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The Dawes Bonds: Selective Default and International Trade

Abstract

Trade sanctions are often presented as a powerful mechanism to force sovereigns to reimburse their debts but their effectiveness is hard to establish empirically. This paper relies on a unique historical example, Germany's external default of 1933, in order to analyze the relationship between sovereign defaults and international trade. After defaulting on its external loans, the German government negotiated separate settlements with various creditor countries. Using daily prices of the sterling Dawes bonds traded in Amsterdam, London, Paris and Zurich between 1930 and 1938 we assess how market participants valued these deals. We show that investors started expecting a differential treatment of foreign creditors as of 1934 and that these expectations were closely related to creditor countries' trade relationships with Germany. However, we argue that trade sanctions did not act as an effective punishment mechanism for creditor countries. Rather, the German government used trade negotiations in order to play out its creditors against each other and minimize its debt burden. This strategy was crucially facilitated by a general trend towards international bilateralism that stifled attempts to maintain a united creditor front.

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1. Introduction

Sovereign bonds are complex financial instruments. Because of the sovereign nature of the borrower, and in the absence of an international court dealing with sovereign defaults, bondholders have no legal means to force the sovereign to repay. As a result, and as pointed out by Eaton and Fernandez (1995, p. 2), part of the challenge in the sovereign debt literature is "to explain the phenomenon of sovereign lending in the first place". The literature usually singles out four main motivations to repay[1]: the fear of a loss of reputation, the fear of super-sanctions (such as gunboat diplomacy or fiscal house arrest[2]), the fear that collateral might be seized and the fear that creditors of the countries where the defaulted bonds are held would engage in commercial retaliations.

Threatening to reduce trade in case of default seems at first sight a good way to force the sovereign to behave and reimburse its debts. The use of, let alone the effectiveness, of commercial sanctions is however hard to establish. To be true, several authors have shown a strong decline in international trade following defaults. On basis of a database covering 200 commercial partners over 50 years, Rose (2002) reports an 8% decline in international trade following default. But attributing the observed trade decline to post-default sanctions may be misleading as the reduction in trade may very well be due to the economic consequences of default, not to sanctions. Weidenmier (2005) analyzes the case of the Confederate States during the U.S. Civil War. The Confederacy had an extremely bad reputation on international capital markets as many of the states forming the confederacy had repudiated their debts in the 1840s and the president of the Confederacy, Jefferson Davis, had advocated repudiation. The threat of trade sanctions, mostly by gun manufacturers, prompted the Confederacy to honor the Cotton Bonds it had floated in London. This case shows that trade or trade credit sanctions

[1] See for example Oosterlinck (2013).
[2] On this concept see Mitchener and Weidenmier (2010).

may promote repayment, but as pointed out by Weidenmier (2005, p. 420), this was the acse only for a small amount of lending. Martinez and Sandleris (2011) find that the decline in trade with a defaulting country is not statistically different for creditor and non-creditor countries suggesting it cannot be attributed to sanctions. By contrast, Fuentes and Saravia (2010) report a higher decline in Foreign Direct Investment (FDI) for creditor countries, supporting the idea that sanctions might be conducted via another channel. Of course if a foreign court rules that the commercial assets of a sovereign may be seized then the sovereign will refrain from trading, leading to the equivalent of a creditor-imposed embargo (Weidemaier and Gelpern, 2014). The impact of international trade on the motivation to repay seems however elusive at best (Panizza et al., 2009). According to Ritschl (2012, p. 945), "the possible effects of trade sanctions, embargoes and other measures of coercion that can be taken against an unwilling debtor country are often surprisingly limited".

Examples linking sovereign default, trade and reimbursement may nonetheless be mentioned. Historically many bonds were issued with a clause stating that a given stream of revenues (typically from monopolies) would be pledged to guarantee reimbursement. In some instances the revenues came directly from international trade. This was for example the case for the guano which was used as collateral for the Peruvian debt (Vizcarra, 2009). Trade was thus viewed as an element which would bring hard currency and help repay the debt. In the 1930s the view was that bondholders' committees should give priority to repayment of commercial debts in order not to jeopardize overall payment by aggravating the country's current account (Eichengreen and Portes, 1989). This is in stark contrast to the modern view which focuses on trade retaliation. But was it irrational to view international trade as a potential solution to the default rather than a tool to sanction the defaulter? The fact that large cross-country studies do not find an important role for international trade need not however mean that trade does not matter once countries opted to default.

This paper relies on a unique historical example, the German default on its external debts in 1933 and 1934, to show not only that trade matters but also that market participant realized the central role trade could play to settle the default. We argue that the relationship between trade and sovereign default is in fact complex and goes well beyond the sanctions approach.

On the one hand, the threat of trade sanctions may not be credible *ex-post*. Once a debtor country defaults, creditor countries might have an incentive to pursue beggar-other-creditors policies by concluding bilateral agreements with the defaulting debtor. Such an approach is strictly preferable for each creditor country when the gains of maintaining a multilateral approach have become small enough, just as they had during the rise of protectionism in the late 1920s and early 1930s. On the other hand, enforcing debt service in the wake of default through, for example, clearing arrangements introduces a distributional struggle within the individual creditor country which the debtor country can exploit to minimize debt payments. To make our point the balance of the paper is organized as follows. Section 2 provides the historical context of the Dawes Loan. Section 3 details the negotiations related to German external debts following the 1933 default. Finally, Section 4 offers an interpretation of the market for Pound Sterling Dawes bonds in four European countries during the 1930s.

2. Historical context of the Dawes Loan

The Dawes Loan was born from the reparations asked from defeated Germany after World War I. On 5 May 1921 the Reparation Commission decided that Germany would have to pay a total of 132 billion marks (£6.6 billion), and cover Belgium's war debt, worth the equivalent of 5.6 billion marks. The perception in Germany that the requested amounts were too high translated into an unwillingness to pay. As a result, tax collection stalled forcing the Reichsbank to rely on the printing press to cover the budget deficit. This measure would start the hyperinflation which would plague the German economy (Ritschl, 2012). German inability to pay its due led to retaliation. The occupation of the Ruhr region in 1923, meant to force Germany to pay, proved costly and actually revealed the limits of the sanctions France and Belgium could impose on a reluctant Germany.

Negotiations ensued which materialized in the form of the Dawes plan. The Dawes plan was meant to restore the German economy, which would then be able to pay the reparations. Most importantly, it included a stabilization loan which allowed Germany to return to the gold standard. The German External Loan of October 1924 was issued in five currencies (US-$, UK-£, CHF, Lire and Swedish krona) on nine different financial markets (Belgium, France, Germany, Italy, Sweden, Switzerland, the Netherlands, the United Kingdom and the United

States of America). All tranches carried a nominal interest rate of 7%, were issued at 92 percent of par and were to be reimbursed after 25 years, in October 1949. The US-$ tranche was the only one carrying a gold clause and was repayable at 105% of par, while all other tranches were repayable at par. In contrast to the other tranches, the sterling tranche was floated on six different markets, amounting to £22 million with the following distribution: £1,500,000 in Belgium, £3,000,000 in France, £12,000,000 in Great Britain, £2,500,000 in The Netherlands and £3,000,000 in Switzerland[3]. Holders of sterling bonds could either cash their coupons with the underwriter in the respective country of issue or at the Bank of England. Amortization started in October 1925 through a Sinking Fund.

In the short run, the Dawes loan led the way for an unprecedented foreign borrowing spree by the German public sector, private companies and other private entities, described in detail by Ritschl (2002). Despite already high debt levels implied by reparations, foreign investors were keen on lending to Germany under a special clause of the Dawes Plan that granted seniority to commercial debt service over reparations payments (Ritschl, 2012). The borrowing spree came to a halt when the terms of the Young Plan, which was to become the successor to the Dawes Agreement, started to emerge in early 1929, (Ritschl, 2012). Among these terms was also the new German external loan of June 1930, which was eventually issued in nine different countries in their respective currencies[4]. The Young Plan increased effective reparations annuities by abolishing the transfer protection clause of the Dawes Plan. This triggered a sudden stop of foreign lending, as well as a first wave of capital flight from the country (Ritschl, 2012). The second wave coincided with the Central European financial crisis of 1931, leading to a rapid dwindling of the Reichsbank currency reserves (James, 1985). In reaction to this, the German government opted to suspend convertibility of the Reichsmark and introduce capital controls on July 15. These emergency measures were designed to stop capital flight by preventing the rapid repatriation of foreign capital, especially short-term assets held in Germany. This was flanked by successful international cooperation. Following the announcement of the Hoover moratorium on June 20 and negotiations during the 1931

[3] Loan Agreement, Bank of England Archives, AC30-433.
[4] For details, see Glasemann (1993) p. 14, and Clement (2004), p.34-35.

London conference, the private short-term creditors of Germany concluded an international standstill agreement on September 19, 1931. The agreement provided for maintaining existing credit lines in exchange for uninterrupted interest payments (Forbes, 1987). With regard to Germany's long-term liabilities, the measures taken in 1931 did not compromise regular debt service. Interest and amortization payments remained fully convertible for the time being (Frech, 2001). It was only after the rise to power of the National Socialist regime that Germany eventually defaulted on its long-term foreign obligations. As a first step, the new government responded to the decision of the US administration of April 19, 1933, to abandon the Gold Standard by reneging on the Gold clauses of the American Dawes tranche and all Young tranches in early May (Clement, 2004).

Only a week later, on May 15, the Reichsbank communicated to its international partners that the German foreign exchange reserves had become so low that further orderly debt service would soon be impossible[5]. After long negotiations a two-tiered compromise was reached: The Loans of the German Central Government, i.e. the Dawes and Young loans, were granted a special status, which meant that they continued to be serviced in full for the time being[6]. For all the other loans, up to December 31st, 1933, payments would be made in foreign currency for 50% of the amount, the remainder being paid in Reichsmark scrip. The Deutsche Golddiskontbank, a subsidiary of the Reichsbank, was in charge to cash in this scrip at a 50% discount in the owner's currency[7]. This arrangement resulted in a general conversion rate of 75% for all long-term, external liabilities of Germany except the two Reich Loans. The German government subsequently implemented the terms of its default, first by a law of June 9th stating that payment in Reichsmark by a German debtor was as good as payment in foreign currency[8], then by publishing the law's terms of application on June 30th (Clement, 2004, p.39).

[5] Telegram for the Reichsbank to the Bank of England, Bank of England Archives, 15 May 1933, BoE, G1-445

[6] In fact, amortization payments into the sinking fund for the Young Loan were terminated, while they continued for the Dawes Loan. Full interest payments continued for both the Dawes Loan and the Young Loan (see Clement 2004, p.39).

