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THE GERMAN TRANSFER PROBLEM

THE Dawes Committee divided the problem of the payment of German Reparations into two parts—into the *Budgetary* Problem of extracting the necessary sums of money out of the pockets of the German people and paying them to the account of the Agent-General, and the *Transfer* Problem of converting the German money so received into foreign currency.

As time has gone on, opinion has become even more sharply divided than it was on the question whether this dichotomy has theoretical and practical significance. The view has been widely expressed that the Transfer Problem is of quite secondary importance and that, so long as the Budgetary Problem is solved, the Transfer Problem will, in the main, solve itself. The following note is directed to a theoretical discussion of this issue.

Those who think that the Transfer Problem is secondary argue thus. The German people receives its income in return for its current output of goods and services. If an appropriate part of this income is sequestrated, there will be no buyers for a corresponding amount of goods, which will therefore be available (in addition to what would be available otherwise) to expand exports or in diminution of imports. Since not all the consumption of goods and services, which the German people are compelled to forgo, is suitable for export, there will have to be a certain amount of change-over in the character of production. There is, however, no reason to suppose that ordinary economic forces will not bring this about within a reasonable space of time. Thus—according to this school—the real question is, how much cash can the German Government raise by sound financial methods and pay over to the Agent-General. Once this is settled, we can be sure that a way will be found of looking after the Transfer Problem.

Now I do not doubt that there are sets of premisses from which this conclusion follows. For example, there is one very simple set from which it obviously follows. For let us suppose that the German factors of production produce nothing but exports and consume nothing but imports; in this case it is evident that there is only a Budgetary Problem and no Transfer Problem;—or rather the Transfer Problem is removed from the shoulders of Germany and becomes a problem as between the recipients of reparation and the countries from which Germany previously drew her imports.

But, on the other hand, if we suppose that Germany is already exporting all the goods which she has facilities for producing on any terms on which the rest of the world will buy them—suppose, for example, that, not so unlike Russia to-day, her exports are limited to caviare and platinum, of which the output cannot be increased—then the Transfer Problem is paramount and, indeed, insoluble. Or, again, let us suppose that, whilst, as before, Germany's exports are limited to caviare and platinum, she is, this time, in a position to increase their output, but unfortunately the demand of the rest of the world for these articles has an elasticity of less than unity. In this case the more she exports, the smaller will be the aggregate proceeds. Again the Transfer Problem will be a hopeless business.

The first question to consider is, therefore, a question of fact—whereabouts between the two extremes exemplified above is present-day Germany situated? In other words, our first question is, whether there exists an ideal distribution of Germany's factors of production as between different uses which, if it could be arranged, would solve the Transfer Problem?

When this question has been dealt with, there remains a second question,—How completely and by what train of causation is the machinery of the Dawes scheme capable of bringing about this ideal distribution?

I

(1) If £1 is taken from you and given to me and I choose to increase my consumption of precisely the same goods as those of which you are compelled to diminish yours, there is no Transfer Problem. Those who minimise the question of transfer seem sometimes to imply that the above is a fair representation of the present facts. To the extent that high taxation causes German consumers to buy less foreign goods, it is a fair representation. But clearly only a proportion of their abstention from consuming will be in respect of foreign goods, and, so far as one can judge at present, not a very large proportion. Moreover, the German balance of trade *already* has most of the benefit

of this, inasmuch as individual Germans are already paying enough, or nearly enough, taxes to solve the Budgetary Problem, and are, therefore, already reducing their personal consumption to the requisite extent.

(2) For the last two or three years the Transfer Problem has been temporarily solved by Germany borrowing abroad for capital purposes at home, cash which she does not bring home in the shape of imports. She has been using this cash to buy back from the Agent-General the proceeds of taxes paid over to him, out of which she then pays the wages of German workmen employed on capital improvements within Germany. Clearly this process of borrowing from abroad cannot go on indefinitely. When it comes to an end, it will be necessary to divert the labour which it now employs to producing for export.

Thus it will not be—in the main—a question of reducing German consumption. In so far as the Budgetary Problem has been already solved, the necessary reduction of consumption is already effective. When the foreign borrowing comes to an end, it will be a question, not of reducing current consumption in Germany, but of transferring labour from capital works in Germany to the export trades. Only in so far as additional savings within Germany take the place in future of foreign loans will there be any surplus of resources which were previously directed to supplying German consumers. On the other hand, where the output of capital improvements, financed by foreign loans is not in an exportable form (and much of it will not be in such a form), the diversion of production out of other employments into the export trades (or to produce goods previously imported) will have to be on a greater scale than is required by the payment of Reparations alone, since it will be necessary to provide also for the interest on the foreign loans.

