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The Payment Of the French Indemnity

The preliminaries of peace between France and Germany, signed at Versailles on the 26th of February, 1871 stipulated that France should pay Germany five milliards of francs or one billion dollars as a war indemnity or fine, and that Germany should occupy certain specified French strongholds as security for full and prompt payment. By the Treaty of Frankfurt, May 10, 1871 the dates and amounts of the installments were definitely settled, also what was to be regarded as legal tender or liberative \$100,000,000 were to be paid thirty days after the restoration of order in Paris.

\$200,000,000 in the course of 1871

\$100,000,000 on May 1st, 1872

\$600,000,000 on March 2, 1874

These amounts were to consist of gold or silver coin, notes of the Banks of England, Prussia, Holland, or Belgium, or commercial paper of the first class in these countries.

The rate of exchange was determined for the thaler and the German florin but all other values were to be reduced to these two at the prices current when the payments should be made, the expenses of the exchange to be defrayed by France. The last \$600,000,000 were to bear 5 per cent interest payable on March 30 of each year until maturity. France was granted the privilege of anticipating her payments and stopping interest on them, but she was required to give at least a month's notice of the exact date and amount of each installment. In no case was there to be anything like a running account.

Such, in brief were the conditions of the greatest financial transaction of history, when they were made public all Europe was amazed at the proposal to transfer so vast a sum from one country to another in the short space of three years, and predictions were freely made that it would be physically impossible for France to get together the quantity of capital required to carry out her agreement, or that the financial equilibrium of Europe would be destroyed and disaster would come upon the whole commercial world. The Old Lady of Threadneedle Street in London and her sisters in Berlin, Vienna, and Frankfort shook their heads ominously and spoke of the future with dire forebodings.

The prophets of evil certainly had the probabilities in their favor. France had just passed through a disastrous war in which she had already spent an amount equal to the indemnity. She had lost two of her provinces, had changed from the Empire to the Republic, the latter still being on a shaky basis. She had allowed the military hegemony of Europe to pass to Germany, and, when the final promise to pay was signed, Paris was in the hands of the Communists and the whole power of the national government was taxed to reduce them to subjection and reestablish order in the city.

In these circumstances the French negotiations seemed to be courting failure by asking for only three years in which to acquit themselves of their obligations to Germany. And yet the whole transaction was carried out in twenty seven months, and no difficulty or

disorder was produced by it. France's reserves were as much underestimated in 1871 as her military strength was overestimated in 1870. The Chauvinists who in 1870 marched through the streets of Paris shouting to Berlin, to Berlin were no further wrong in their judgment than worthy pessimists who a year later cried impossible, impossible.

The commercial world had no idea of its own power; though it had grown so enormously that the transfer of a billion dollars could be added to its regular operations without entailing disturbance, it was not aware of the change. It continued to live in the traditions of twenty-five or fifty years before until an occasion arose to show how much its ability to transact business had developed. The lesson taught by the payment of the indemnity was in its practical importance like a new discovery or invention in the physical world. The treasury was obliged, in order to meet the heavy demands made upon it, to have recourse to loans, one of \$400,000,000 being opened for subscription in June, 1871 and another of \$600,000,000 in August, 1872. They were promptly taken up both at home and abroad, but even before the minister could apply any funds from this source the Germans had agreed to accept \$25,000,000 in irredeemable notes of the Bank of France.

The Emperor had been compelled by the continuous defeats in the first part of the war to resort in August 1870 to a forced loan under the form of legal tender, irredeemable bank notes. Although France had made several unsuccessful experiments with fiat money during her revolutions, another trial of it seemed to be the only way out of her financial straits in 1870. The people, having less faith in their armies, were rapidly converting their paper money into specie, and the vaults of the Bank would soon have been empty, if it had not been relieved by the lawmaking power of the obligation to regain its notes in coin on demand. When the war broke out the circulation of \$251,000,000 was secured nearly dollar for dollar by the rise of \$229,000,000. By November, 1871 the issue of notes had risen to \$146,000,000, the reserve had fallen to \$120,000,000, the rate of foreign exchange was above the specie exporting point, and gold was flowing out of the land. A feverish speculation in the new state bonds sent them to such a price that foreign investors returned their purchase en masse for sale on the Paris Bourse and manufacturers moreover, were generally importing raw material and machinery in order to get their works into running order after the devastation of the war.