[7] Letter from the Chairman of the British Long Term and Medium Term Creditor Committee to the Treasury, 19 October 1933. BoE, G1-445

[8] Letter from the Chairman of the British Long Term and Medium Term Creditor Committee to the Treasury, 19 October 1933. BoE, G1-445

The German default of June 1933 represented the beginning of a sequence of acrimonious negotiations that would drag on for a year until the second, more radical default of June 1934. On the background of Germany's ever decreasing currency reserves the German authorities led by the Reichsbank President Hjalmar Schacht periodically demanded fresh concessions from the creditor side. In this spirit, it had become clear since at least March 1934 that the two Reich Loans would likely lose their special status once the existing agreement ran out on June 30 (Clement, 2004, p.40). The German government indeed announced a complete transfer moratorium on all long-term foreign liabilities on June 14, which was to take effect at the beginning of July[9]. From this date onwards Germany was determined to stop the service of its long-term foreign liabilities completely until further notice. This unilateral move, and especially the end of the special status for the Dawes and Young Loan, amounted to a major provocation of Germany's international partners. It was followed by a wave of protests and triggered harsh reactions abroad (Wendt, 1971). It did, however, achieve the final breakup of a united creditor front. Switzerland and the Netherlands had already reached separate agreements with the German government following the June 1933 default, drawing intense criticism at the time from other creditor countries. A year later most of them had gradually abandoned that stance and would in time negotiate their own settlements individually with Germany, trying to secure a deal that would fit best their specific needs. The German regime duly exploited this new constellation with a characteristic combination of "Machiavellian skill and Prussian clumsiness", as the British financial writer Paul Einzig (1934, p. 46) put it.

3. German default and bilateral negotiations in the 1930s

"In the face of the danger of repudiation, the attitude of the creditors leaves much to be desired. There is no united front even within one country or between the national groups of the same class of creditors, and this provides excellent opportunities for Germany to play off one against the other. The German authorities have,

[9] In fact, the German Finance Minister had already warned the Bank for International Settlement on May 7, 1934, that such a step would be imminent (Clement, 2004, p.42).

indeed, taken full advantage of these opportunities, and have handled the matter with a skill worthy of a better cause" (Einzig 1934, p. 105).

Switzerland and the Netherlands

As mentioned before, Switzerland and the Netherlands were the two countries that had first left the united creditor front after June 1933. The two countries shared many common characteristics in their relations with Germany. Both had been neutral during the First World War. Consequently, they had both provided avenues for German banks and private companies for re-establishing their financial links with the outside world after the War. In fact, the status of Amsterdam as an important financial center during the interwar period was closely connected to this intermediating business with Germany. Thus, in 1926 the value of German securities issued on the Amsterdam market exceeded the amount issued in London (Euwe, 2009, p. 164). The Dutch government actively encouraged this new role of the Amsterdam market during the 1920s (Euwe, 2009, p.169). Switzerland, especially its rising Zurich market, had also been a major supplier of capital for the Weimar Republic during the 1920s (Lussy et al., 2001). Moreover, both countries had large trade deficits with Germany that they financed with equally large surpluses: Next to the returns on their capital exports, the Netherlands had always provided important transport and trade services for Germany (Klemann, 2009), while Switzerland had been home to a large tourism industry (Kellenberger, 1942, p.87). Both countries were also hit hard by the global economic crisis. Swiss exports shrank by almost 60% between 1929 and 1933, while its imports fell by only 42% (Hug and Kloter 1999, p.28). With respect to Germany, Swiss imports decreased by a moderate 20% between 1928 and 1932, while Swiss exports dropped by a stunning 71% during the same period (Hug and Kloter, 1999, pp. 36-38). In other words, Switzerland traditionally large trade deficit with its northern neighbor grew dramatically during the late 1920s and 1930s, leading the Swiss government to terminate its trade treaty with Germany in early 1932 and to impose quantitative import restrictions (Meier et al., 2002, p.78). This situation had important ramifications for the interests at stake of each of the two countries following Germany's default in 1933: While it was essential for Switzerland to be able to transfer as much of its capital earnings from Germany and to maintain its German tourism revenues, trade with Switzerland was an important source of surplus foreign exchange for Germany, which it could use to finance its deficit with third countries. Accordingly, public reaction in Switzerland to the German default was hostile, demanding retaliatory measures such as the imposition of compulsory clearing and the blocking of German assets in Switzerland (Frech, 2001 p.53). Although the Swiss government desisted from such countermeasures for the time being, it stressed the special situation of Switzerland and pushed for continued full interest transfers (Frech, 2001 p.55). The Dutch for their part also made it clear that they could limit German imports in the absence of an agreement[10]. On the other side, the German government was anxious to stop the Swiss and Dutch from imposing compulsory clearing, in order not to lose the precious surplus foreign exchange (Frech 2001, p.54). The threats made by their counterparts were well understood in Berlin[11]. In particular, the threat of a clearing was viewed as credible[12]. Thus, the Swiss and Dutch negotiators concluded unilateral agreements with Germany in October 1933 that put their creditors at an advantage with respect to other creditors. Under these agreements the former continued to receive the full amount of their interest. In exchange, the Swiss and Dutch governments committed to allowing additional imports from Germany equaling the additional interest transfers (Frech, 2001 p.55).

The situation established by the separate agreements was only short-lived. After they had been renewed once in February 1934 for another six months they expired in the wake of the second German default of June 1934. Again coming under intense public pressure at home the Swiss government renewed its threat of a compulsory clearing (Frech, 2001, p. 57). Compared with a year ago, however, the underlying situation had changed. Germany's export surplus with Switzerland had been steadily decreasing. This development endangered the foreign exchange surplus that had induced German negotiators to cave in to Swiss demands for a separate agreement in the first place. Consequently, the German stance on compulsory clearing had

[10] Letter from C. E Ter Meulen and W Cnoop Koopmans to Dr Schacht, in Memorandum of Conference held in Berlin, January 25 to January 31 1934, BoE, G1-445.
[11] "It could have been to nobody's advantage if these two countries had endeavoured to carry their point of view by taking unilateral action to secure to the Swiss and Dutch debtors a full satisfaction of their interests claims." Speech by Dr. Posse of the Reichswirtschaftsministerium at the Opening of the Conference in Berlin, January 1934 in Memorandum of Conference held in Berlin, January 25 to January 31 1934, BoE, G1-445.
[12] Memorandum of Conference held in Berlin, January 25 to January 31 1934, BoE, G1-445.

changed. Under the condition that any clearing agreement should include a guaranteed amount of foreign exchange that the Reichsbank could dispose of at will (the so-called "*freie Devisenspitze*") Germany now demanded a clearing agreement that would include all economic transactions between the two countries without exemption (Frech 2001, p.59). To the Germans this had by now become a surer way to safeguard foreign exchange revenues from their trade with Switzerland. The Swiss negotiators, on the other hand, were not necessarily interested in a comprehensive clearing because the imbalance between exports and imports was expected to lead to struggles amongst different interest groups as the amounts paid by Swiss importers would be dwarfed by the amounts to be paid to exporters and other claimants. The Swiss negotiators tried therefore to secure the full transfer outside the clearing system of as many categories of claims on Germany as possible. Such constellation of interests resulted in the compromise reached in the form of the Clearing Treaty between Germany and Switzerland signed on 26th July 1934. In exchange for securing the *Devisenspitze*, Germany conceded that insurance and certain capital transactions, as well as standstill interests would be transferred fully outside the clearing (Frech, 2001, p. 61). With regard to interest payments on Germany's long-term obligations, Swiss negotiators managed to secure a general transfer quota of 4.5%. The Dawes and Young loans, as well as a number of other privileged bonds, were given a special status. Their interest continued to be fully transferred for the time being (Ferralli, 1955, p. 13). The Netherlands, acting jointly with the Swiss, settled for the same terms in their clearing treaty with Germany of 13th October 1934 (Frech, 2001, p.62).

Ideally, clearing treaties were useful mechanisms to maintain trade at an elevated level without the need to spend much valuable foreign exchange. However, in practice they had a number of negative consequences which necessitated frequent adjustments. Swiss claims on Germany could henceforth only be paid out of the clearing system to the extent that Swiss importers of German goods paid into the system, yet German net exports to Switzerland continued to fall during the second half of 1934 and early 1935 (Ferralli 1955, p.15). The scarcity of clearing funds in turn triggered a distributional struggle among the different types of Swiss creditors (Hug and Kloter, 1999, p. 60). In this struggle the Swiss authorities clearly favored the interests of the export industry and the tourism sector (Frech 2001, p. 73). In a situation where prolonged economic crisis had led to high unemployment the Swiss public clearly sided with the sectors that could create jobs through increased exports of goods and services (Frech 2001, p.75). On the other hand, organized Swiss banking had managed to safeguard its interests - mainly in Standstill credits - outside the clearing system (Frech 2001, p.83). The clear losers of the distributional fight were the mass of private investors who had bought German securities during the 1920s (Lussy et al., 2001, p.59). Their claims were satisfied last. Moreover, the particular design of the clearing system until 1937 meant that effective interest transfer were negligible, despite the 4.5% stipulated in the agreement (Kellenberger, 1942, p.180). It is important to note that the interests on the Dawes and Young Loans continued to be paid fully at that point, privileging owners of such bonds relative to the rest of Germany's long-term creditors. However, both Swiss and Dutch authorities had shown no real interest in preserving their special status. Given the fact that the Reich loans constituted a relatively small share of their total claims on Germany they had already been ready to abandon preferential treatment of Dawes and Young creditors during the creditor conferences preceding the German moratorium of June 1934 (Clement, 2004, p. 43). Thus, when the clearing system ran into trouble by the end of 1934 and Germany demanded fresh negotiations, both Swiss and Dutch negotiators practically conceded the end to the special status of the two Reich loans. In the second Swiss-German clearing agreement of 17th April 1935 and in the Dutch-German transfer protocol of 17th June 1935 respectively the Dawes and Young loans were put on an equal footing with other long-term German obligations (Ferralli, 1955, p.20). First, interest payments were only made in the form of so-called Funding Bonds that carried a 4% nominal interest rate (Frech 2001, p. 244). In later agreements, limited cash transfers of 2% to 4% were made, the remainder being paid in so-called *Dawes-Mark* which the creditor could use for certain payments inside Germany (Devisenarchiv 1936, p. 678).