(3) I conclude, therefore, that the solution of the Transfer Problem must come about, in the main, not by the release to foreign consumers of goods now consumed by Germans (*e.g.* wheat, sugar, cotton), but by the diversion of German factors of production from other employments into the export industries.[1]

(4) Now, what prevents Germany from having a greater volume of exports at the present time? Is it that the export trades cannot attract more labour at the present level of remuneration? Or is it that they cannot sell an increased output at a profit unless they can first reduce their costs of production? The available facts seem to indicate that the first, namely, inadequate

[1] For brevity, I include in these in what follows the production of goods previously imported.

supplies of labour at the present rates of remuneration, plays little or no part, and that the second is the real explanation.

That is to say, the solution of the Transfer Problem requires a reduction of German gold-costs of production relatively to such costs elsewhere. There are three ways of bringing this about. Either German industrialists must increase their efficiency faster than industrialists elsewhere; or the rate of interest in Germany must be lower than elsewhere; or the gold-rates of efficiency-wages must be reduced compared with elsewhere. Since German industrialists are reputed to be already at a fairly high level of efficiency relatively to those of other countries, I do not know why we should assume that they will outstrip us yet further. For it is not enough that they should increase their efficiency (that they will doubtless do); they must increase it faster than others increase their efficiency. Nor is there any prospect of relatively cheap money for Germany; though there may be some future gain from a fall of German interest rates below their present high level. It follows that the Transfer Problem requires a reduction in the present gold-rates of efficiency-wages in Germany relatively to efficiency-wages elsewhere.

That is the first point to establish. The expenditure of the German people must be reduced, *not only* by the amount of the reparation-taxes which they must pay out of their earnings, but also by a reduction in their gold-rate of earnings below what they would otherwise be. That is to say, there are two problems, and not—as those maintain who belittle the difficulties of transfer—one problem. Indeed, a short way of putting the case is this. The *Transfer* Problem consists in reducing the gold-rate of efficiency-earnings of the German factors of production sufficiently to enable them to increase their exports to an adequate aggregate total; the *Budgetary* Problem consists in extracting out of these reduced money-earnings a sufficient amount of reparation-taxes. The *Budgetary* Problem depends on the wealth and prosperity of the German people; the *Transfer* Problem on the competitive position of her industries on the international market.

(5) If x is the percentage by which German efficiency-wages in terms of gold have to be reduced in order to develop an excess of exports sufficient to pay for Reparations, x—we may say—is the measure of the gravity of the Transfer Problem.

So far we have no experience to guide us as to the value of x. Nor shall we, so long as the Reparations payments are provided by borrowing abroad. It is quite certain that this must come to an end some day. But when, no one can say. Meanwhile the new Committee, now sitting in Paris, has very little more evidence to guide it as to the value of x than the Dawes Committee had five years ago.

In round figures German exports (including deliveries in kind) now stand at about £600,000,000 per annum. It looks—again in round figures—as if their excess over imports would have to increase by about £150,000,000 (perhaps even by £200,000,000) in order to balance the account without borrowing. Since German industry is largely dependent upon foreign sources for raw materials, this means a still larger increase in the gross figure of exports. The Agent-General concludes that Germany must look mainly to an increase in her exports of finished goods, which came to a total of £434,000,000 last year. Very roughly, therefore, Germany has to increase the value of her exports of finished goods by (say) 40 per cent. It is a formidable task.

Now, a reduction in the money-rate of efficiency-wages does not help her, and may injure her, in the following cases:

(i) Where the output, *e.g.* personal services or buildings, cannot be exported anyhow;

(ii) Where the world's demand for Germany's goods has an elasticity of less than unity, *i.e.* where a reduction in price stimulates demand less than in proportion, so that the greater quantity sells for a less aggregate sum;

(iii) Where Germany's foreign competitors fight to retain their present trade connections by reducing their own rates of wages *pari passu*;

(iv) Where Germany's foreign customers, reluctant to allow this more intensive competition with their home producers, meet it by raising their tariffs.

Moreover, if a reduction in price of 10 per cent. stimulates the volume of trade by 20 per cent., this does not increase the value of the exports by 20 per cent., but only by 8 per cent. ($1{\cdot}20 \times 90 = 108$).

