must find its own level. In doing so it drags down to the lowest level the standards of living both of individuals and of nations.*

In the inflationary stage, the export of goods is rendered difficult and unprofitable, owing to the high prices and the abundance of purchasing

power in the home market. Whereas the import of goods, to correct the shortage of finished wealth, resulted from its having been handed over *gratis* to producers to sink in future production, is favoured because of the high prices in the home market, and the possibility of obtaining from abroad goods at the same price as before by the use of gold. In the deflationary stage the opposite obtains. The destruction of money and calling in of loans curtails employment and reduces the purchasing power of the community concurrently with the arrival on the market of the abundance of goods still in course of production, and there is a catastrophic fall of prices. Import from abroad is prevented and, instead, the goods that cannot be sold at home through the destruction of the medium of exchange are rushed to the ports for shipment abroad at any price they will fetch.

Money at Call and Short Notice.—In the first stage, the banker's loans are in demand at home, but in the second, having called in his internal loans, he has lending power to lend, and his revenue in the form of interest is drying up. It is at this precise moment that the demand arises for loans to finance the export trade. In this situation, therefore, the business grew up of lending money at call and on short notice to the international bankers financing the shipment of cargoes being exported and imported, on the security of these cargoes. Clearly money created for this sort of transaction, essentially transport,

can be very much more quickly recalled and destroyed than that sunk in production. By dividing the business into long term lending, and lending on call or short notice, and by increasing the ratio of the first in the inflationary period and of the second in the deflationary period, the internal bankers contrived to extract a more constant revenue by lending out the Virtual Wealth of the community, which, as regards the second source, they shared with the international bankers. Of the main items in a bank balance-sheet, on the assets side, " Money at Call and Short Notice " and " Bills Discounted " refer mainly to the international lending market, " Advances, Loans, etc." to the internal loans, and " Investments " to what the banks have bought with the money they create for themselves under open market operations.

How the International Banker Rules the World.— By alternately lending and withdrawing loans at home and withdrawing and lending them abroad, the internal and international bankers played into each others' hands, keeping the whole world in a continuous ferment, and internal price-levels always on the move. But in this sordid game the international banker soon learned that he had the whip-hand, and could absolutely control the situation and force the internal bankers to follow his lead. For by lending at any time to a country under circumstances which make it more profitable for that country to take the loan

not in the form of goods but in gold, with which to buy in a third country what the loan is really required for, he could drain the gold out of each country in turn. So he could enforce deflation and a break of prices leading to prolonged economic depression there, until its workers were reduced to a more humble and less independent frame of mind. The gold-standard became not so much a device for forcing back, after inflation, the monies of all countries adopting it, and for maintaining their constant relative exchange value, as one for forcing down wages and prices in all countries to the level of the poorest and most backward.

It will be the main purpose of this chapter to try and clarify some of the excessively complicated consequences of what is euphemistically termed banking in the international sphere. From the standpoint of the professional money-lender, and from his alone, prosperity is a curse. His trade is debt, his object its creation, and his supremacy over the creators of wealth depends on the trick that his loans being fictitious they can never be repaid. National frontiers now alone bar his world dominion, so that those too must go down.

Money is National not International Debt.—The first consideration about international economic transactions is that the money of any one country only has meaning in that country in which it is legal tender, or can be at demand converted

into legal tender, for the payment of debts. It is a debt of that country alone, or a claim on *its* marts and not upon those of another nation. For the exchange ratio to remain at any definite figure without gold flowing from one country to another, in each country the value of the sales of its own money for the other country's money must be always the same as the value of its sales of the other country's money for its own money. Thus if the par of exchange between England and Germany was, as before the War, about twenty marks to the pound, £100 can only be changed for 2,000 marks if some one else wants to change 2,000 marks for £100. If only 1,800 marks for £90 were offered, then the difference £10 can only be exchanged for marks by buying 200 marks with gold. Failing that, the 1,800 marks became worth £100 or the exchange falls from 20 marks to 18 marks to the pound.

The second consideration has to do with the exchange of goods. Here for the foreign exchange ratio not to vary and gold not to flow, any excess value of imports over exports must be balanced by the country receiving the excess (1) owing for them, that is contracting a new debt as regards the rest of the world, or (2) being already owed them and in receipt of interest payment or capital repayment for debt contracted previously by the rest of the world to it. If exports balance imports (or in so far as this may be the case) they are settled by the importer in each several

country paying the exporter of his own country in his own currency. An elaborate system of " bills of exchange ", bill-brokers, accepting houses, discount markets, etc., explained in technical works on money, enables this to be done. The technicalities, being concerned with the means by which it is done rather than the actual purpose achieved, need not here detain us.

