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TO GOVERNOR DRAPER

FROM MR. CLAYTON

REMARKS:

I thought you would be interested to see the Chairman's letter to Randolph Burgess respecting the article in the National City Letter of a month ago. Please return to me after you have finished with it.

WC

This is a cracking good reply. If it doesn't flatten out Randolph B., there must be something the matter with his reasoning powers! E. G. D.

4/5/44

CHAIRMAN'S OFFICE

April 5, 1944

Mr. W. Randolph Burgess, Vice Chairman,
The National City Bank of New York,
New York, New York.

Dear Randy:

Following up our brief discussion of the matter when you were down here some weeks ago, I wish to comment on some of the points made in a part of the National City Letter of March 1944. I refer to the discussion of the recommendation in the Baruch Report for a broadening of the Federal Reserve System's authority under section 13b.

The article first states that "***it should be noted that the Federal Reserve Banks now have authority to make many more of these loans than they have ever had outstanding; they make few because there are few credit-worthy applicants not cared for elsewhere". This rather superficial conclusion is supported by a quotation from the August 1938 Monthly Review of the Federal Reserve Bank of New York which indicates that the expenses and losses involved in such credit are greater than the income, even with interest as high as six per cent. If the author had taken the trouble to check more recent figures, he would have found that the New York Bank's experience up to the end of December 31, 1943, would look quite different. Furthermore, the article is discussing the operations of the twelve Federal Reserve Banks so that it would have been more accurate and fairer had the author checked into the experience of the System as a whole. Thus for the entire period of operations under section 13b up to December 31, 1943, the twelve Federal Reserve Banks, as a group, had made net earnings of $1,423,000 after providing for losses of $3,052,000.

Bearing upon the question of the volume of loans made by the Federal Reserve Banks, I am enclosing herewith a copy of a letter I wrote to Jesse Jones back in 1939.

More importantly, the Baruch recommendation is criticized because it "departs from the principle of getting the Government out of business". Evidently the assumption is that the Federal Reserve Banks are "Government" and the funds appropriated under section 13b in reality a return of part of the capital funds of the Federal Reserve Banks appropriated to the FDIC in 1934, are Government funds. With this I agree, although most bankers look upon the Federal Reserve Banks as private financial institutions owned by the member banks. However, the funds in question are not to be loaned directly but are to be used as a guarantee fund so as to generate loans by commercial banks up to three or four times the amount of the fund. If losses should prove to be heavier than the income from the guarantee fund so that the capital of the fund would be impaired, one might say that public funds had been used. All this, however, is almost academic argument, since the important question is not whether the proposal by itself does or does not "get the Government out of business" but whether it will serve to keep the Government from getting into the private credit field more heavily at some other point. It is a question of alternatives.

It seems to me the signs are unmistakable that, due to the political appeal of legislation in behalf of small business, Congress will provide some governmental mechanism for liberal financing of small business during the reconversion period and thereafter. A review of the "small business" influence in Congress is illuminating. Notwithstanding the fact that the Smaller War Plants Corporation bill had little or no support from the Armed Services and only a reluctant approval by the Chairman of the War Production Board, it passed both Houses without a single opposing vote. Hearings on that bill before the Banking and Currency Committees of both Houses are replete with declarations by Republicans and Democrats alike that they favored special consideration for small business. The Small Business Committees, which were not taken seriously a few years ago, have now become powerful in their influence. In addition to the perennial Mead Bill, other bills are being prepared. I am informed that the Senate Small Business Committee has prepared a Confidential Print of a bill which would, in effect, greatly enlarge and broaden the powers of the Smaller War Plants Corporation, changing its name to Federal Smaller Business Corporation, raising its capital to one billion dollars, authorizing loans to, and investment in the stock of, any type of business and for any purpose, and in other respects making it a powerful credit and service organization for small business during the reconversion period and thereafter until July 1, 1948. Senator Taft has himself introduced a bill, S. 1777, providing for a small business financing administration in the Department of Commerce. This bill would authorize the insurance of a total of $500,000,000 of loans to be outstanding at any one time and, in addition, would permit the insurance of investment companies against loss on stocks up to an aggregate of $500,000,000 at any one time. Companies whose borrowings or stock issues would be eligible for insurance could have an equity capital of as much as one million dollars. Doubtless other bills will be offered. You will agree with me, I am sure, that legislation of either type mentioned above would be most unsound and should be prevented.