France

Following the German moratorium of June 1934, France and Germany signed a clearing agreement in Berlin on 28 July 1934. Under the terms of this new treaty, payment of all commercial transactions between the two countries was centralized through the Reichsbank and the Franco-German Office for Commercial Payments[13] Importers/exporters in both countries directly paid/were paid by these institutions in their own currency. In addition, 15.75 per cent of the daily value of French imports from Germany was to be credited to a special Reichsbank account with the Franco-German Office and used for the payment of the coupons of the Dawes and Young Loans.[14] Through this means, the French government sought to secure maintenance of the full service of the Reich loans to French bondholders. Indeed, the Franco-German trade balance had been favorable to Germany since the year 1929 and this trade surplus appeared largely sufficient to cover interest service on German loans as well as payment of French exporters while allowing the Reichsbank to gain some additional foreign exchange. Yet, the French-German clearing system did not turn out to work in the way French authorities had anticipated. Starting 1934, French imports from Germany declined considerably and were reduced by 42 per cent between 1933 and 1935. Moreover, as in the Swiss and Dutch cases, Germany managed to use the clearing system at its advantage by importing large quantities of raw materials from France. As a result, the German trade surplus deteriorated in 1934 and soon became insufficient to cover both the interest service on foreign debts and payment to French exporters.[15] Germany accumulated substantial clearing arrears with the Franco-German Office. By August 1935, its clearing debts to France amounted to 700 million francs.[16] In order to liquidate the clearing arrears, the French government attempted to drastically reduce French exports through the imposition of export quotas. French exports to Germany declined from 1,989 to 667 million francs between 1934 and 1936.[17] However, France's trade policy towards Germany was detrimental to French industry and agriculture and eventually became unsustainable. In the face of pressure from industrial firms, the French government relaxed its export quotas in 1936 and a new clearing arrear

[13] French-German Agreement on Commercial Payments, July 1934, article 1, found in Archives, Banque de France, 1069199005/49.
[14] French-German Agreement on Commercial Payments, July 1934, article 5, found in Archives, Banque de France, 1069199005/49 and *The Economist*, 4 August 1934, p. 221
[15] According to the figures in Mitchell (2013).
[16] Archives, Banque de France, 1370200008/178, "L'accord commercial franco-allemand", 12/7/1937.
[17] Mitchell (2013)

emerged (estimated at 226 million francs in August 1937).[18] Both the French and German governments now considered the clearing system unfavorably. While the 1934 treaty was detrimental to French exports, it did not allow the Reichsbank either to gain any foreign exchange. Negotiations resumed between both governments and eventually resulted in a new trade treaty signed on 10 July 1937. Both countries granted each other the most favored nation clause as well as tariff and quota reductions and the clearing system was abolished. French importers could now directly pay their German exporters in francs and the latter had to convert the foreign exchange so acquired into marks at the Reichsbank. Payment of commercial transactions remained centralized on the German side as the Reichsbank stayed in charge of allocating available foreign exchange to German importers. [19] Any positive balance of foreign exchange was to be allocated in priority to the service of the Dawes and Young bonds.[20] Therefore, France's policy turn of 1937 appears to have been inspired by the authorities' realization of the necessity to grant Germany favorable trade conditions in order to both support French industry and guarantee the service of German debts to French bondholders. Franco-German trade rebounded spectacularly following the signature of the treaty. Imports and exports to/from Germany increased by, respectively, 96 and 135 per cent in 1937 and the German trade surplus amounted to 1,927 million francs in that year.

Great Britain

The cases of Switzerland and the Netherlands show that under certain circumstances a mechanism such as compulsory payments clearing, intended as a sanction against the defaulting debtor, can actually be in the interest of the latter. Germany profited from the distributional struggle within the creditor countries for payouts from the Clearing system. With the express collaboration of the creditor governments it discriminated among stakeholders entitled for clearing payouts to the detriment of bond holders, thereby reducing the burden of its debt service gradually over time. The British case, for its part, can serve as an interesting example

[18] Archives, Banque de France, 1370200008/178, "Mobilisation par la Banque de France. Les arriérés du clearing franco-allemad", 10/8/1937.
[19] Archives, Banque de France, 1370200008/178, "Le traité de commerce franco-allemand", *L'Information*, 13/7/1937.
[20] Archives, Banque de France, 1370200008/178, "Les accords financiers franco-allemands. Emprunts extérieurs et créances privées", *Agence Economique et Fianncieère*, 13/7/1937.

with respect to issues surrounding the bargaining power of a creditor country faced with a defaulting debtor: On the one hand, the feasibility of trade sanctions against a defaulting debtor depends on the openness to trade of the creditor country. On the other hand, the bargaining power of the debtor country tends to increase rather than decrease in the amount of its outstanding debts.

The 1930s famously represent the period "when Britain turned inward" (de Bromhead et al., 2017). The devaluation of Pound Sterling in September 1931 was followed by a series of import duties acts in November 1931 and February 1932. Soon after, the Ottawa Agreements of August 1932 instituted Imperial Preference within the British Empire to the detriment of third countries. Although the general effect of this protectionist turn on international trade flows has been disputed empirically (Wolf and Ritschl, 2011), it had a very important impact specifically on trade between Germany and Britain: German exports to Britain collapsed by almost two-thirds between 1931 and 1932, while imports from Britain declined by only about 40%. As a result, the historically large German export surplus with the United Kingdom disappeared rapidly, falling by more than three quarters between the last quarters of 1931 and 1932. This negative effect was fully appreciated within the British administration. Forbes (2000, p.26) even claims that there was "a sense of guilty responsibility" among decision makers in London. Importantly, the nexus between Germany's export surplus and its ability to service its debts to Britain was well understood, even before the German default of June 1933 (Wendt 1971, p.127). This can explain the ambivalence with which British negotiators reacted to the separate agreements Germany concluded with Switzerland and the Netherlands in October 1933. Officially Britain was still a partisan of inter-creditor equity in the resolution of Germany's default[21]. Supporting inter-creditor equity implied rejecting the German effort to establish conditionality between debt payments and sufficiently large German export earnings. However, important factions within the British government were sympathetic towards the German viewpoint (Forbes 2000, p. 72). By April the British Treasury expressed support for trying "to get an agreement for equal national treatment of all the creditors if possible; but if

[21] Letter from the Chairman of the British Long Term and Medium Term Creditor Committee to the Treasury, 19 October 1933. BoE, G1-445

that is not possible, to press Germany for a special agreement in favor of the United Kingdom by which British creditors receive as good treatment as the Swiss and the Dutch and to make our acceptance of any special Swiss and Dutch agreements conditional on Germany giving us equivalent terms" [22]. At the same time, calls to impose compulsory clearing on Germany were gathering strength among the British public and within the government. Unilateral decisions by Germany to reduce effective interest transfers in December 1933 and the preferential treatment of other creditors exasperated public opinion in the UK (Wendt 1971, p.164). Moreover, German export subsidies via buybacks of bonds and scrips abroad directly challenged the effectiveness of the British tariff system that was supposed to protect British industries from their German competitors (Wendt 1971, p.168). During negotiations held in January 1934 British officials reacted by indeed threatening to impose unilateral clearing on Germany[23]. The effectiveness of such a threat, however, had long been questioned within the British government. The biggest concern was that British protectionism had reduced the German export surplus to an extent that a clearing had lost its punitive power. In addition, other factors weakened British bargaining power: Ever since the Brüning government had imposed capital controls in July 1931 it had become more and more difficult for German importers to secure the necessary foreign exchange from the Reichsbank in order to pay their bills with foreign suppliers. As a consequence, German companies had run up important commercial debts in the UK that amounted to the enormous sum of £4.7 million by late 1934 (Forbes 2000, p. 107). The German authorities under the Reichsbank president Schacht used these outstanding bills as a bargaining chip in negotiations with the British. Authorities in London were well aware of the dilemma: Harsh sanctions against Germany would likely trigger German countermeasures and thus put at risk the financial health of important British industries (Wendt 1971, p. 219).

The two Reich loans occupied a more important place in the UK than they did in Switzerland or the Netherlands. At the time of their issue, the British government had actively encouraged public subscription. They constituted an important part of the international

[22] Letter from the Treasury to the Governor of the BoE, 4 April 1934, BoE, G1-446.
[23] Memorandum of Conference held in Berlin, January 25 to January 31 1934, BoE, G1-445.

settlement after the First World War in which official British policy had played an important role in accommodating Weimar Germany. Thus, when Germany had first planned to stop honoring them in June 1933 the British government came under intense pressure at home to secure their continued full service (Wendt 1971, p. 135). While the compromise reached in mid-1933 had deferred this thorny issue for the time being, the German full moratorium of June 1934 that included the Dawes and Young loans forced Britain to act. Within two weeks of Schacht's declaration of 14th June, the British parliament passed the "Debts Clearing Office and Import Restrictions Reprisals Bill" that authorized the government to impose a comprehensive payments clearing system against Germany (Wendt 1971, p. 190). In the meantime, hasty negotiations had begun between British and German representatives in London. The British side insisted on continued service for the Reich loan. Faced with the real possibility of a unilateral British clearing, Germany gave in on 4th July and committed to fully paying interest to British holders of Dawes and Young bonds until a permanent solution was to be found during the following six months (Wendt 1971, p. 213). The solution came in the form of the Anglo-German Payments Agreement of 1st November 1934. The compromise reached in this treaty was decidedly different from the agreements reached between Germany and other creditor countries. On the one hand, contrary to the clearing treaties with Switzerland and the Netherlands which needed frequent renegotiation and adjustment, the Anglo-German Payments Agreement survived essentially unaltered until the outbreak of the War. On the other hand, it avoided many of the shortfalls the other Clearing agreements suffered from. The solution eventually found had first been proposed by the Bank of England (Wendt 1971 p. 207). Comprehensive control over all payments transactions between the UK and Germany would only be exercised on the German side, which committed to spending specified shares of the foreign exchange revenue from German exports to Britain on individual categories of British claims. For example, 55% were reserved for British exports and another 10% for reducing outstanding commercial debt. Due to these arrangements Germany had gained Britain's interest in increasing German exports to Britain and thus German Sterling revenues (Forbes 2000, p. 110). Britain had avoided imposing stringent payments control on British companies, which had turned out to be problematic to enforce in the case of Switzerland and its importers (Frech 2001, p. 217). It had also secured binding commitments by Germany to reduce outstanding debts. With respect to the Reich Loans, Germany agreed to permanently transfer the full amount of interest payments on the Dawes and Young Loan to British investors. This amounted to a significant concession by the German side, which can be explained by the dire situation the German economy had come in the meantime (Wendt 1971, p. 273). The British Empire was of vital importance to the German economy as a supplier of raw materials. The German government eventually decided that avoiding interest payments on the Reich loans wasn't worth risking access to important inputs for the German economy in case Britain had decided to impose a unilateral clearing system (Forbes 2000, p. 106).

Exchange Clearing as a sanction mechanism

Interpreting exchange clearing arrangements in general, and unilateral clearing in particular as a form of sanction against a reluctant debtor country represents to a large extent the conventional wisdom of the 1930s. Paul Einzig remarked already by late 1933 that exchange clearing was "[…] practically the only means of making countries such as Germany pay their debts", while he acknowledged the "many disadvantages in such an arrangement" (Einzig 1934, p. 89). About a year later he had come round to see exchange clearing as the cornerstone of a future, more rational economic system (Einzig 1935, p. viii). At the same time, he still noted the "widespread belief that unilateral clearing has been introduced as a retaliatory measure against a country which has defaulted on its obligations" (p. 69). In addition, the connection between bilateral trade balance and the bargaining power of individual creditor countries was well understood. Harris (1935, p. 61) argued at the time that a passive trade balance was the necessary precondition for extracting concessions from Germany after its default, while countries with an active balance such as the US were in no such position. A few years later the continued service of annexed Austria's foreign debts became an international bone of contention. In this case, it was observed that "the measure of creditors' success largely depended […] upon the size of the creditor country's adverse balance with Germany" (Ellis 1941, p. 71).