In order to simplify the complicated question of international economic transactions, the two propositions will now be discussed more in detail. It is only outside of these simplifying propositions that complication arises. Both reduce the problem to one as between a single country and the rest of the world taken as a whole in order to avoid having to consider the innumerable cases that would arise if we considered all the countries in pairs at a time, as of course applies to the actual transactions. The discussion is concerned to distinguish the type of transaction that has no effect on the stability of the foreign exchanges from those which disturb them.

Importers Pay Exporters of their Own Nation.— The second proposition is usually taken for granted but it is well to state it precisely. It is that in any country in so far as the value of its imports is offset by the value of its exports, in its dealings with all other countries for which the same is true, the trade is really barter and does not necessarily involve any exchange of the monies of the countries at all. In each country

the importer really pays the exporter in the money of that country. The simplest case is when two countries only are concerned, for example Britain exporting herrings to the U.S.A. and the U.S.A. exporting the equivalent value of tractors to England. If the British importer of tractors pays the British exporter of herrings and the American importer of herrings pays the American exporter of tractors, each in their respective currencies, the accounts are squared.

The next most complicated case would be a triangular one with, say, equivalent values of herrings exported by Britain to Russia, of platinum by Russia to the United States, and of tractors by the latter to Britain. If we imagined each importer remitting his own money in payment of the import, Britain would have Russian, Russia would have American, and America would have British money to exchange each for its own. If one country, say Britain, took the initiative, and sent its Russian money to Russia in exchange for their American money, it could then send the latter to America in exchange for British money, and all would be satisfied. This is what in effect is done under the bill-of-exchange system. The bill-of-exchange is a sort of reversed cheque, issued by the receiver of the money and endorsed or accepted by the payer. It is in effect an I.O.U. which is exactly of the same nature as cheque money if immediately payable on demand (a " sight-draft "). But usually it is payable within

three or six months from acceptance. " Discounting " such bills means creating now the money that the acceptor of the bill will have to give up later when it falls due. This is as much a creation of money, followed by its destruction when the bill is honoured by its acceptor, as the ordinary bank " loan ". We are not, however, now concerned with this aspect, though it makes chaos of international trade relations.

The Balance of Trade.—The foregoing proposition applies to any number of countries however interlaced the exchanges of goods and services may be, so long as in each the value of the imports equals that of the exports. Or to put it the other way, international trade and commerce can only be carried on without complications, as simple barter, when this condition obtains. But if it does, then it is clear that there can be no imports without equivalent exports and instead of the interests of exporters and importers being opposed they are the same. Literally, in each country the first are paid by the second. But if one of the group of countries imports more than it exports, for example if Russia imports more herrings from Britain than are equivalent to the platinum it exports to America, it must be cut out of the group altogether. For, in the illustrative case of each importer paying the exporter in his own currency, there would not be enough American money in Russia to exchange for the Russian money in Britain. In the simplest case

the Russians would have to make up the deficit by sending gold in exchange for their money. All of this is quite simple to understand from the standpoint of money as a debt instantly repayable in goods and service on demand in the country in which it is legalized (or can at will be converted into legal tender), but entirely meaningless outside that country. The whole is an illustration of the cancellation of the mutual inter-indebtedness of nations, which modern money itself effects between individuals of one nation. The cheque system, as it operates in a single bank, is an example as between the clients of that bank, and, as extended by the Clearing House system, as between all the clients of all the banks. In every case it is only the unbalanced residuum that matters.