Thus turning thumbs down on the proposal I made to Mr. Baruch and which he recommended in his report will not "get the Government out of business". Politically, I don't think it is possible to get the Government out of industrial lending, so that it comes down to a question of what kind of an agency the Government should have and on what basis the credit should be extended. The answer to these questions will determine in large part the welfare of the private banking structure. For that reason, I believe that the Federal Reserve System should become the Government's arm in the credit field except for agricultural credit. I realize that many influential bankers oppose such an idea on the ground taken by your Bank Letter that the System's assets should not be so used. But by keeping the Federal Reserve out of the picture, we succeed only in affording an excuse for Congress to set up other agencies which compete with the private banking system. I believe an aggressive program under a liberalized 13b might have forestalled the creation of the Smaller War Plants Corporation. And I believe today that if the Federal Reserve System were entrusted with the responsibility of assisting small and medium sized business to weather the financial storms of the termination and reconversion periods, proposals such as the Federal Smaller Business Corporation might have difficulty obtaining support. And I think you and I will both agree that if private credit is to be supplemented by some form of governmental intervention, it would be preferable that it be handled by the Federal Reserve Banks through the guaranteeing of loans made by the commercial banks. Otherwise, you will have new agencies not only lending Government funds directly, but also investing directly in shares.

I would appreciate it if you would bring this matter to the attention of the editor of your monthly letter. It has such a long-established and excellent reputation for speaking with authority and with impartiality that I am confident that those who edit it would not intentionally misinform your large number of readers. It is not merely that the article to which I referred does a disservice, in my opinion, to the Federal Reserve, but if my analysis of the situation is correct, it is not in the interest of our private banking system. Accordingly, I felt that the subject was of such importance that I should give you and, through you, the editor the reasons why I differed so strongly from the attitude expressed in this article.

The information respecting the Committee Print of a bill to establish a Federal Smaller Business Corporation is confidential until released by the Senate Small Business Committee.

With kindest personal regards,

Sincerely yours,

s/ Marriner

M. S. Eccles,
Chairman.

LC:ET/mg

cc: Miss Benton

1812

1944

Economic Conditions
Governmental Finance
United States Securities

New York, March, 1944

General Business Conditions

THE most important business development in February has been the publication of the Baruch-Hancock report on "War and Post-War Adjustment Policies," and of the report to the Senate of its Committee on Post-War Economic Policy and Planning — the George Committee —, dealing with cancellation of war contracts, disposition of surplus property and industrial demobilization and reconversion. Both reports have official standing, and it is certain that official policy will be based on them. Two major recommendations of the Baruch-Hancock group were put into effect at once, through the appointment of General Hines to handle "human problems" resulting from demobilization and of Mr. W. L. Clayton to be the Surplus War Property Administrator. Both men have long experience and recognized capacity in these fields. The Senate recommendations are embodied in a bill (S. 1730) introduced by Senators George and Murray.

These reports are the products of the most intensive and expert study yet given to problems which are so important that, as the George Committee says, "no amount of study put upon them can be greater than they deserve." Nothing comparable to these studies was prepared during or after the first World War. If there had been it is likely that the wide swings in production, employment and prices between 1919 and 1922 might have been moderated; and of course the danger of economic disruption after this war, unless the Government has a sound reconversion program, is incalculably greater.

Where the Reports Agree and Disagree

In some public comment much has been made of the differences between the Baruch-Hancock proposals and those of the Senate Committee. Actually the similarities of the two programs and their broad areas of agreement are far more impressive than their differences. Both are based upon the principle that the compelling need in the demobilization period will be to get people back to work on peacetime jobs. To that end, both would get the Government out of business promptly by having it pay its debts, move war materials out of plants and sell its surpluses; and both would preserve and strengthen the system of free competitive enterprise. The specific proposals of the two reports are in harmony with these principles.

On the subject of contract termination particularly there is evidence of constructive cooperation between the Senate leaders and the Baruch-Hancock group. The Senate's legislative proposals are commended in the Baruch-Hancock report, which says that as a result of cooperation "the program for contract termination legislation is now remarkably far-advanced." Meanwhile studies to perfect termination procedure will be continued by the Joint Contract Termination Board, of which Mr. Hancock is chairman.