The interpretation of exchange clearing as sanction, however, is not straightforward and comes with important caveats, especially for the case of 1930s Germany. As much as exchange clearing was widely viewed at the time as a sanction device, there was also a sense that certain policy decision since the outbreak of the Great Depression had led to the "inevitability to the imposition of clearings" (Ellis 1941, p. 190). The countries of Central Europe by and large reacted to the financial crisis of spring 1931 by suspending the free convertibility of their national currencies. Germany in particular left the Gold Exchange Standard in July 1931 by imposing capital controls, while maintaining the official gold parity of the *Reichsmark* for all current account transactions. Subsequent devaluations, especially the Pound Sterling in September 1931 and the US-Dollar in April 1933, thus left Germany with an overvalued currency. The German authorities tried to counteract the consequence of rising imports and falling exports by a variety of measures. While the Brüning government may be most famous for its austerity politics that represented one of these measures, it also already imposed quantitative restrictions on imports and experimented with early export promotion mechanisms (Ebi 2004, p.42). Nevertheless, payments arrears on commercial transactions started to appear already at an early stage. The problem became worse as soon as the von Papen government abandoned austerity in the wake of the Lausanne conference and began to implement the first countercyclical measures. This "active economic policy" (Ellis 1941, p. 198) was widely credited with rising import demands and decreasing exports. In combination with the unaltered gold parity of the Reichsmark it increased external payment arrears to a point where creditor countries were forced to implement one form of exchange clearing or the other, in order secure their claims on the German economy. From the point of view of Anglo-Saxon observers, this systemic problem was made worse when Germany ceased to behave like a faithful debtor. In fact, according to Paul Einzig (1935, p. 114) much of the bad reputation exchange clearing suffered from at the time was due to the way Germany exploited the system to its advantage. It was already shown how the German regime after 1933 used to run up substantial debts on its clearing accounts with other countries, for example France, in order to satisfy its import needs cheaply. Moreover, the bad faith embodied in German debt buyback operations on foreign financial markets during the 1930s and especially after the country's external default had gained notoriety already at the time (Kluge 1993). On a more fundamental level, the National Socialist regime after 1933 embraced an ideology of national autarky, in which the satisfaction of import demand was paramount and foreign debt a mere nuisance that had to be gotten rid of (Boelcke 1994, p. 31ff).

Interpreting exchange clearing as sanctions implies to a certain extent that such sanction represented a discretionary policy instrument at the disposal of creditor country governments. If the imposition of clearing was indeed inevitable, that is, only a matter of time given previous policy choices, creditor governments would not have been able to choose freely whether or not to apply such sanction. In fact, the German regime itself concluded clearing agreements with its Eastern neighbours that had been in a debtor position towards Germany (Neal 1979). However, the particular design and the eventual outcome of each single clearing arrangement matters decisively for the latter's interpretation. This is true even if the imposition of some sort of exchange clearing was inevitable in the first place. Importantly, different types of clearing agreements meant different degrees to which surplus funds were available for debt service. A number of contemporary writers disputed that there was any fundamental difference between Swiss-type Clearing Agreements and British-style Payments Agreements, on the grounds that both types entailed government interference with international trade. Ellis (1941, p. 215) contends that instead of interfering with payment conditions between Germany and Britain, British authorities instead had to directly restrict British trade to the superimposed 55:100 ratio that has been described above. Similarly, Einzig (1935, p. 182ff) attributes the relative success of the British payments agreement to special circumstances, part of which were political in nature. However, the important difference between the two types was that the British payments agreement implied less restrictions on German exports. Put differently, British authorities did not have to restrict imports from Germany, but "only" had to adjust British exports to the level of imports from Germany. In this vein, the immediate success of the Anglo-German payments agreement has been credited by Harris (1935, p.72ff) to the fact that in the absence of a centralized British clearing system, the Bank of England did not guarantee payment of export claims towards British private exporters, which made the latter less prone to export to Germany than their - for example - Swiss counterparts. In short, "any arrangement which places an additional obstacle in the way of Germany's exports is bound to decrease her capacity for payment" (Harris 1935, p.73).

The attitude of National Socialist Germany towards its foreign creditors may be problematic on a different level. In theory, sanctions against sovereign debtors are effective because the potential consequences of any sanctions would conflict with the economic interests of the debtor country or its government. This is why they do not default in the first place and cooperate in case default is inevitable. Among these economic interests, debtor countries would like to retain access to markets in creditor countries notwithstanding their debt problems. Since at least the imposition of the "New Plan" in September 1934 Germany embarked into a deliberate policy of trade diversion, away from its traditional trade partners and creditor countries in Western Europe and North America, towards supposedly new markets in Eastern Europe and Latin America (Boelcke 1994, p. 69ff). Although trade diversion took place to some extent, it was exceedingly costly for the German economic sectors concerned (Ellis 1941, p. 242ff). Furthermore, trade with South-Eastern Europe was hardly beneficial for Germany and contrary to conventional wisdom, it achieved little economic domination at a high cost (Neal 1979). With respect to Latin America, the German economy had little investment capital to spare and export orders took exceedingly long on the background of German rearmament (Boelcke 1994, p.94ff). Germany was therefore of limited attractiveness as a partner to South American countries. Instead, Western Europe remained the dominant export market for German products throughout the 1930s. In addition, in spite of all ideology and rhetoric, export promotion remained a central element of Germany's foreign policy until very shortly before the outbreak of the Second World War (Ebi 2004). It would therefore be wrong to assume that Germany was insensitive to the threat of trade sanctions by its creditors. Indeed, the German reaction to the British threat of unilateral clearing provides a case in point. But was what the market perception of the various agreements reached by Germany? Were markets valuing the threat of trade sanctions? Or linking bonds' value to the ability to extract foreign exchange from Germany or were they rather indifferent to these issues?

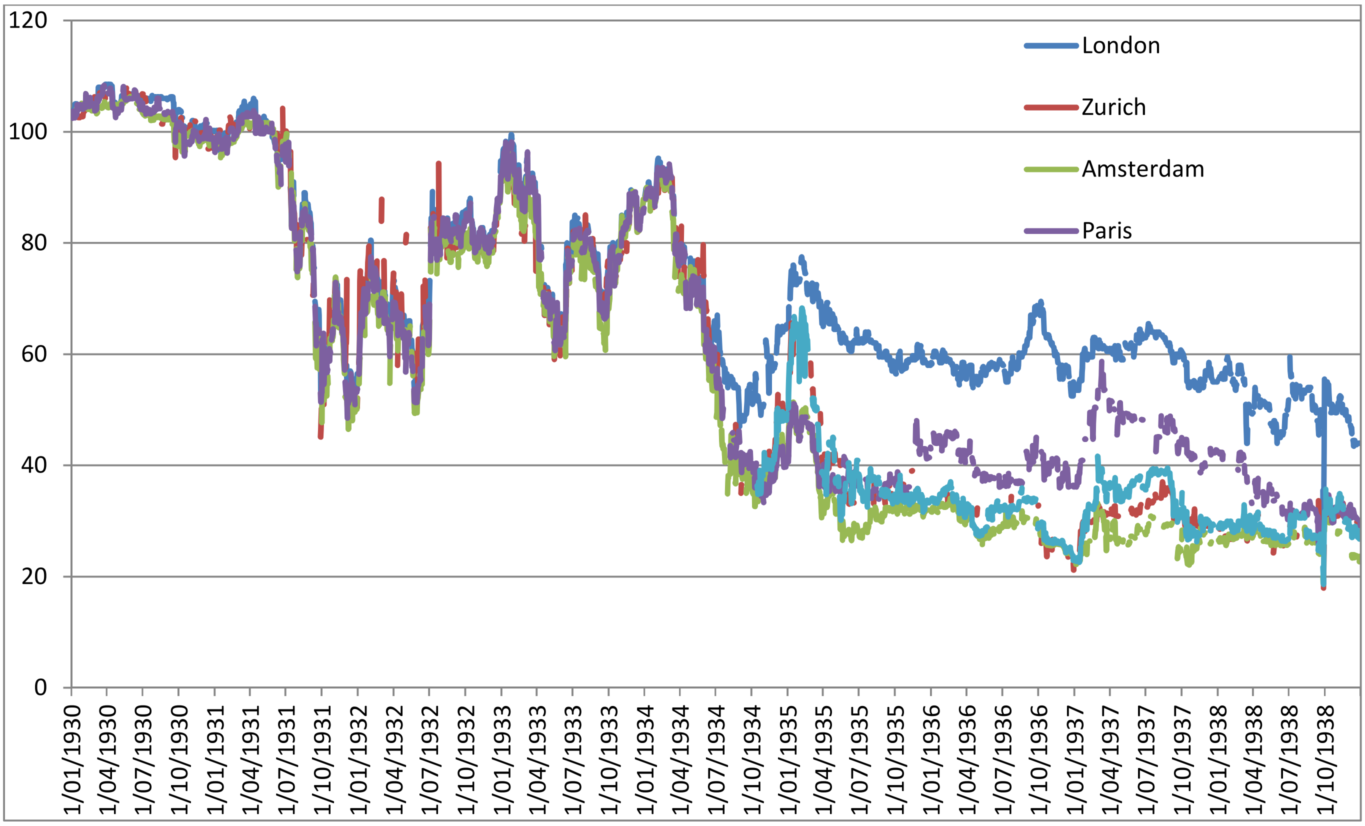
4. The Dawes bond market during the 1930s

As pointed out in section 2, Dawes bonds denominated in Pound Sterling were traded at the same time in Britain, France, the Netherlands and Switzerland[24]. In theory the price of such a cross-listed bond should remain broadly similar across countries, since otherwise it would be profitable to conduct arbitrage operations. Even when arbitrage is not possible because of an external shock, prices tend to be relatively similar as they reflect the fundamental value of the assets. For example when arbitrage between Paris and London became impossible during the First World War, the prices of cross-listed Russian bonds remained similar for a long time (Bernal et al., 2010). However, permanent price differences across markets can emerge under the exceptional conjunction of both the absence of arbitrage and differentiated treatment of bondholders in different markets. This is what happened to the Pound Sterling Dawes bond following the German moratorium of June 1934. Market segmentation occurred instantly as soon as Germany officially defaulted on the Dawes bond on June 14, 1934. Investors clearly started expecting differential treatment of creditors. This becomes evident when considering the development of the prices of the Dawes bonds converted in £ at the current exchange rate[25] in Amsterdam, London, Paris and Zurich (Figure 1).

[24] We disregard the case of Belgium in this paper for reasons of space and data availability.

[25] Since the bonds were all issued and payable in sterling, they are immediately comparable. Exchange rate risk is visible directly for Dawes bonds quoted and traded in another currency. Figure A in Appendix 1 provides the price in Swiss franc of the Dawes bond for both the CHF and the Sterling tranche. The British departure from the gold standard in 1931 is clearly visible as well as the Swiss one in 1936.