Effect of Loans and Repayments.—The proposition can be widened to include the case of loans, extended say from country A to country B and repaid, either interest or capital, by country B to country A. We may term the latter interest repayment and sinking fund repayments, for brevity, loan service. Then the proposition is still true if, in each country, the difference between the values of exports and imports can be accounted to loans and loan service. The former will increase exports without corresponding imports, and the latter imports without corresponding exports. Thus consider a loan from country A to country B. A in effect puts B in

possession of power to buy *in A* goods and services, and if B exercises this power A's exports to B are correspondingly increased without any corresponding imports into A from B. So with loan service, B repaying its loan, or interest on it, in effect puts A into possession of power to buy *in B* goods and services, whereby imports come into A from B unbalanced by any corresponding exports. In so far as this extended proposition applies to each nation severally of a group of nations, then still, however interlaced and various the relations between the several countries, the international traffic proceeds without any flow of gold and with no disturbance to the foreign exchanges. This is not to deny that these may still take place through other factors, such as tourists and others taking or sending money to be spent in other countries. Conversely, in so far as it is not true of any one of the nations, its transactions must be cut out from those of the group under consideration, and its accounts with the others can only be squared either by gold movements, exchange fluctuations, or other countervailing factors. If all the countries are on the gold-standard then there will be a flow of gold from those countries whose imports exceed exports into those whose exports exceed imports, reckoned in the manner as extended to include loans and loan service. If there is no gold-standard, the exchange will go against the former in favour of the latter.

The Foreign Exchanges.—It may be useful to consider a simple case of the latter. Suppose no attempt is made to affect the exchange between two countries, either by speculators or others holding foreign currencies in preference to their own, or by tariff and bounties. Then the imports and exports, apart from those paid for by loans, loan service, or other direct imports or exports of money, *must* be of equal value, whatever their relative amounts. To take the first case again, the British importer of tractors has pounds to pay the American exporter who wants dollars, and the American importer of herrings has dollars to pay the British exporter who want pounds. The exchange ratio between pounds and dollars means and is absolutely determined by how many dollars are obtainable for £1. Before anyone in England can exchange his pounds for dollars, someone in America must possess pounds to exchange and want dollars instead. The exchange of monies is pure barter applying to the two kinds of money exactly as to any two different kinds of commodities, and the exchange rate is simply the ratio between the quantities of each offered and demanded. The only difference is that normally money has a homing instinct and each kind tends to return as quickly as possible to the place of its origin, where alone it is a legal claim for wealth and can always and instantly be exchanged for it.

It is not possible in international commerce

to cross the frontier and to replace a debt for the goods and services of the one country by a debt for a similar value of goods and services of the other. The debts, that is the monies, must be exchanged, and, before anyone can change foreign money for his own kind, someone else simultaneously must want it and give up the other kind for it. It is only within the jurisdiction of one country that the banking system can create money like a conjurer producing rabbits out of a hat, and then destroy it again. People may think our bankers are singularly unprogressive in as yet not having created an international currency apart from gold, but such people are usually more concerned with their own comfort and ability to travel about from one country to another than with anything so entirely beyond their comprehension as this aspect of money. It would be but small compensation to America to have to give up on demand for international money, say, a house to a British subject, because the latter used to have a house in Britain but had exchanged it with another Briton for the money.

Gold-Standard Drags all Nations down to Level of Lowest.—The ostensible object of a number of countries uniting in making their monies convertible into gold, that is adopting the gold-standard, was simply to facilitate the accountancy between nations. For if, as in the preceding example, Russia exports less platinum to the States than Britain exported herrings to Russia,

the difference is made up by a shipment of gold from Russia to Britain, and the accounts were squared. But unfortunately in practice correct international accountancy under the gold-standard, operating with the entirely false accountancy within the nations severally, where money was arbitrarily created and destroyed at will, came to mean that each nation was in turn frustrated and brought back to the standard of living prevailing in the poorest and most backward. So long as a loan from one country to another is a loan of goods and services, and repayment is also in the form of goods and services no gold drain results. The citizens of the debtor country are empowered to indent on the marts of the creditor country in the one case, and the citizens of the creditor country on those of the debtor country in the other. No money passes the frontier.

Now it is of the nature of the case that the countries that lend are richer and more highly developed than those which borrow in the monetary sense. But it is almost equally of the nature of the case, when we use the words rich and poor in the original sense of wealth or well-being, that costs of production will tend to be higher in rich countries than in poor. At first, of course, as in the acquisitive Victorian epoch, scientific methods of production, in exposing the worker to the direct competition of the machine, cheapen these costs. It was this which

enabled Britain to become the factory of the whole world. But, as such methods become general and all nations become equipped with the same labour-saving plant, the cost of production will tend to be lowest where wages are lowest, that is in the countries where the standards of living are lowest and least protected from reduction by labour unions and ameliorative legislation, such as unemployment and health insurances.

