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JAS. J. SALMOND
President and General Manager

FRED. W. FIELD
Editor

A. E. JENNINGS
Assistant General Manager

How Germany Has Financed the War

All Paper Money Required Has Been Raised, Regardless of Inflation —Arrangements for Rectifying Finances Left Until After the War —Sir Edward H. Holden, Chairman of the London City and Midland Bank, Gives Details of the Methods by Which the Teutons Have Expanded Currency to Meet the Increasing Demands

WHAT is the financial position of Germany as the country enters on the second half of the fourth year of the world war? Whence come the funds for the war loans which have followed one another at half-yearly intervals, in March and September, ever since the fall of 1914? How, with little and decreasing assistance from outside, has the nation financed itself through the period that saw the Allies turn to the United States for replenishment of their money bags? And what is to be Germany's position when the war ends: Will the country be solvent or bankrupt?

Sir Edward H. Holden, chairman of the London City and Midland Bank, Limited, of England, has answered some of these questions in his report for the last year to the shareholders of his bank. From a comparison of the balance sheets of the Reichsbank for July 23, 1914, just before the start of war, and for December 31, 1917, Sir Edward shows that the ratio of gold held by the bank to notes issued fell in three years and a half from 71.7 per cent. to 20.9 per cent.; the ratio of gold to liabilities (notes issued and credit accounts) from 47.8 per cent. to 12.3 per cent.; the ratio of cash balance to notes from 95 per cent. to 34 per cent., and the ratio of cash balance to liabilities from 63.4 per cent. to 20 per cent.

Only by the device of creating banks privileged to make loans by issuing notes which the Reichsbank was empowered to include in its cash balance was this last item of relation of cash balance to liabilities kept from a worse showing. Without the addition of these so-called Darlehnskassen notes the ratio for December would have fallen to 13.3 per cent. The device was one of Germany's first provisions to adjust her banking facilities to the demands of the war and Sir Edward discusses this, and other preparations in detail. After stating that before the war began Germany had thoroughly prepared the financial lines on which to proceed, he continues:—

"Two decisions appear to have been reached: First—To raise all the paper money she required, regardless of inflation, through the Reichsbank, *i.e.*, the National Bank of Germany, and, in case this proved insufficient, through the loan banks. Second—To leave all arrangements for rectifying her finances until after the war. Let us see how she has manufactured her paper money through the Reichsbank, and in explaining this I repeat two principles which I laid down last year—(1) Every bank is a manufactory of credit, and (2) when a bank makes a loan or discounts bills it creates a credit account or issues notes. You will find the loan or bill on the asset side of the balance sheet and the credit account or notes issued on the liability side. Loans are made by the Reichsbank by discounting bills and to a small extent in other ways, but it is only against bills discounted and the cash balance as cover that notes can be issued, and, further, the amount of the notes issued must never exceed three times the cash balance. Thus, the law, by making these conditions, controls the issue of notes, but there is no legal control over the creation of credit balances, which may be increased to any extent.

"When the war broke out, the German banking law was that the cash balance of the Reichsbank must be equal to at least one-third of the notes issued and that the bank must hold bills of exchange equal to the remaining two-thirds; these bills of exchange were to fall due within three months and to bear three names, except in special cases, when only two names were required. The ordinary government treasury bill was not a bill of exchange within the meaning of the law, and was not regarded as 'bank cover' for notes issued. It was anticipated by the government that, as the war progressed, the inland bills would be diminished by reason of transactions being settled in cash, and the foreign bills would also be diminished by reason of the imports and exports being curtailed. The government also recognized that they would be compelled to obtain large supplies of notes from the Reichsbank, and that it would be necessary to provide large amounts of bills of exchange as 'bank cover' for these notes. They, therefore, obtained authority by a law of August 4, 1914, to raise the necessary funds by issuing bills of exchange of the empire or treasury bills, and it was further provided that these treasury bills bearing the signatures of two members of the National Debt Office should be regarded as bills of exchange within the meaning of Section 17 of the Act of 1875, provided they matured within three months; that is to say, after being discounted at the Reichsbank they were to be regarded as 'bank cover' for Reichsbank notes. We thus see how they overcame their first great difficulty of providing 'bank cover' for an increased note issue, because as the treasury bills discounted increased, so the power to issue the banknotes increased.

"Their second difficulty was the cash balance itself. They could not continue to issue notes unless they continued to increase the cash balance. This cash balance