Figure 1: £ Dawes Prices for Amsterdam, London, Paris and Zurich, 1930-1938 (converted in £ at the current exchange rate)



Considering the prices themselves on the different markets, the evidence presented in Figure 1 leads to the following conclusions: The price of the bond in London was persistently higher than on any other market, even when the actual cash-flows from the bond were still the same in all markets. This means that investors did not perceive trade sanctions and clearing systems as useful tools to obtain repayment from Germany. By contrast, they expected that creditor countries, especially Britain, which had granted Germany favorable trade conditions would obtain better debt settlement terms than others. Therefore, guaranteeing the trade surplus with the defaulting country by increasing bilateral trade was perceived as a viable solution to obtain a favorable debt settlement. Even if this observation stands in sharp contrast with the trade sanctions approach in the literature, creditor countries at the time actually had little incentives to sanction Germany with trade restrictions. Once bilateral agreements began to be signed, expected cash flows began to differ across countries. Importantly, this was the case even though actual cash flows remained identical for the time being.

Figure 1 shows that significant price differences between Pound Sterling Dawes bonds traded in London and the Netherlands emerged very rapidly already at the beginning of June 1934. Therefore, Dutch investors clearly anticipated the Clearing Agreement of October with its adverse effect on the availability of foreign exchange for interest transfers, which would in time end the special status of the Reich loans. Very much the same picture can be observed for Dawes bond prices in Zurich and Paris during these months. Inversely, the Dawes Loan continued to trade in London on a higher level than on any other market after June 1934. Accordingly, the general recovery of prices in late 1934 was most pronounced on the British market. This reflected the terms of the Anglo-German payments agreement of November 1st, which curtailed trade between the two countries decidedly less than the clearing agreements did that Germany had struck with the other countries. Thus, British investors rewarded the conciliatory solution the British government had opted for in its standoff with Germany over the June 1934 moratorium.

To more formally test the difference between the markets, Table 1 and Figure 2 provide the mean price spread of the Paris, Amsterdam and Zurich market with respect to the London one. The difference between the mean of the mean price spread before and after the 1934 default is large and statistically significant at the 1% level. Arbitrage between different markets was not perfect before the default as the mean price spread was significantly greater than zero even before the default. The difference across markets is however fairly small for the first pre-default period and may reflect transactions costs or differences in market microstructure. The spread increases however dramatically immediately after Schacht's announcement that Germany would no longer service the Dawes bond. Importantly, the standard deviation of the mean price spread increases too across the two sub-periods, pointing to a more differential development on the different markets and in general to an increase in risk perception.

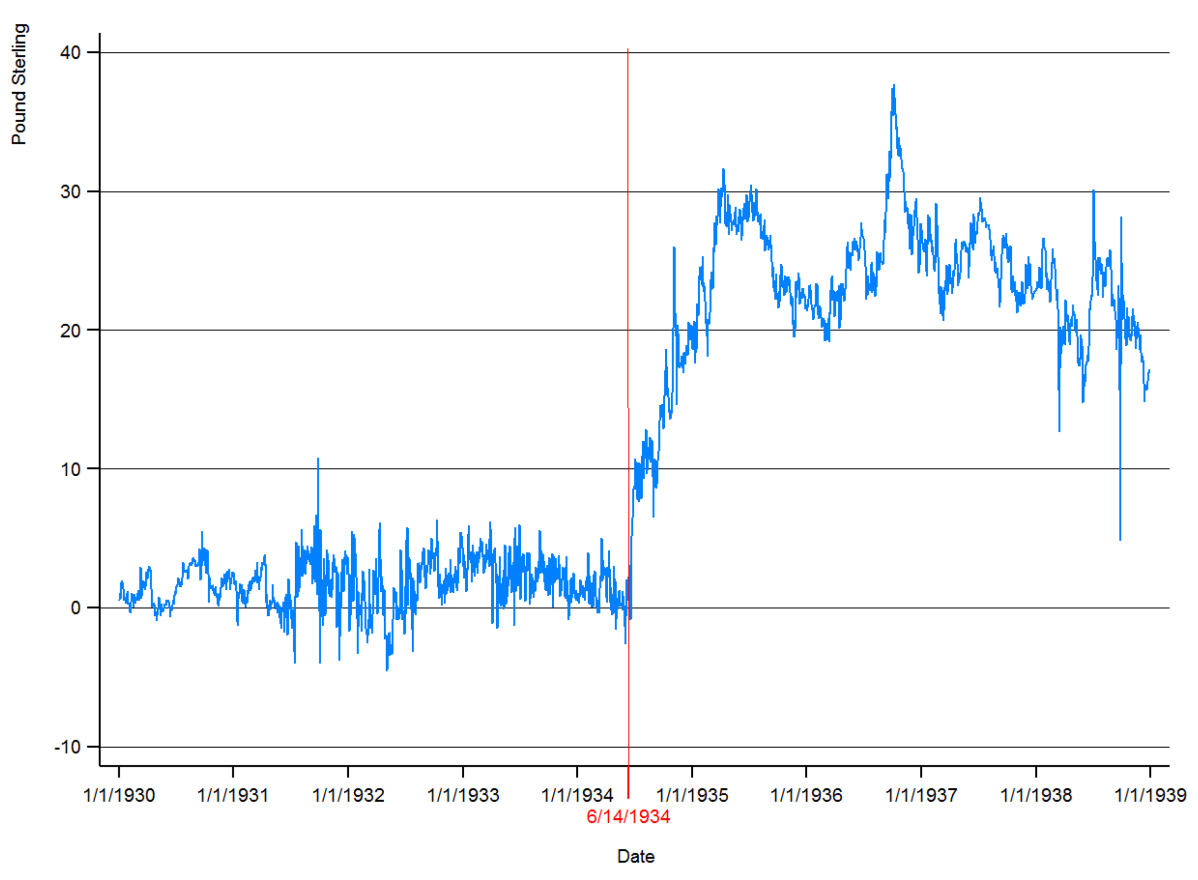
Table 1: Mean price spread between continental markets and London.

	whole period (1/3/30 - 12/29/38)	pre-default (1/3/30 - 6/14/34)	post-default (6/15/34 - 12/29/38)	difference
Mean	12.44***	1.70***	22.95***	21.25***
Standard deviation	11.315	1.685	5.226	3.541
Median	7.81	1.73	23.36	21.63
Minimum	-4.50	-4.50	-0.87	3.63
Maximum	37.72	10.76	37.72	26.96

*** different from zero at the 1% level of significance

Figure 2 illustrates perfectly the change occurring after June 1934 (represented by a full line on the figure). Whereas before June 1934 the spread remained fairly limited in size, after that date not only did it increase substantially but it also experienced much more volatility, with many large changes occurring on a regular basis.

Figure 2: Mean price spread between continental markets and London



The Dawes bond markets were not only segmented internationally, but also within countries. The agreements were extremely complex: in France, Great Britain and Switzerland a similar treatment was given to nationals wherever they lived and foreigners living in the country. By contrast, in Belgium, Italy, the Netherlands and Sweden, it was the place were bondholders lived which mattered. Nationals living abroad were not treated on par with foreign residents of the country in question. As a result, expected cash flows became a function of place of issue, as well as residence and nationality of the bondholders. In view of the complexity of the rules, a table summarizing payment conditions had to be created (see Appendix 1) Since some of the rules were based on nationality and others on residence (or both), some investors could decide to which regime they wanted to be incorporated into. Since Great Britain promised the better deal, the amount certified as British exceeded the amount issued in the United Kingdom already in September 1934 (Table 2). As time went by additional investors managed to get their bonds certified as having British ownership leading to an amount close to 1,000,000£ to be considered as such.

Table 2: Amounts certified as British in 1934 and 1938

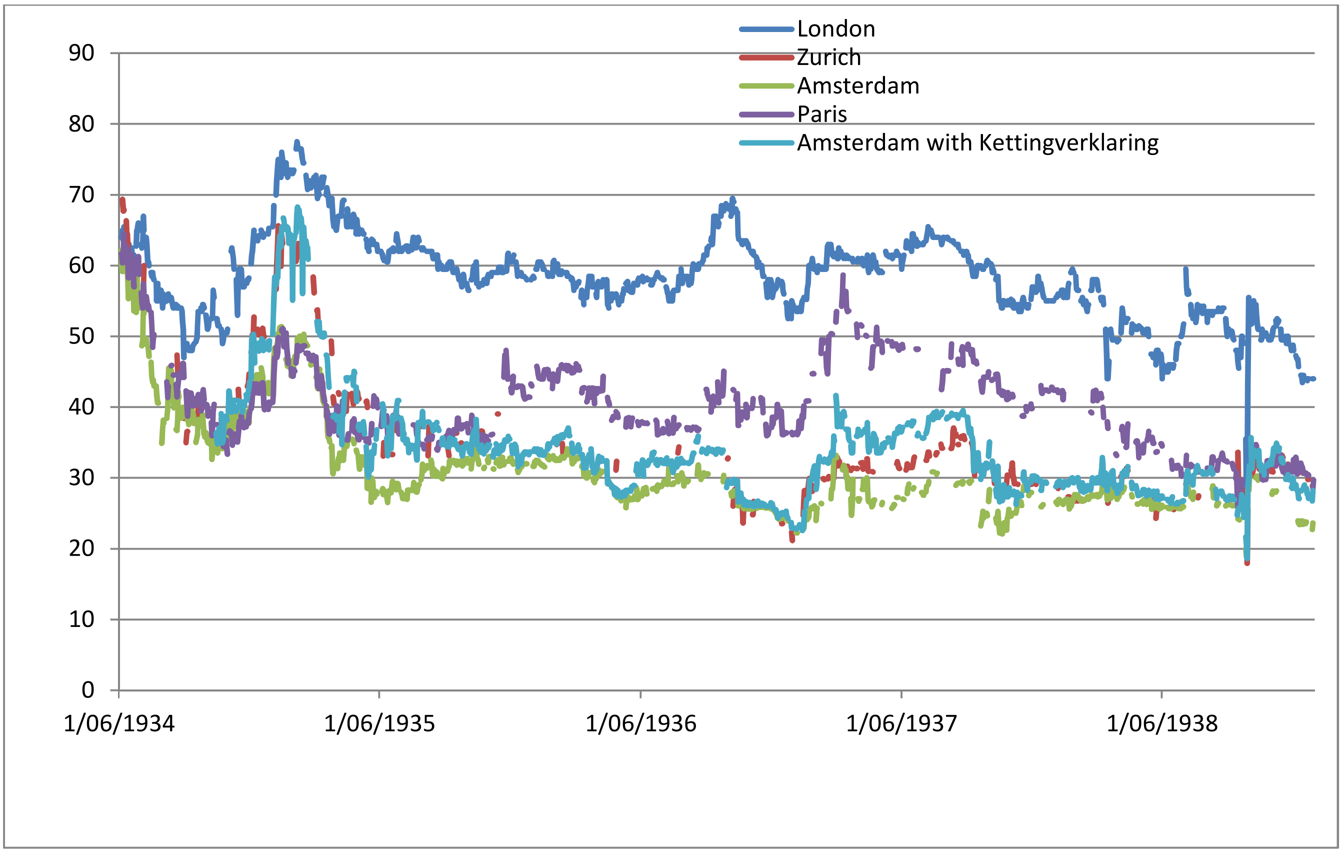
UK British issue (gross)	9,158,600 £	
Certified amounts (£)	**In 1934**	**In 1938**
British issue	7,387,000 £	8,114,100 £
Belgian	479,500 £	574,200 £
Dutch	263,600 £	303,700 £
French	1,319,900 £	1,402,500 £
Swiss	297,900 £	316,600 £
TOTAL	**9,747,900 £**	**10,711,100 £**

Source: BoE archives, OA26-2, for 1934; and OV34/281, for 1938

In practice, these regulations were enforced by introducing affidavit systems. Only holders of bonds that were equipped with an affidavit were eligible for interest payments under the particular clearing or payments system in place. However, in some countries bonds could still be traded on the market even if they did not meet the affidavit requirements. Figure 3 contains the Amsterdam prices for both the bonds that did and did not carry the equivalent Dutch affidavit called "Kettingverklaring" from 15 October 1934 onwards. Bonds without affidavit were considered as in default on their interest payment[26].

