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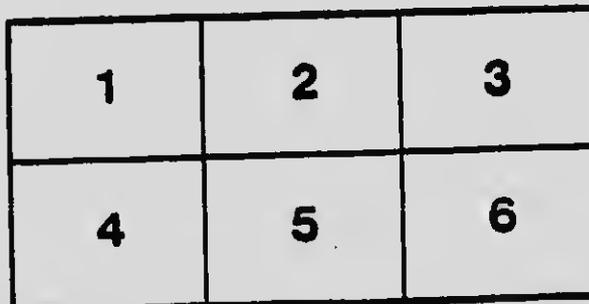
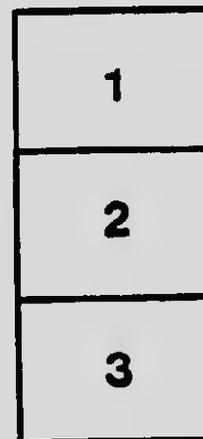
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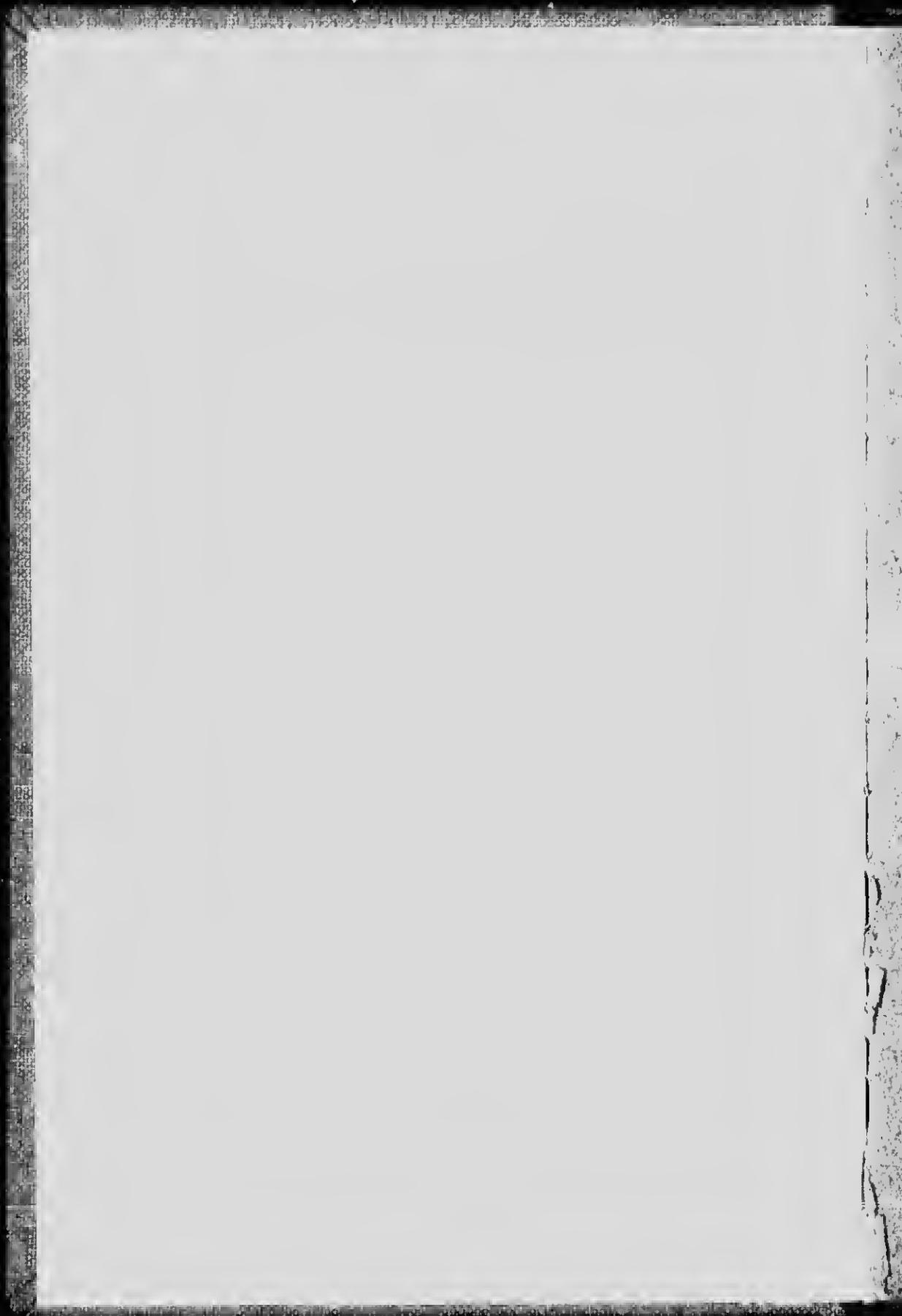
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THE WAR AND FINANCE

