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Capital Investments and Trade Balances

How Loans Abroad Affect Course of Trade — Other Invisible Factors Entering Into a Nation's Financial Balance Sheet — Illustrations from Debtor and Creditor Countries—Effects of the War on United Kingdom, United States and Other Countries

By THEODORE H. BOGGS

IT has long been recognized by students of world commerce that there is a close relation between foreign trade and foreign investments of capital. With the close of the world war, however, this relationship has come to enjoy a wider recognition. Many have become persuaded of the truth of this principle when confronted by the prospect of altered conditions in the foreign trade of their own country, the changes coming in large part as a result of the vast lending and borrowing operations of the war. We are beginning to see, as perhaps never before, that the foreign investment of capital brings in its wake many trade consequences. The popular notion that "trade follows the flag," may be paraphrased to fit the case more accurately by saying that trade follows the dollar.

This important principle, that finance is a pioneer of trade, may be supported by evidence drawn from the experience of Great Britain. Although her pre-eminence in international trade has been powerfully furthered, it is true, by her merchant marine and extensive colonial empire, yet, in the final analysis, we shall find the principal key to her commercial supremacy in the vastness of her overseas investments. British capital invested abroad has been variously estimated as amounting in 1914 to \$15,000,000,000 to \$20,000,000,000. While functioning as a great silent factor, it none the less has served effectively to insure both imports of raw material for her industries and foreign markets for her exports. Commenting on this general principle, Sir George Paish declared, in 1909, that "the investment in the last sixty years of about £2,500,000,000 of British capital has occurred simultaneously with a vast growth of British trade and prosperity, and in my opinion this growth of our trade and prosperity is largely the result of our investment of capital in other countries."¹

Both the volume of a nation's foreign trade and the nature of its trade balance are alike affected by the international flow of capital. Generally speaking, the trade balance reflects the net position of a country as a lender of capital for overseas investment or as a borrower of foreign capital for domestic investment. This principle applies equally to countries with an excess of imports, such as the United Kingdom, France and Germany, and to those with an excess of exports, such as the United States and India. Moreover, as is at once obvious, a nation's trade balance may in time undergo a transition to conform to changes which may appear in its position as a lender or a borrower of capital.

As generally used the term trade balance is applied to a country's foreign trade in merchandise. It is used for the purpose of indicating the excess value of the merchandise exports over merchandise imports or the excess value of such imports over exports. In financial circles the term is employed to denote the condition of foreign trade which

enables a country to import supplies of the precious metals, or the reverse condition, which necessitates the exportation of the same.

Through the modern development of commerce and international banking we have learned to recognize the fallacy inherent in the "Mercantile Doctrine" so widely accepted during the sixteenth, seventeenth and eighteenth centuries. It was then believed that a country must secure a favorable balance of trade, a balance, that is to say, of merchandise exports over imports, if it would escape the ruinous consequence of having its stock of the precious metals totally drained away. To the statesmen and financiers of that time it was accordingly a matter of supreme concern to attain and retain a balance of exports over imports. Much legislation therefore was passed for the purpose of restricting imports and stimulating exports.

In modern times we have come to see, as Sir George Paish has pointed out: "That a nation could under certain circumstances purchase goods of a greater aggregate value than it exported, without sustaining any drain upon its stock of the precious metals or suffering any inconvenience whatsoever; and in recent time no one has paid any great amount of attention to the question of the trade balance, other than for the purpose of ascertaining the factors which caused the imports of certain countries largely to exceed their exports, or of discovering the reason for the exports of certain countries largely exceeding their imports." It is now recognized that a nation's foreign trade will adjust itself more or less quickly to the needs of that country, and that under normal conditions the effect of some disturbing factor which may reduce temporarily its exporting ability may be counteracted by financial operations in the international money markets. Thus, save under the stress of some abnormal influence on the scale of the European war, no apprehension need be felt that an excessive drain can occur of the precious metals.

Yet evidence still abounds that the dictum of Sir Robert Giffen that "the 'balance of trade' and 'the excess of imports over exports' are pitfalls for the amateur and unwary," has lost little of its pertinency. Recognizing alike the plausibility and widespread popular acceptance of the "favorable balance" doctrine and its relation to conditions of trade, let us consider first the general underlying principles. Later, for the purpose of illustration, we shall turn to the trade balances of the United Kingdom and the United States.

Generally speaking, those countries of the world which have an excess of merchandise imports over merchandise exports are the capital-lending countries, whereas those whose exports exceed imports are the borrowing countries. This is so, because the lending country must secure payment, in the guise of imports, not only for its merchandise exports, but also for the interest upon its capital invested abroad in earlier years. Similarly, if we exclude other factors from consideration, the capital-borrowing country must export more goods than it imports in order to offset the merchandise

¹ Paish, Great Britain's Capital Investments in Other Lands, Journal of Royal Statistical Society, September, 1909.