[26] Officiele prijscourant der Vereeniging voor de Effectenhandel, Amsterdam 15 October 1934.

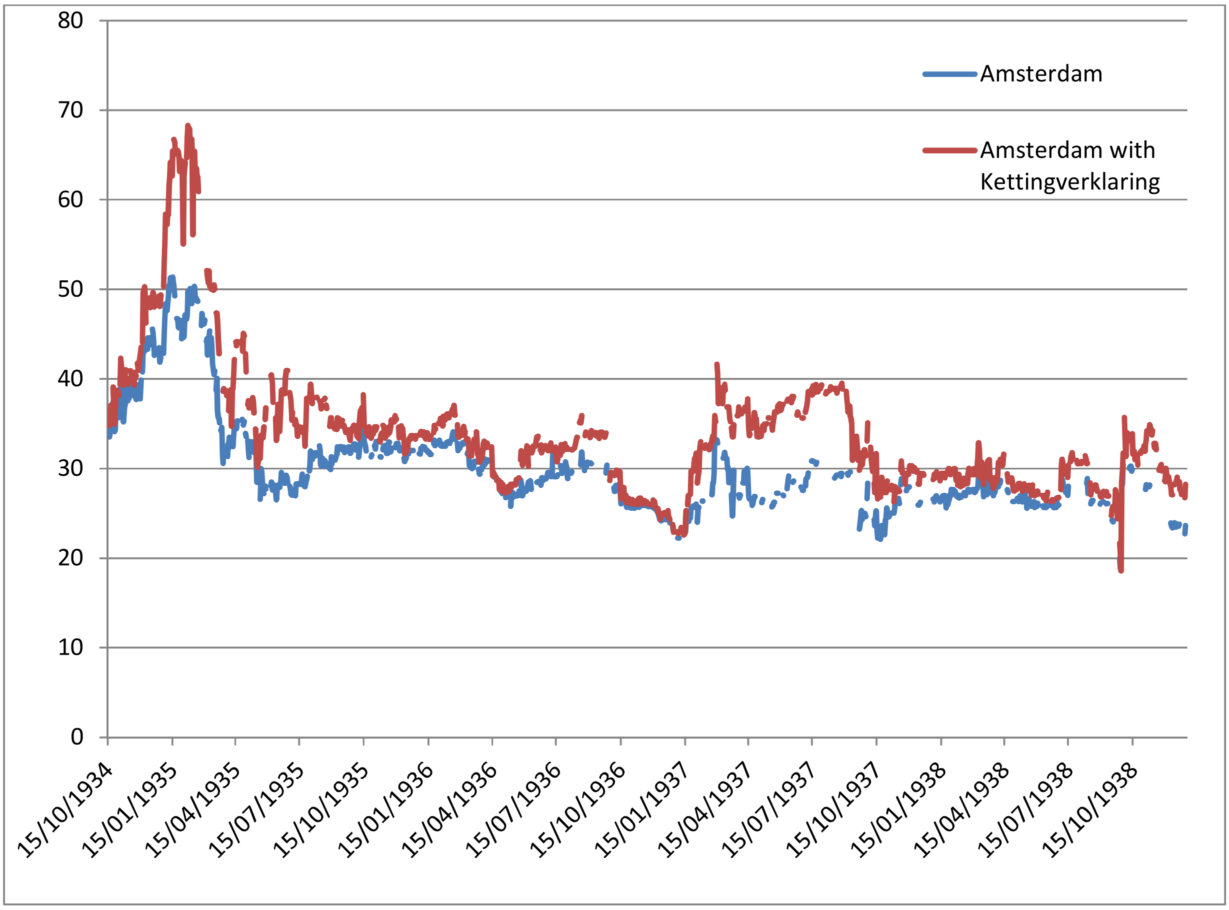
Figure 3: £ Dawes Prices for Amsterdam, London, Paris and Zurich, June 1934-1938 (converted in £ at the current exchange rate)



(For Amsterdam, two prices are provided, with and without kettingverklaring (affidavit))

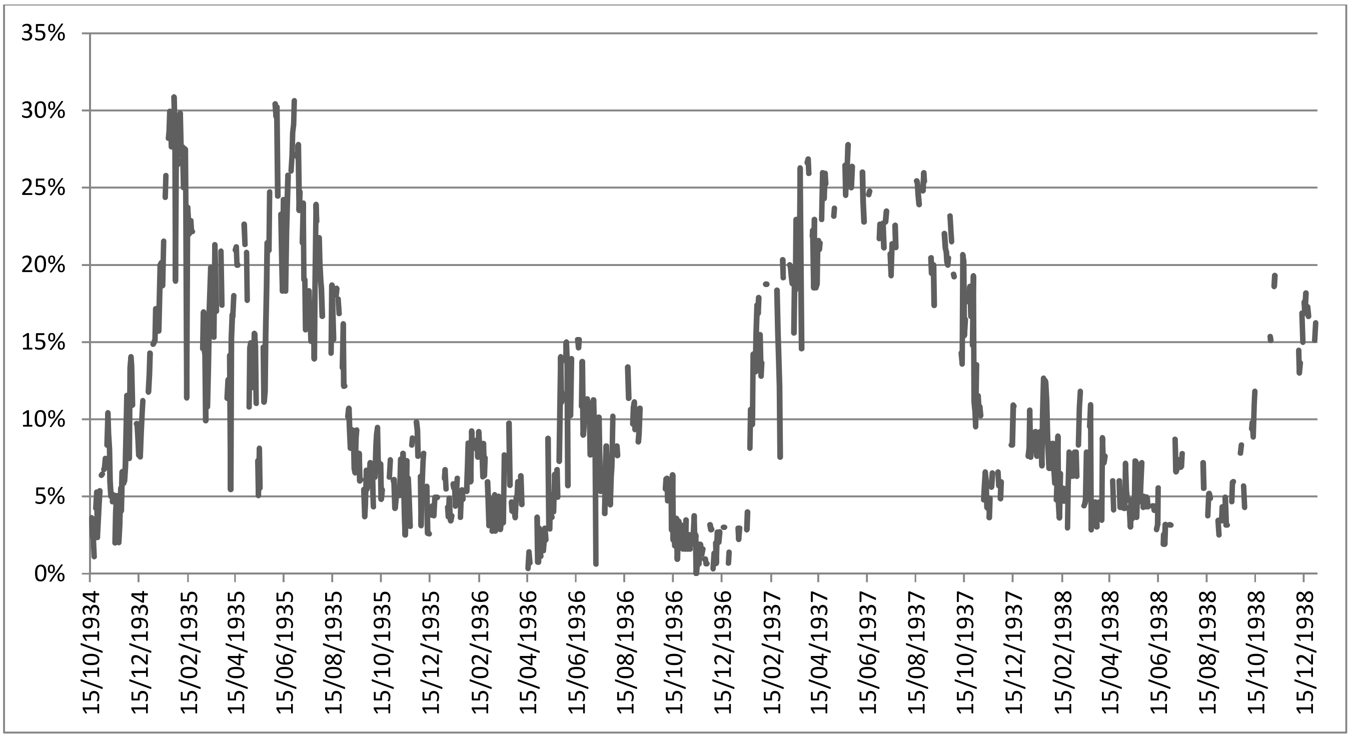
To better view how markets valued the affidavits Figure 4, provides the difference in £ between the bonds with and without affidavits. The price difference between the bond with and the bond without Kettingverklaring changes considerably over time (Figure 5). During some periods, the price difference was minute suggesting that market participants did not care so much about how much effective interest transfers they could exact at the given moment. During other periods however the price differed much more.

Figure 4: £ Dawes Prices for Amsterdam, with and without affidavit (kettingverklaring), 15 October 1934-1938 (converted in £ at the current exchange rate)



Another way to look at the market perception of this affidavit is to compare absolute price difference to the price of the bond $\left(\frac{P(ketting.) - P(w/o\ ketting.)}{P(ketting.)}\right)$, and thus compute the affidavit premium. This premium, reported in Figure 5, is extremely large during some periods.