ADDRESS

BY

SIR EDMUND WALKER, C.V.O.

Delivered at Toronto, 16th March, 1915.

THE WAR AND FINANCE

By Finance, I do not mean the finance of the war, but the science of monetary affairs generally. A better title might be "The Effect of the War upon Credit," because in the main all finance depends upon credit.

Credit is one of the very greatest accomplishments of civilization—not merely because of its amazing effect upon the material prosperity of those who have fully developed it, as compared with those who have not, but in its uplifting effect upon society.

This willingness to put such trust in another that we part with enormous sums of money or of merchandise even when the scrap of paper received in exchange is only a telegraphic message in code words, and is consequently without the signature of the party we trust, demonstrates such an advanced state of civilization that it seems to be at the furthest possible extremity from War, and so it actually is. When we consider the progress made in the western world, both in our social conditions and in our material prosperity, we are apt to be satisfied by recognizing political and physical reasons alone for this vast change. The growth of personal liberty, the use of steam and electricity, the protection of inventions by patents, the development of transportation on land and sea, and many other reasons, at once arise in our minds to account for the change, but all these would have been of little avail if they had not been accompanied by a corresponding growth in those relations between man which render possible the power of Credit. As society evolved from simple to complex conditions the interdependencies of small communities became interdependencies of a nation, and finally of the world as a whole, and of all the interdependencies existing among the nations of the world, none is so complex, so vital, and formed of such delicate machinery, as credit.

I am sure it is not necessary for me to enlarge upon this, but at the risk of wearying my audience I should like to present a few of the many forms in which the credit machinery of the world is so vital to society. I do not need to describe the working of a great Canadian bank where within its own branches one credit transaction is so balanced against another as to avoid the use of actual money except to a trifling percentage, or the working of bank clearing houses which perform the same function as between the different banks, or the working of stock and merchandise exchanges where credit transactions are as far as possible balanced in order to lessen the work of the banks. You have often been told that in North America 90 to 95 per cent. of the transactions in business are settled by cheque or by some credit instrument other than bank currency, which is itself a credit instrument, and while gold is practically the basis of all the transactions it is scarcely used at all. It might, however, interest you to follow such an international use of credit as that involved in moving products grown in America to their ultimate point of consumption in Europe. The cotton crop of the Southern States is worth annually seven or eight hundred millions of dollars—often, indeed, more than this. A very large part of it is sold in Europe, and the financing of the crop is one of the main financial features in the United States each year. Yet this great crop, so far as payment is concerned, is moved from the hands of the planter in America to the spinner in Europe or elsewhere entirely by instruments of credit. At the primary market the coloured farmer with a single bale to sell is probably paid by a credit on the books of the shopkeeper who gives him his supplies, and the larger planters are paid as a rule by cheques, a much larger percentage of bank currency, however, being required at this time of the year than at others. All, however, are paid by credit instruments. The cotton buyer at this primary point ships the cotton, say, to New Orleans and draws through his bank for the value of the commodity. The dealer in New Orleans sells the cotton to a spinner in Europe and pays the draft of the buyer at the

primary point by drawing on a correspondent in New York and by sending to him a bill of exchange on the cotton spinner in Europe or in most cases on a bank named by the latter. The New York correspondent pays the New Orleans draft by selling the bill on Europe, which usually means London, and thus the cotton has been financed out of America. The bill of exchange on the London banker has been drawn payable sixty days after sight, so that the cotton spinner has seventy or seventy-five days in which to receive the cotton before paying for it. We need not follow the various processes of credit until the articles manufactured from the cotton fabric have been sold to the public. If we turn to Egypt and witness the purchase of the cotton crop there we can see at once the advantage of a perfect credit system. The Egyptian farmer does not understand credit, he has not had occasion to put absolute trust in scraps of paper, and in the main he likes to get gold when he parts with his cotton. Thus sovereigns in large quantities have to be sent every year to Egypt to buy the cotton and to a very troublesome degree they do not come back. The profit on the American cotton crop made by each individual concerned merely takes the form of a credit in a bank or on the books of a merchant, and when any actual money is desired, bank currency is used, so that practically no gold is disturbed in the operation. In Egypt some gold disappears from circulation each year.