Two points should be noted in passing. The reduction in real wages would be by no means so large as the reduction in money-wages, since the prices of home-goods for home consumption might be expected to fall.[1] It does not follow, however, that it would be any the easier to reduce money-wages, as we have found in this country in the last four years. On the other hand, such reduction in real wages as does occur may reduce efficiency, in which case a still greater reduction in money-wages per head would be necessary to secure a given reduction in efficiency-wages.

[1] For the reverse phenomenon see the figures quoted on the next page, from which it appears that the recent increase in money-wages has caused the cost of living to rise by more than half the amount of the increase in money-wages.

In the light of these considerations, what reduction in the money-rates of German wages will be required to increase German exports of finished goods by 40 per cent.? I do not venture to guess—except that I should expect it to be substantial. Only those who believe that the foreign demand for German exports is very elastic, so that a trifling reduction in German prices will do what is required, are justified in holding that the Transfer Problem is of no great significance apart from the Budgetary Problem.

My own view is that at a given time the economic structure of a country, in relation to the economic structures of its neighbours, permits of a certain "natural" level of exports, and that arbitrarily to effect a material alteration of this level by deliberate devices is extremely difficult. Historically, the volume of foreign investment has tended, I think, to adjust itself—at least to a certain extent—to the balance of trade, rather than the other way round, the former being the sensitive and the latter the insensitive factor. In the case of German Reparations, on the other hand, we are trying to fix the volume of foreign remittance and compel the balance of trade to adjust itself thereto. Those who see no difficulty in this—like those who saw no difficulty in Great Britain's return to the gold standard—are applying the theory of liquids to what is, if not a solid, at least a sticky mass with strong internal resistances.

Meanwhile—so far from a start having been made in reducing wages—the breathing space allowed by foreign borrowing has weakened Germany's competitive position by allowing German wages to rise again from the very depressed position which they occupied in 1924 after the Great Inflation. Mr. Parker Gilbert reckons that money-wages in Germany have risen by 40 per cent. since 1924 and real wages by 23 per cent., with the result that real-wages are now estimated at 8 per cent. higher than they were before the war.

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Thus the Transfer Problem involves a reduction of x per cent. in the rates of gold-wages in Germany relatively to rates elsewhere, the value of x being determined by the factors outlined above. The next question is—How does the Dawes scheme propose to bring about this reduction of wages? The answer is that it makes almost no contribution to the solution of this problem.

The easiest method would be to allow the exchange value of the German mark to fall by the amount required to give the necessary bounty to exports and then to resist any agitation to raise money-wages. But it is precisely this method which the Dawes scheme's device of "transfer protection" expressly forbids. Nor—as I read the Dawes scheme—is there any compulsory deflation when the "transfer protection" comes into play and the proceeds of the reparation-taxes accumulate within Germany, since these proceeds are to be invested in the short-loan market.

If, however, we suppose that, by agreement with the Reichsbank, deflation is enforced, how will this help? Only if, by curtailing the activity of business, it throws men out of work, so that, when a sufficient number of millions are out of work, they will then accept the requisite reduction of their money-wages. Whether this is politically and humanly feasible is another matter. Moreover, an attempt by foreign financiers to withdraw some part of their vast short-term loans to the German Money Market, estimated at £300,000,000, might be a by-product of a violent political and economic struggle aimed at the reduction of wages in the interests of foreign creditors.

The comfort of Germany's position under the Dawes scheme is this. The surplus, furnished by exports and foreign loans, will be duly remitted up to the amount of the annuity. But if in any year exports and foreign loans fail to furnish a sufficient surplus—and the mere fact that the annuity has been collected by taxation is no guarantee whatever that this surplus will be sufficient—then the Dawes scheme provides no effective means of pressure to increase the surplus. One may assume, therefore, that the German Government will be extraordinarily reluctant to forgo "transfer protection"—at any rate until there is more evidence than exists at present as to the amount of the surplus which exports left to themselves are likely to furnish.

But the retention of "transfer protection" may be desirable from other points of view than Germany's. Addressing the shareholders of Barclay's Bank last January, Mr. F. C. Goodenough said:—"It will be of great importance that the amount to be fixed should be not only acceptable to the Allies, but such as will obviate, as far as possible, forcing Germany into excessive industrial competition with the rest of the world through compelling her people to accept too low a standard of living." If Mr. Goodenough is right, some measure of "transfer protection" should be retained.

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