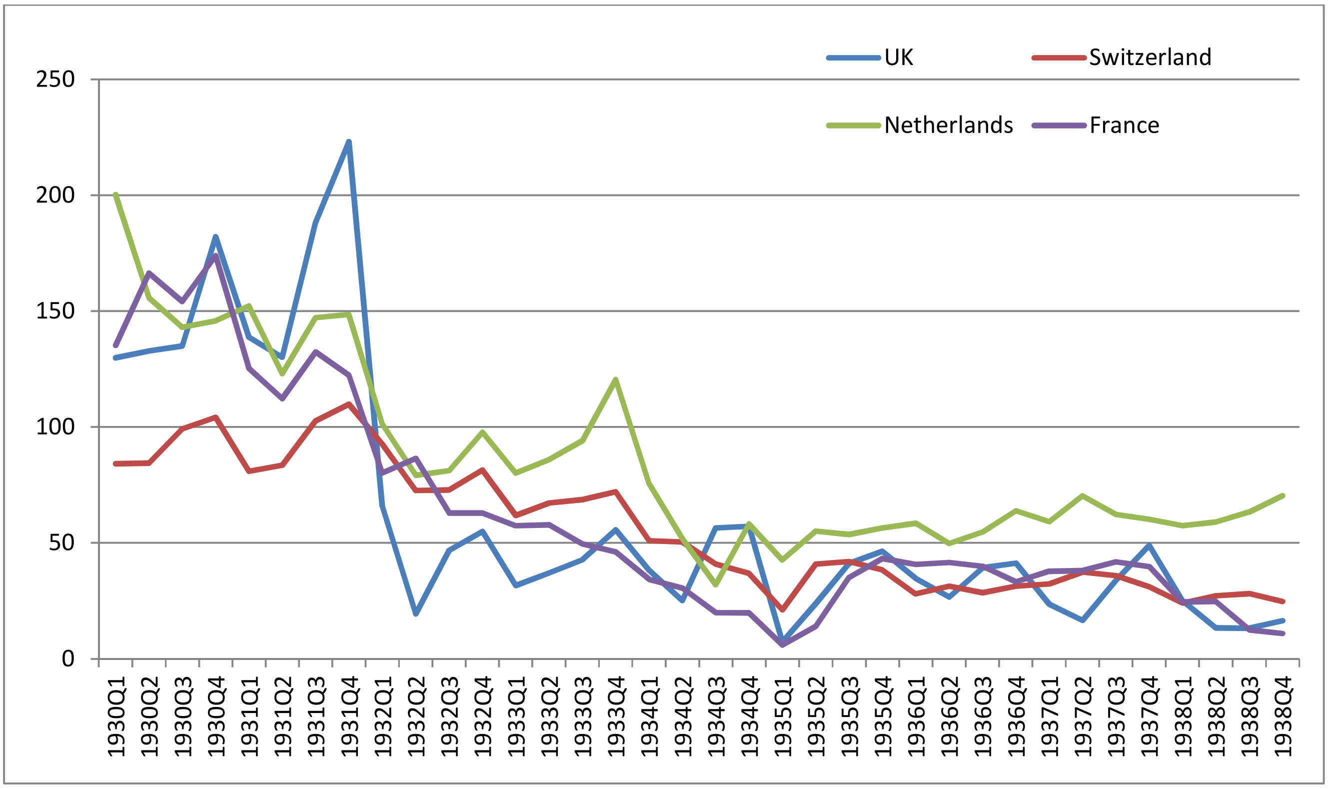
Figure 5: Affidavit Premium 1934-1938 (converted in £ at the current exchange rate)



The premium was particularly high in 1934-1935 and in 1937. To assess whether trade could explain these changes, we compute the correlation between the premium and a one period lagged German trade surplus with the Netherlands. Since trade data is available on a quarterly basis only, the correlation is run on a limited number of points and should therefore be viewed with caution. If colonial trade is excluded from the sample the correlation is equal to 20.18%, once included this figure rises to 26.24%. Even though consistent with priors, these correlations show that many other elements played a role in the bond valuation. Furthermore the premium experiences sharp and rapid changes over the period. If the trade surplus was the main driver of the affidavit premium then it would mean that investors revised their expectations regarding trade surplus extremely frequently.

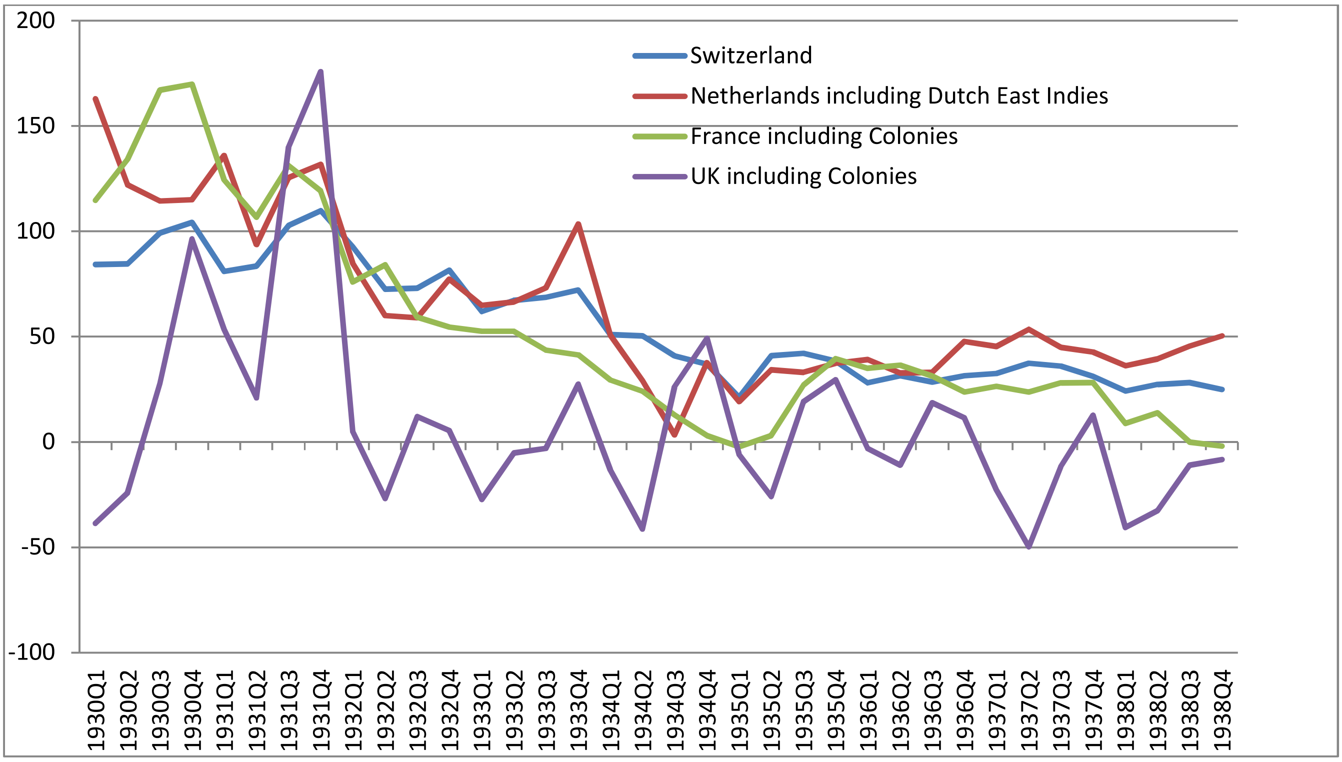
Figure 6 depicts the evolution of the German trade surplus vis-à-vis France, Great Britain, the Netherlands and Switzerland. Figure 6 provides the same information but includes trade with British, Dutch and, French colonies. Both figures are characterized by a sharp decline in the German trade surplus, which even turned into a deficit for the UK once colonial trade is included. As a result, trade became gradually a less and less credible tool to guarantee the Dawes' bonds' reimbursement.

Figure 6: German trade surplus vis-à-vis France, Great Britain, the Netherlands and Switzerland, in Million RM (1930-1938)



Source: Monatliche Nachweise über den auswärtigen Handel Deutschlands, 04/1930-01/1939.

Figure 7: German trade surplus vis-à-vis France, Great Britain, the Netherlands and Switzerland, in Million RM (1930-1938), colonial trade included



Source: Monatliche Nachweise über den auswärtigen Handel Deutschlands, 04/1930-01/1939.

To further assess the importance of international trade we compute the correlations between the prices of the Dawes bonds and lagged trade for the four countries under consideration. The figures are once again consistent with priors, with larger German trade surplus linked to higher prices (with correlations equal to 29.84% d-for Great Britain, 49.41% for Switzerland, 48.38% for France and 34.83% for the Netherlands). Results remain very close for Great Britain and France when colonial trade is included (44% for Great Britain and 44.29% for France) but differ dramatically for the Netherlands (-54.43%). In all cases, international trade at best explains only part of the price differential. This is in fact not surprising as within countries creditors on Germany were vying to get access to the hard currency generated by international trade.

5. Conclusion

Trade sanctions are often presented as a reason for sovereign debt reimbursement. Empirical evidence regarding the effectiveness of this form of sanction is however elusive at best. This paper, focusing on the case of the German default on the Dawes loans, shows the complexity of the imposition of trade sanctions following default. The case of the Dawes loan is exceptional because negotiations constantly linked trade negotiations and reimbursement, rendering it a perfect candidate to analyse the interplay between trade and sovereign default. The threat to impose unilaterally a clearing led to negotiations but at the cost of inter-creditor equity. In the wake of Germany's default clearing agreements had been widely regarded as the preferable solution to the underlying transfer problem. We show, however, that creditors in fact had little to gain from comprehensive clearing agreements. They provided limited incentives for Germany to increase its trade surplus. Furthermore, the interest groups within creditor countries affected by the German debt default were not the same as those that had a stake in trade with Germany. This limited the effectiveness of clearing as a potential sanction against the defaulting debtor. Indeed, the clearing agreements subsequently concluded resulted in distributional struggles within creditor countries. We argue that the German government exploited this situation in order to play out different groups of creditors against each other. Thanks to this strategy, the German government managed to minimize its debt burden. This strategy was facilitated by a general trend towards international bilateralism that stifled attempts to maintain a united creditor front in the first place.

Prices of the Dawes loan across markets show that investors displayed little confidence in the trade sanctions approach that was implicit in the imposition of a Clearing system. Differences for cross-listed bonds are indeed only marginally correlated to the trade surplus of the various countries. Investors were therefore likely to rely on other elements than trade sanctions to value the bonds. Political motives, amongst other the relative importance of each country for Germany in general, seem more likely to explain the price differences. The United Kingdom was much more important in supplying raw material for the German war effort, than either

France, The Netherlands or Switzerland, and therefore managed to protect its holders of the Dawes bonds in a more efficient way than the other countries.