As the reverse of such operations, if an importer in North America desires to buy raw sugar, hemp, tin, drugs, oriental or European manufactures, he does not send money to effect such purchases, but sends a banker's letter of credit or instructs the seller to draw a bill of exchange on him or on a bank, usually in London, again depending purely on instruments of credit.

I do not need to remind you that even travellers no longer carry actual money to any extent, but depend upon letters of credit, now so adapted to their comfort that often hotel bills in remote places in Europe can be paid by a scrap of paper written in Canada. To give you some conception of the extent of such arrangements for the transfer of money for travellers or for ordinary business, I may mention that one bank in Canada has

correspondents for this purpose in 9,770 towns and cities throughout the world, and through these is connected less directly with other towns and cities making a total of 17,440 banking correspondents. In addition to these banks it has arrangements with innumerable hotels, railway companies and steamship lines throughout the world by which travellers' cheques are taken in payment of accounts. The bank correspondents cover Europe, Asia, Africa, America and Australasia, including in the case of Europe 27 different countries. It is true that more than half of these correspondents are in Great Britain, the United States and Canada, but the large figures still remaining will give you some idea of the number of correspondents in countries where English is not spoken.

This was the sort of credit machinery lacing the world together in both vast and intricate design which was suddenly stopped in the last days of July and the first days of August. It might be thought that the machinery existed as innumerable units each one working independently of the other, but as a matter of fact these were either directly or indirectly connected with the great power house of London. They might fall to pieces, even if the power house in London remained intact, they certainly must fall to pieces if anything happened to the power house. In London, where the world's credit was mainly centred, the storm caused by the first hint of war would have to be chiefly borne, and in a few days this actually reached a magnitude of panic and disturbance which made it clearly necessary for some unusual steps to be taken. Even before this, in anticipation of Austria's declaration of war on Servia, people were selling securities, especially for Continental account, while banks were husbanding their resources and forcing the discount market to turn to the Bank of England. This caused the bank rate to rise on 31st July from $3\frac{1}{2}$ to 4%, then to 8%, and on 1st August to 10%. On the 31st July the avalanche of securities was such that the London Stock Exchange closed its doors, soon to be followed by every stock and merchandise exchange in the world.

It was now impossible to discount bills, to sell securities

or to transfer money from one place or country to another, either by a cable transfer or by draft. It was estimated that there were afloat in London acceptances by bankers and wealthy merchants of drafts drawn on them from all parts of the world, representing the commerce of the seas and the finance of many countries, amounting to about £350,000,000 sterling. How under such circumstances could these be met? What would happen to the banks and others whose money was lent upon these bills, or by call or short loans, through the liquidation of which they kept their reserves in sound shape? To avert widespread ruin the Government on Saturday, 2nd August, proclaimed a moratorium for bills of exchange. Monday was fortunately a bank holiday, but an extended holiday until 7th August was made in order to enable a consideration of the whole financial situation to take place. The fate, not alone of London, but of the world, was at stake. A general moratorium for one month was proclaimed. Of this all could take advantage and therefore runs upon banks were practically impossible, but the banks placed no restrictions upon withdrawals when these were for business purposes. They only sought to prevent the hoarding of gold. The Government passed the Currency Act under which £1 and 10 shilling paper notes were created, convertible into gold at the Bank of England, but calculated to drive the golden sovereigns and half sovereigns into the hands of the Bank, where they might be very necessary before the war was over. The Government undertook to lend this paper money to the banks up to 20 per cent. of their deposits, and thus when the banks opened on the 7th some financial machinery existed for the transaction of business. Many other wonderful things had been done, such as the war risk insurance, but I am only touching upon finance.