France had few commodities to export in exchange for her draughts on other countries, and the balance of trade was against her. To add to the embarrassment the Minister of Finance, eager to turn over to Germany the proceeds of the new loan, which were now coming into the Treasury, entered the market as the principal buyer of foreign bills and specie, keeping in mind only his main purpose to pay Germany and rid France of German garrisons, he lost sight of his changed relations to the money market and aggravated the evils of the situation by his hasty purchases. Bills became too dear for ordinary commercial transactions and gold had to be shipped. It should be said to the credit of the Minister that he needed only one lesson; ever afterwards he managed his affairs with consummate ability, using every turn of the market to his advantage. The finance had now reached so critical a state that measures had to be taken at once to prevent a panic. During the discussion on the subject in the Chamber of Deputies the inflationists maintained that the premium on gold being due to speculation and hoarding of the precious metals, the only effective remedy was to issue more paper money to supply the

place of the coin which had been withdrawn from circulation.

In reply to the objection that the currency would be depreciated by an over issue they argued that its value did not depend on its amount, but on the credit of the government, an assertion that sounds familiar in this part of the world. This reasoning prevailed. The legal limit of circulation was extended to \$640,000,000 and the premium on gold as if in obedience to the prediction of the inflationists, disappeared in a few months never again to cause any trouble during the payment of the indemnity.

How, now, did it happen—France apparently saved herself by the very means which had proved so immense to other nations? Austria and Italy, though their issues were less than France's were laboring along with currencies far below par, and we ourselves were little better off. In the first place the outflow of specie was stopped by the shifting of the balance of trade. There was great commercial activity in England and Germany, occasioned to some extent by the quickening influence of the extra French capital which Germany turned in various ways into the channels of trade, the demand for French goods became so strong that during the years in which she was engaged in paying her fine she sold more than she bought and consequently had a balance in her favor resting on a solid foundation.

There were moreover millions of francs of gold and silver in the land outside of the banks. In spite of example and precept the ordinary Frenchman cannot be prevailed upon to deposit his money in a bank and check against it in the course of his business; Such a convenience is little known even in the larger cities, and outside of them it is practically unheard of. The bank reserves are also higher than those of English or American banks and that too though the latter have a heavier strain to endure in a crisis.

The French, consequently require a larger amount of cash for the same volume of business than we do, and seem somewhat by having so much dead capital but they have greater stability in time of need. They have according to Senator Sherman, almost as much coin as England and the U. S. together. Every one remembers how Paris bolstered up London credit a few months ago by a loan of \$3,000,000 in gold. It is well known that in the period from the discovery of gold in California to 1871, France had absorbed far more than her share of the world's total output. She had coined at least \$1,000,000,000, or more than one third of all the gold mined since 1850; the greatest part of this having remained in the country, there is no doubt that, if no war had broken out or if France had been successful against Germany she would have retired from the Latin Union and adopted a single standard of gold in her coinage.

Our government would in that event have been spared the expense of sending our various commissions to monetary conferences in Paris. France would have taken a slight interest in a double standard, and as for Germany, she would have been too poor to think of anything better than silver. Now, though the issue of notes increase rapidly, it is probable that, owing to the caution of the directors of the Bank, the increase never exceeded the coin withdrawn from circulation by hoarding and exportation. The precious metals were not laid away in banks but they exerted an influence in maintaining the value of the bank

bills; the moment confidence began to grow they reappeared in circulation. The directors taking advantage of this return, strengthened their reserves and called in their notes. As early as December 1874 the circulation had dropped to 500,000,000 and the reserve stood at 260,000,000; the danger was past & the Bank was soon able to resume specie payments. One is surprised on reading over the different items of the accounts rendered by the French treasury to find how little gold and silver actually passed between the two countries, only \$100,000,000 or one tenth of the indemnity. When the treaty was made known many assumed that the whole payment would be made by collecting gold and silver and shipping them to Germany.

The stock of these metals in France was carefully computed and calculations made as to how much a billion dollars would weigh in each, how many cars or wagons would be needed to transport it, and other like interesting exercise. The man who had worked out the problem in that way was sure to conclude that France would fail in her undertaking. In its first payments the treasury made use of the gold and silver accruing from taxes and the new loan, but, as this contraction of other circulating medium produced a stringency in the Paris money market, the treasury procured its further supplies from other sources. If the Germans had foreseen in May, 1871 their own financial legislation of the next December, it is doubtful whether they would have put silver on an equal footing with gold, as a legal tender. Their discrimination against the cheaper metal made it impossible for them to dispose profitably of what they had, even if they had received no more from France.

Their adoption of the gold standard aroused apprehension lest France's task would be rendered harder by the complications which might arise from a new and large demand for gold, especially as Germany was to lock her new coins up until they should reach \$150,000,000. The demonitization of silver turned out, however, to be a blessing in disguise, for the fall in the price of that metal helped France materially to get what she needed. The main source from which she secured her supply was out of the oldest bank in Europe.