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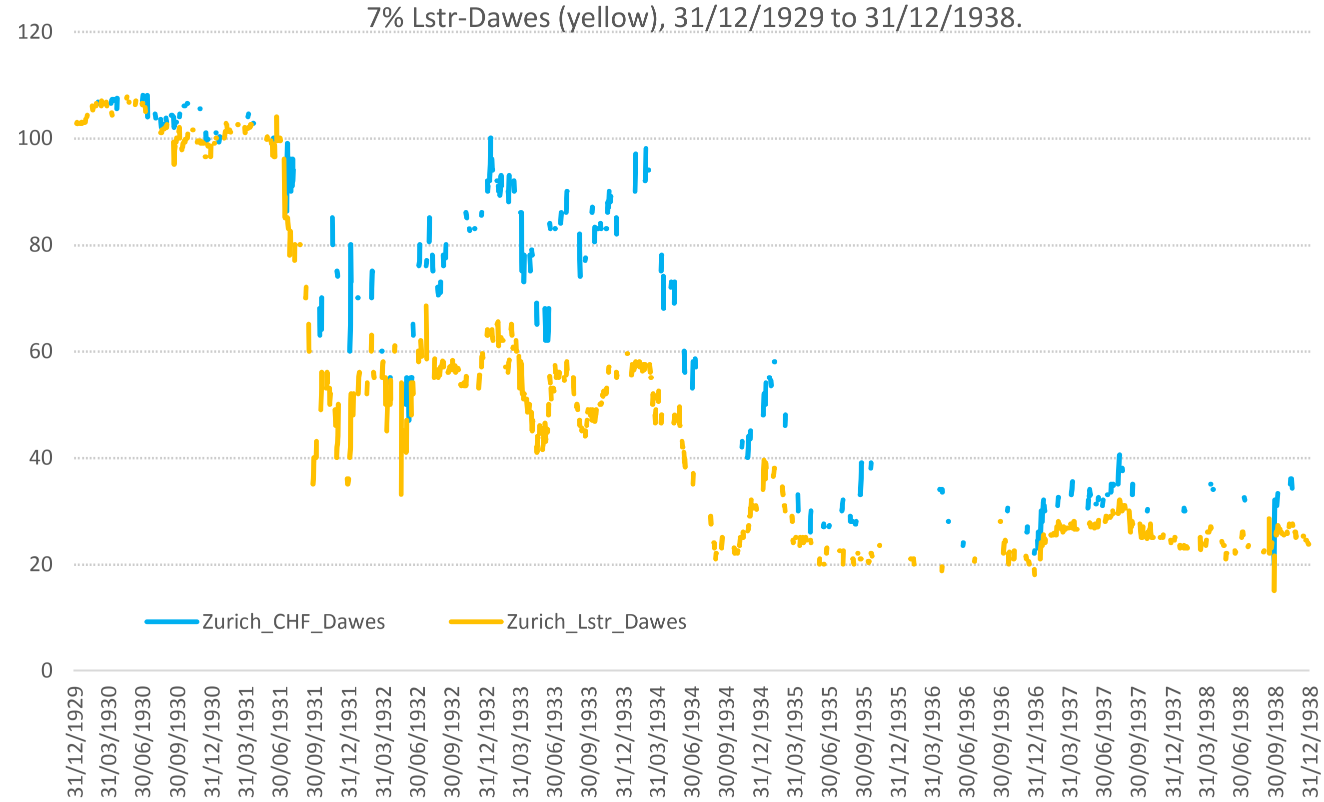
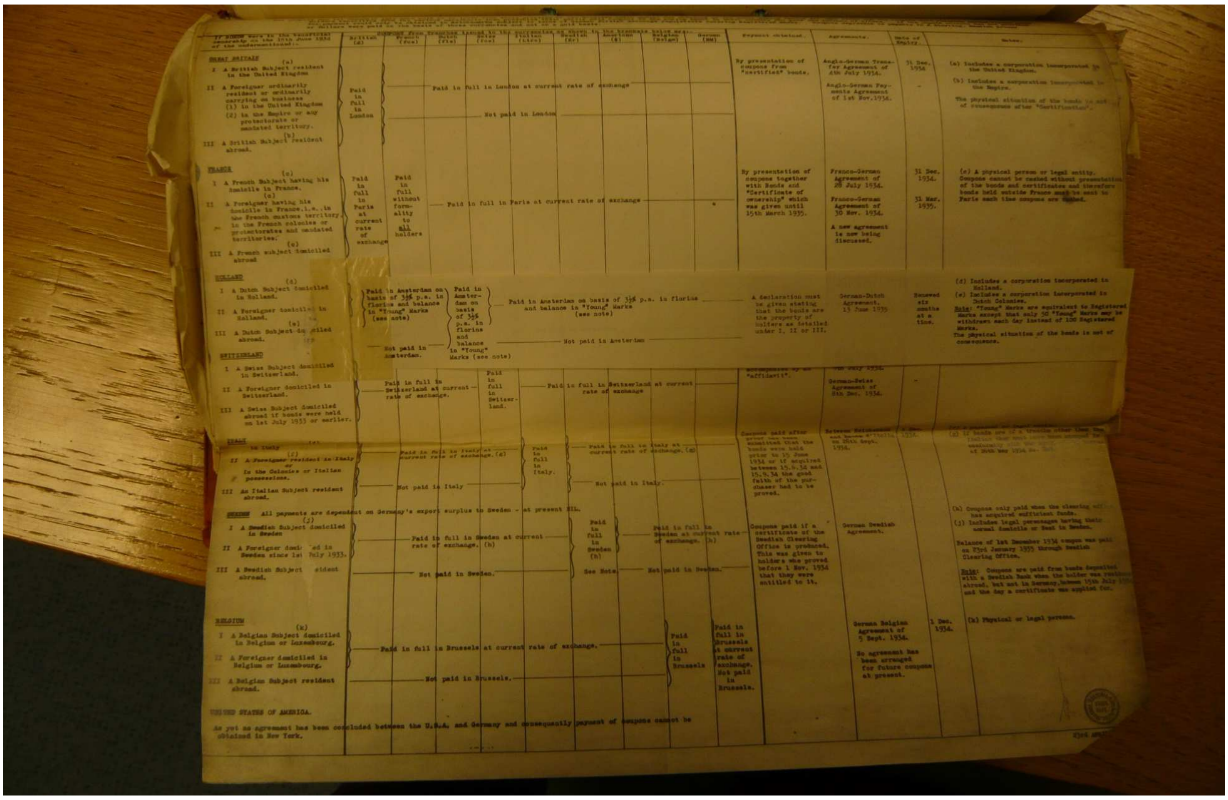
Appendix 1:

Figure A: Closing Prices for the Zurich market, original series: 7% CHF-Dawes (blue), 7% Lstr-Dawes (yellow), 31/12/1929 to 31/12/1938.



Appendix 2:

Table summarizing the different treatments to be applied to each class of bondholders



If bonds were in the beneficial ownership on the 15th June 1934 of the undermentioned:-	Coupons from tranches issued in the currencies as shown in the brackets below are:- British (£), French (Fcs), Dutch (Fls), Swiss (Fcs), Italian (Lire), Swedish (Kr), American ($), Belgian (Belgas), German (RM)	Payment obtained.	Agreements.	Date of Expiry.	Notes.
GREAT BRITAIN (a) I A British Subject resident in the United Kingdom. II A Foreigner ordinarily resident or ordinarily carrying on business (1) in the United Kingdom (2) in the Empire or any protectorate or mandated territory. (b) III A British Subject resident abroad.	British: Paid in full in London. Other tranches: Paid in full in London at current rate of exchange / Not paid in London	By presentation of coupons from "certified" bonds.	Anglo-German Transfer Agreement of 4th July 1934. Anglo-German Payments Agreement of 1st Nov. 1934.	31 Dec. 1934 / –	(a) Includes a corporation incorporated in the United Kingdom. (b) Includes a corporation incorporated in the Empire. The physical situation of the bonds is not of consequence after "Certification".
FRANCE (c) I A French Subject having his domicile in France. (c) II A Foreigner having his domicile in France, i.e., in the French customs territory in the French colonies or protectorates and mandated territories. (c) III A French subject domiciled abroad	British: Paid in full in Paris at current rate of exchange. French: Paid in full without formality to all holders. Other tranches: Paid in full in Paris at current rate of exchange	By presentation of coupons together with Bonds and "Certificate of ownership" which was given until 15th March 1935.	Franco-German Agreement of 28 July 1934. Franco-German Agreement of 30 Nov. 1934. A new agreement is now being discussed.	31 Dec. 1934. / 31 Mar. 1935.	(c) A physical person or legal entity. Coupons cannot be cashed without presentation of the bonds and certificates and therefore bonds held outside France must be sent to Paris each time coupons are cashed.
HOLLAND (d) I A Dutch Subject domiciled in Holland. II A Foreigner domiciled in Holland. (e) III A Dutch Subject domiciled abroad.	British/French: Paid in Amsterdam on basis of 3½% p.a. in florins and balance in "Young" Marks (see note) / Not paid in Amsterdam. Dutch: Paid in Amsterdam on basis of 3½% p.a. in florins and balance in "Young" Marks (see note). Other tranches: Paid in Amsterdam on basis of 3½% p.a. in florins and balance in "Young" Marks (see note) / Not paid in Amsterdam	A declaration must be given stating that the bonds are the property of holders as detailed under I, II or III.	German-Dutch Agreement. 13 June 1935	Renewed six months at a time.	(d) Includes a corporation incorporated in Holland. (e) Includes a corporation incorporated in Dutch Colonies. Note: "Young" Marks are equivalent to Registered Marks except that only 50 "Young" Marks may be withdrawn each day instead of 100 Registered Marks. The physical situation of the bonds is not of consequence.
SWITZERLAND I A Swiss Subject domiciled in Switzerland. II A Foreigner domiciled in Switzerland. III A Swiss Subject domiciled abroad if bonds were held on 1st July 1933 or earlier.	Paid in full in Switzerland at current rate of exchange. Swiss: Paid in full in Switzerland. Paid in full in Switzerland at current rate of exchange	[illegible] accompanied by an "affidavit".	[illegible] July 1934. German-Swiss Agreement of 8th Dec. 1934.	–	
ITALY (f) I [illegible] in Italy (f) II A Foreigner resident in Italy or in the Colonies or Italian possessions. III An Italian Subject resident abroad.	Paid in full in Italy at current rate of exchange. (g) / Not paid in Italy. Italian: Paid in full in Italy. Paid in full in Italy at current rate of exchange. (g) / Not paid in Italy.	Coupons paid after proof has been submitted that the bonds were held prior to 15 June 1934 or if acquired between 15.6.34 and 15.9.34 the good faith of the purchaser had to be proved.	Between Reichsbank and Banca d'Italia on 26th Sept. 1934.	1 Dec. 1934.	(f) A physical or legal entity. (g) If bonds are of a tranche other than the Italian they must have been stamped by [illegible] of 26th May 1934 [illegible]
SWEDEN All payments are dependent on Germany's export surplus to Sweden - at present NIL. (j) I A Swedish Subject domiciled in Sweden II A Foreigner domiciled in Sweden since 1st July 1933. III A Swedish Subject resident abroad.	Paid in full in Sweden at current rate of exchange. (h) / Not paid in Sweden. Swedish: Paid in full in Sweden (h) / See Note. Paid in full in Sweden at current rate of exchange. (h) / Not paid in Sweden.	Coupons paid if a certificate of the Swedish Clearing Office is produced. This was given to holders who proved before 1 Nov. 1934 that they were entitled to it.	German Swedish Agreement.		(h) Coupons only paid when the clearing office has acquired sufficient funds. (j) Includes legal personages having their normal domicile or Seat in Sweden. Balance of 1st December 1934 coupon was paid on 23rd January 1935 through Swedish Clearing Office. Note: Coupons are paid from bonds deposited with a Swedish Bank when the holder was resident abroad, but not in Germany, between 15th July 1934 and the day a certificate was applied for.
BELGIUM (k) I A Belgian Subject domiciled in Belgium or Luxembourg. II A Foreigner domiciled in Belgium or Luxembourg. III A Belgian Subject resident abroad.	Paid in full in Brussels at current rate of exchange. / Not paid in Brussels. Belgian: Paid in full in Brussels. German: Paid in full in Brussels at current rate of exchange. Not paid in Brussels.		German Belgian Agreement of 5 Sept. 1934. No agreement has been arranged for future coupons at present.	1 Dec. 1934.	(k) Physical or legal persons.
UNITED STATES OF AMERICA. As yet no agreement has been concluded between the U.S.A. and Germany and consequently payment of coupons cannot be obtained in New York.					

23rd April [illegible]

Source: Bank of England Archives