Business, however, did not respond quickly. The shock had been too great. When the thirty days' moratorium expired how many would be able to pay their acceptances? Would the foreign banks, especially the banks of belligerent countries, be able to pay? How could we discount new bills freely if we were uncertain about our large holdings of these postponed

bills? To meet this difficulty, on the 12th August the Government authorized the Bank of England to discount without recourse to the holder approved bills which had been accepted before 4th August. This meant that a bank or any other holder of a bill of exchange, accepted before the war, could, provided at the outbreak of the war the acceptor was in good standing, obtain the value of the bill of exchange and be relieved of all responsibility if for any reason the acceptor could not eventually pay. And we must presume that for all such failures to pay, and they must be very many, the British Government will as a matter of public policy bear the entire loss.

On the 1st September the general moratorium was extended until 4th November, but it was expected that as far as possible acceptors would now begin to take up their bills. In this connection as a natural sequence to the action of the 12th August, the Government authorized the Bank of England to lend to acceptors, where necessary, the funds with which to retire their bills extended by the moratorium, the bank to wait until one year after the close of the war for repayment. This still left unprovided for the acceptances of the London branches of alien enemy banks, and on 16th October arrangements were made by which the British Liquidator was able to pay those in full. Early in November steps were taken by the Government to enable the Stock Exchange to do a limited business, to assist British traders to finance export business and to carry debts owing for such, and to enable the Liverpool Cotton Exchange to reopen for business.

Some of these are astonishing actions for any Government. They sound like the last word in autocracy, but perhaps they are the last word in democracy. The Chancellor of the Exchequer said by way of explanation: "There is no doubt that we have, I will not say, departed from any principles which have been accepted in this country, but that we have undertaken responsibilities which no Government has ever been called upon to undertake in the past." The man in the street is not so slow to understand if the event is large enough

and simple enough in scope, and political opponents were stilled by the vastness of the issues at stake. Thus measures which seem curiously novel were judged mainly by what they accomplished, and this, as was almost universally evident, was immeasurable good. It is not too much to say that Great Britain saved at least the whole Western world from financial ruin by her prompt and highly intelligent actions.

I need hardly remind you of the action taken in Canada. Our affairs are small compared with those of the great financial powers, but our gold supply is as important to us as that of Great Britain or Germany is to them. It was necessary to prevent the hoarding of gold and also to prevent the lack of currency with which to do business. Practically within twenty-four hours the Minister of Finance had made the following arrangements :

(1) For the first time in the history of Canada, banks were empowered to pay their debts in their own notes. When these notes reached the clearing house, however, they were redeemed in Government legal tenders or in gold. The notes were not, as many people suppose, made a legal tender as between individuals, and the main object of this arrangement was to prevent people from securing actual gold coin in order to hoard it, a process which would have been ruinous to the nation as a whole, although comforting to the individual who secured the gold.

(2) The banks would have been able, under the Bank Act, to issue the usual emergency circulation for crop-moving in September, and this date was set back to August.

(3) The Government raised somewhat the limit for that part of its legal tender issues which is not entirely based on gold.

(4) The Government undertook to make loans to banks on approved security in order to aid them in carrying on the business of the country.

At the moment when these measures were put into force no Canadian bank having either cash or call loans in either London or New York could use a dollar of these resources to pay debts in Canada. If a cargo of grain were sold by a Canadian shipper to England, he could only obtain payment by

selling the bill of exchange in New York. For this bill he could only obtain a credit in the New York clearing house, and how could he pay the Canadian farmer for his grain with this? But the measures of relief set in force by Great Britain and by Canada, the ending of the British moratorium, the partial resumption of operations by stock and merchandise exchanges, and more than all, the conviction that Great Britain is still mistress of the seas, with its effect on war insurance rates, have gradually made a considerable volume of business possible.

The intricate machinery for the world's credit which I have described had been smashed almost completely, and among the great acts of statesmanship to be recorded in history will be placed in letters of gold the wonderful steps so promptly taken to re-establish that machinery at least between the neutral nations of the world.