Among the many unexpected results of the France German war none was more so than the closing of the Hamburg Bank founded in 1619. Its original purpose was to facilitate the exchange of silver from all quarters of the globe by certifying to the degree of fineness and giving out certificates of deposit in terms of the mark []. These certificates passed current every where, exceeding in importance the Mark [] itself, which, having no real existence after 1763 was only a fiction. The millions of them in circulation formed a possible hindrance to the introduction of the new monetary system in Germany. They were basis (*sic*) on silver instead of on gold, and on the mark [] instead of on the mark. It was voted, accordingly, to abolish the Bank after February 15, 1873. It had to liquidate its accounts by paying on-demand fine silver for its bills until February 15, 1873, but after that date the holders of bills could claim, not fine silver, but only half a thaler, a subsidiary coin for every mark banco.

The French treasury gathered together about 100,000,000 worth of these bills and thus had the Hamburg Bank at its mercy, for the Bank would not have been able to meet any

such demand for silver as the French Minister of Finance could have made upon it at almost any time before its obligation to pay pure silver ceased. He seems, however, to have been very fair in his treatment of the Bank, employing his power only to protect himself by regulating the course of foreign exchange. Pure silver was not liberative, but it could be brought from Hamburg to Paris, coined into liberative five franc pieces and then shipped back to Germany. The French minister used 18,000,000 worth of his certificates in this way, and the balance was converted into German thalers. As the Germans did not want the silver, it soon found its way back to France again, some five francs making the journey back and forth more than once. Besides the amount of specie sent out directly by the treasury an estimate based on certain house reports from 1871 to 1873 places France's exports of specie at \$100,000,000 mainly in gold and her imports and \$60,000,000 almost entirely in silver.

The outflow of gold probably went to the German mint for it coined into marks \$115,000,000 worth of French twenty franc pieces in addition to the \$55 million worth which came from the French treasury. Germany did not, however, limit herself to the French supply in her demand for gold, every available stock was called into requisition. She felt rich and would have gold, which, being piled up in the vaults of the mint, went out of existence for the time being.

The uneasiness resulting from the scarcity of gold and the consequent rise in the rates of discount, especially in the Bank of England induced the Bank of France to advance gold to the treasury in preference to bills. The Minister of France was authorized by the law of July 15, 1872 to enter into relations with the Bank or with other companies in order to raise \$40,000,000. The bank agreed to furnish this sum offering of its own accord to advance gold. This arrangement was of advantage both to the Bank and to the treasury; to the latter because by appeasing Germany's hunger, it could prevent the threatened disturbance in international trade, and it was also spared the trouble of exchanging banknotes for bills at various dates; to the former because it drew from its gold supply, which was of no actual use during the suspension of specie payments, and avoided a large and sudden increase in its issue of notes followed by a probable fall in value.

It is worthy of remark that this is likely the first example, in the history of any national Bank, of a bank electing to make an advance in specie, as being less dangerous than to deliver its own notes. The fact that the treasury was able to refund in gold within six months the whole \$30,000,000 – that was all it had to borrow from the Bank is a striking proof that France had plenty of specie within her borders, and that a restoration of confidence was all that was necessary to bring it out of its hiding places.

The wants of the Germans, as soldiers were supplied by stores sent from home, or by requisition on French provinces and cities; until peace was signed they did not have to pay for anything of public or official need. And yet they left behind them in France a considerable quantity of German coins and bills as payment for what they consumed. How many of these found their way back by the ordinary channels of exchange is not possible to say, but among the first French installments stands an item of \$21,000,000 in German money. The treasury being only too glad to get hold of legal tender had accepted

German thalers, florins, and banknotes in payment of tax dues and shipped them to Strasbourg. That was the nearest city in which the German fiscal agents had authority to receive, count, and receipt for payment to, and nearly all the cash was sent there. The bills of exchange were, on the other hand delivered in Frankfort or Berlin.

When France was obliged to cede Alsace and Lorraine to Germany she received from the latter country a credit of \$65,000,000 for the railroads in the two provinces. These roads, being the property of a private company, had to be bought by the French government before it could pass them over to Germany. There was no difficulty in coming to terms with the railroad company; it willingly sold out its interest at the German price and took in payment perpetual 5% bonds. As this credit just covered, in round numbers, the cost of exchange and the interest charges on the last \$600,000,000 of the indemnity, there remained the original billion dollars to be raised by other forms of payments. The French and German coins and notes amounted in all to about \$150 million; the balance \$850,000,000 was paid by directing to Germany every bit of available commercial paper that the French treasury could lay its hands on.

The means to collect so fabulous a sum came, as I have said, from two loans, but the transaction lies in the skillful French utilization of the forces which modern commerce has placed at their disposal. Their first plan was to deliver to Germany bills of exchange to be cashed by her on the day fixed for a payment, but the accounts rendered by Germany soon convinced the Minister of Finance that he could guard his own interests much better than Germans could or at least did..