No other considerations than these are necessary to make it clear that, though the poorer countries will borrow from the richer ones in a monetary sense, the borrowers will find it increasingly to their advantage to borrow money rather than goods and services, and to expend the money in still poorer countries where costs are lowest and the things they need are cheapest. Then arises the triangular situation, of a country A lending to another B which buys not in A but in a third country C, and pays by draining gold from A to C, precipitating in A deflation and a period of prolonged economic paralysis. Thus inevitably the gold-standard acts to keep all the world as poor as the poorest nation which competes for markets.

Effect of Freeing Foreign Exchanges.—Now let us examine this same case with the exchanges absolutely free to adjust themselves. If A lends money to B, B must take it as goods and services from A. Conversely if B repays a loan to A,

A must take it as goods and services from B, because any attempt to buy in a third country C will put the exchange at once against the country attempting to buy and make it more profitable for the buyer to avoid exchanging money and this he can do only by buying in the country from which the money is received. Under these circumstances the exchanges come nearly to reflect, as they ought to do, the relative worth of the monies, each in its own country. The par of exchange then means the relative quantities of the various monies which, each in its own country, buys the same average amount of goods and services. To be more precise, there is on the average no economic advantage in changing money at all. In so far as individuals are under the necessity of doing so and their necessities do not cancel each other, the exchange will move against the country which, on the balance, is changing its own money to pay foreign indebtedness, so making it easier for the debt to be settled directly by the transference of goods and services rather than by exchanging money at a loss.

Usually the case is argued along the lines that it is impossible to maintain both a constant internal price-level and a constant exchange ratio abroad, and that the choice has to be made between them. But the argument here is directed to show that it is quite essential to leave the exchanges free to find their own parity, when the

internal price-level has been stabilized. Let us suppose two countries in which the par of exchange reflects equal buying power of the two monies, each in its own country. So far as the argument is concerned, we may for simplicity ignore the differences of quality between the imports and exports of the one or between the exports and imports of the other country, and even suppose each country is importing exactly the same things as it exports, as indeed to some extent happens under our mad system, much to the mystification of seafaring men. Then let the one country, A, be inflated while the other, B, maintains a constant price-level, the exchanges being quite free to adjust themselves. Goods in country A are becoming dearer. This operates to check its exports and stimulate its imports. But as in both countries the importer pays the exporter of his own country in his own currency, unless the exchange rate adjusted itself, the importers in A will be paying the exporters for more goods than they have exported, while the importers in B will be paying the exporters in B for less than they have exported, which, as Euclid would say, is absurd. The device of imagining the goods imported to be the same as those exported merely makes what tends to happen clearer without essentially distorting the truth. The debts incurred by A in B, on the balance for imports in excess of exports, can only be squared by the greater quantity of A's

money in B exchanging for the lesser quantity of B's money in A, since each is useless to the exporters furnishing the goods until it is exchanged for the other. But this is exactly what has really happened, for it takes a greater quantity of B's money to buy in B the same goods as before. So far from attempting to equalize the exchange any attempt to do so is to rob Peter to pay Paul, and the more quickly the exchange turns against a country debasing its money the better for all concerned. But private speculation on the foreign exchange must be completely stopped and the exchange of national money for that of other countries must also be put under direct national supervision.

Correct Use of Gold.—Nor is there anything in all this in the least detrimental to gold being used as a convenient form of merchandise to correct purely temporary or spasmodic disturbance of the exchanges. For this, indeed, it is very well suited. But it must be regarded as a commodity and divorced altogether from its " gold-standard " function of producing by its outflow and inflow thirty-fold reductions and increases of the total quantity of money. A currency stabilized at a constant index number or price-level by increasing the total quantity of money, as increase of production puts on the markets increased quantities of goods for consumption, would still find a certain average holding of gold an advantage in stabilizing the exchanges. If another

country with money convertible into gold began to inflate, its increased imports would be paid for by outflow of gold so long as it had any, but the gold accumulating in the country exporting to it would under this system tend to be worth less, in relation to the average of other goods, than before. This itself would be an effect of the same nature as the exchange going against the country debasing its money. But, so far as concerns the country with stable money, gold is just one of the commodities it can buy abroad with, and, apart from the convenience of using it for smoothing out spasmodic exchange fluctuations, it is free to import or export just as much or as little as may be to its economic advantage.