Meantime the shadow of the greatest war in the history of the world hangs over us, and we can only with much difficulty turn our minds from it to those ordinary features of life which must be encountered whether we wish or not. How do we in Canada carry on our affairs despite the war? That country is best able to stand the effects of war, whether it be a helligerent or only a neutral country indirectly affected, which is what we may call self-contained. Mexico in the days of Diaz was self-contained. Its exports exceeded its imports, and it had very little public debt. But it was a very backward country and had not the disposition to incur debt in order to enable enterprise to progress. Canada has been the very reverse. We have been so eager to plan for the future that when the fiscal year of the Dominion ended in March, 1913, we found that we had bought abroad 300 millions of dollars worth of goods more than we had sold, and in addition we had about 125 millions to pay for interest on money borrowed to pay previous deficiencies of a like kind. We were able to meet this as usual by selling securities in Great Britain, but a world wide contraction was setting in and clearly the expansion of Canada had reached its limit for the moment. It is indeed fortunate for the world that a period of fierce contraction in all

financial markets preceded the war. By March, 1914, we had brought our debit balance in foreign trade down from 300 millions to about 170 millions, and in a few months the war came, acting as a much more violent adjuster than a mere period of ordinary business contraction.

Imports must now fall very much, some exports also, but in many articles exports will increase in volume and value, while new exports in war material will be of great assistance. Our war expenditure is all arranged in England, and since much of the money is spent in this country the effect is the same as in the case of any other sale of securities. The outstanding fact, however, is that, whatever our deficiency may be in each year, we have always paid it by selling securities almost entirely in Great Britain. Since the war began, and doubtless as long as it lasts, this market is and will be almost completely closed to us.

It was this fact which made the prospect so very serious for Canada during the first few months of the war. If we could not sell any securities, how could we pay our way internationally? Should we have to declare a general moratorium and thus ruin our fine credit for the moment? Our international debtor in the end always meant the United States. It was the excess of our purchases from them over their purchases from us that gave us anxiety. They were really the people who should buy our securities, and not Great Britain. Would they do so? Well, happily, this new market for our securities is growing satisfactorily, and with all the other favourable features I have mentioned we can see our way, provided there is no slackening in our determination as individuals to do everything, whether disagreeable or not, which is necessary to lessen our debts to outsiders.

Every dollar's worth of merchandise imported which could be made at home, or which could be avoided as an expenditure altogether, is a sin against Canada at this moment. We cannot live precisely by such a severe principle, but so far as we do we are helping to win the great battle. Every extra dollar's worth of produce raised on every farm or plot of ground,

every dollar's worth added by better labour or other economy to the product of every factory, every dollar's worth of food or any produce released for export by being saved in the economy of the household, is so much towards winning the great battle. I do not mean that wealthy people should so change their scale of living as to lessen the need for employing so many servants, indeed, every man must decide as to his own duty, but I do wish to point out that a man who is perfectly able to pay for any foreign object he may desire to buy may have a distinct duty to perform to Canada in not indulging his power to buy, laudable as that may be at another time.

Let us hope, then, that our faces are set as to a few things, and that until the curtain falls on the great drama in Europe we shall not relax.

1. We shall not build anything or buy anything which is not in a high degree necessary for the immediate good of Canada. That does not mean that we shall not do a good deal in finishing what we have begun, in building roads, and in many improvements the wisdom of which is beyond question.
2. We shall avoid as far as possible that waste in every physical aspect of life which characterizes the habits of almost all people in North America. If for the moment we could even approach the economy of the people of Europe, we could easily withstand any financial pressure that could be imagined.
3. While we spend so warily, we shall, as the result of unusual industry, greater intelligence and longer hours of application, produce a larger amount of new wealth than ever before.

We shall indeed be surprised if our next crop of cereals does not create a debt-paying power largely beyond anything we have ever known. We shall, however, be thankful enough for any good luck. There are thousands in Canada, as in other countries, out of work, even after tens of thousands have gone with our contingents; we are more busy with army contracts

than with useful industries; we are bending our backs to taxation for the cost of war which our children must bear for many a year to come; we open our eyes in the morning only to think first of what our newspapers may say about the war; we are indeed so conscious of living amidst the greatest historic events of all time, that I frankly apologize for giving so much consideration to matters concerning our material welfare. And yet, do not let us misunderstand the meaning of our efforts.

We are a part of that great empire which, with the help of her allies, has determined to crush the enemy of all that we cherish in the civilization of the world, and every good deed done in Canada by those who stay at home, whether it be the planting of a grain of wheat, the knitting of a stocking, the management of some great business, or the administration of our government, is also a blow struck in the great battle for the freedom of the world.