He determined, consequently, to convert his bills himself and present the proceeds in some one of the liberative forms prescribed by the treaty of May 10th 1871. He established agencies of the French treasury in several foreign cities, the leading one in London, which shows itself at this period to be more than ever the banking center of the world. Luckily for France Germany was heavily in debt to England for short loans and for Army supplies so that English bills were plentiful in the market. \$308,000,000 of them were used by France in her payments. These agencies in addition to their manifold other functions as representatives of the French treasury, enabled it to keep a regulatory hand in the European money market. As he could make payments only in fixed sums on fixed days, it had to prepare for each one long before hand, holding for months at a time as much as \$150,000,000 in bills. If the proceeds of these bills had as they matured, been locked up in some form of legal tender until they should be needed, the Treasury would have suffered a loss of interest and there would have been danger of tightness in the money market.

The agencies, therefore, had instruction to keep their deposits in circulation on short loans in their respective cities. When the two special loans, payable in installments, were offered to subscribers, particular facilities and inducements were extended to foreigners to persuade them to become subscribers. They received commissions of from 1/4 to 1 per cent; the object of the Treasury being to get the power to draw on them for their installments, and thus create bills outside of the ordinary course of trade. Again everything was done to encourage the anticipations of these installments. By these means

drafts of other countries to the amount \$350,000,000 were obtained. The first loan had been considerably aided by speculation and it was feared, at the time of the second loan in August 1872, that as this speculation and the savings of the land had perhaps been exhausted, the new loan might fail. The Minister of Finance, accordingly made a bargain with the leading banks throughout Europe to guarantee \$140,000,000 of the loan to be paid for in foreign bills at fixed rates of exchange. This agreement was signed by fifty-five houses, but as many of them represented syndicates of banks, the number interested was much larger. It was, in truth, a concentration of all the financial power of Europe, and for a time all other forms of business seemed to be suspended in order to assure the success of the French loan and convey capital to Germany.

It was a new fact in the economic history of Europe. After the deduction of these two items the Treasury still had \$360,000,000 to provide by purchases on the Bourse. Fortunately the foreign commerce of France for the three years 1871–73 was enormous and there was a large variety of bills for sale. Some idea may be formed of what the Treasury accomplished from the statement that its portfolios contained during these years one hundred and twenty thousand bills ranging in value from \$200 to \$1,000,000 and drawn on all countries. Probably only a small fraction of this mass of bills was created for the purpose of exchange and not based on actual mercantile transactions; the smaller export of specie proves that there could not have been much manufactured or uncovered paper. These thousands of bills were brought together, cashed and the proceeds remitted to Germany while exchange remained at a price that was the marvel of financiers.

The temperate use of paper money for internal business, the well tuned exports of gold as part of installments to supply the German mint, the liberal method of attracting outside capital to the new loans, the contract with bankers to furnish a large number of bills and exchange at a fixed price, and the establishment of agencies abroad were the main acts of Minister of Finance to effect this astonishing result.

Foreigners subscribed, as I have stated, over one third of the whole amount of the new loans, but France, having bought back all their purchases in 1874, was out of debt to the rest of the world. She had thus actually paid out of her own resources the entire indemnity in little more than the three years originally stipulated. The capital to carry out this gigantic work was derived from the accumulated savings and yearly earnings of her people. The spirit of the systematic economy is stronger among them than any country of Europe at least. Sir Robert Peel said, in discussing in 1841 the comparative wealth of France and England: "In England one person in five spends all his income or earnings; in France there is scarcely one in forty who does the same; the other thirty-nine make savings." This is as true today as it was in 1841. Leon Say taking the reports of the Paris Bourse as his starting point calculates that for several years before 1870 the annual investments of the French in foreign securities were more than \$150,000,000; he states further that in 1870 France's dividends from foreign stocks amounted to \$125,000,000 and that she received an accession of 500,000,000 from strangers traveling there.

If these figures be accepted as correct, and Say supports them by good reasons, then we have the key to her easy discharge of her debt. Her people simply sold their foreign

holdings and applied the proceeds together with their income, to assisting the state by buying its bonds. As soon as the new loan appeared their effect was to lower the price of outside securities in French markets. Now as nothing has occurred to impair the value of the latter in other markets, they naturally sought these markets for sale, returning as bills of exchange to swell the portfolios of the French Treasury, to the amount it is estimated, of 300,000,000. The foregoing are the principal facts in connection with this great achievement in international banking. The French were loaded with a burden which, it was thought would keep them quiet for a generation, but they bore it lately.

The brilliant success of their Treasury Department appealed to their national vanity and did much to strengthen the hands of the government in the troublous times from 1871 to 1875, when failure might have meant the downfall of the Republic.

G. S. Sykes

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