The major difference between the two reports is that the Senate Committee proposes (and Senate bill 1730 so provides) to set up a separate Office of Demobilization, headed by a Director responsible to and under the oversight of Congress, to be supreme in all matters relating to industrial reconversion. The Baruch-Hancock report, on the contrary, takes a strong position against a separate organization. Believing that the agencies which did the mobilizing also have to do the demobilizing, it argues that while the war lasts —

> preparations for demobilization are inseparable from the actual conduct of the war, from the constant adjustments required by the war . . . Such an agency could hardly avoid coming in conflict with every other war agency and would hinder the prosecution of the war. By the nature of its assignment we fear it would tend to become a pressure agency seeking to quicken demobilization for its own sake, forgetting war needs. . . . There is already too much over-lapping government machinery.

Despite this strong statement, however, the two proposals are not completely apart. The Senate bill provides that as long as hostilities continue the Office of Demobilization shall be subordinate to the Office of War Mobilization. The Baruch-Hancock report for its part says that "Congress should lay down whatever policies it feels wise and desirable to guide the existing agencies in their handling of demobilization problems," and that "later it may be advantageous to create a new, clearly post-war agency to liquidate present war agencies."

Argument whether Congress or the present O.W.M. is to supervise demobilization should not obscure the fact that the dominant public interest is in the kind of policies established, and the faithfulness and effectiveness with which they are carried out. The most important aspect of the two reports is their agreement upon the sound principles which have already been mentioned. The problem is to make the policies effective. The tremendous influence that the reports seem certain to exert, derived from their own merits and from the prestige of their authors, is probably the best assurance that the policies they recommend will govern.

Reducing the Size of the Reconversion Problem

In applying the stated principles, the Baruch-Hancock report, which is much the longer of the two documents, naturally goes into more detail. One of its main themes is that the size of the post-war reconversion problem should be reduced, and the war effort itself speeded, by tightening up efficiency during the war. It states forcefully that scrutiny of war requirements to avoid waste — such as accumulating excess stocks of weapons which rapidly become obsolete — should be intensified. It points out —

> the potential benefits from sweating down the programs, in avoiding the waste of material, manpower and facilities used to produce unneeded goods, at the same time permitting increased production of needed goods; the effect of these goods in lessening the dangers of inflation; the reduction in the dollar cost of the war; lowering the national debt, and the cost of carrying that debt, which must be met through taxes.

It goes on to say that this applies with equal force to every aspect of the production program. It denounces the making of goods no longer needed, simply to provide employment or profit, either in the war or post-war period. It argues for an early effective review of the programs for the production of raw materials, for stockpiling, for imports, for subsidies, premiums, or other devices to stimulate marginal production. It would use materials left after the war needs are met to expand civilian uses, or "if that cannot be done because of a lack of manpower or manufacturing facilities the production or import of these primary materials should be cut back. This will release manpower and facilities for a new balance of the program at a higher level."

It calls for making necessary decisions promptly; otherwise later decisions will be more difficult. "Where there have been war expansions far beyond any possible post-war future, it will be better to cancel war contracts earlier and begin reducing the 'bloat' than to wait until it has to be done all at once."

This emphasis on speed in shifting from war to peace runs throughout the report. It applies to cutbacks in production, to settlement of contracts and to handling of surpluses. The report says:

> Some short-sighted persons will oppose prompt decisions in the hope of continuing unnecessary production. We call them short-sighted because they are only borrowing employment from the future when it will be needed and using it up in the present when there is more work than all of us can do. Unneeded stocks of raw materials beyond the margin of military safety will hang over the post-war market depressing future production, employment and prices. It will be stockpiling trouble for the future.

The report draws a distinction, however, as to strategic materials which ordinarily are not produced or produced in small quantities in this country. It points out that "such materials can always be utilized for future war needs, for peacetime production, or be held in a strategic reserve." But it adds:

> While not unduly alarmed at the physical size of such stocks, we do feel that the timing of their acquisition can be most important. Present high costs argue for restricting such stocks to no more than a reasonable margin of safety above current needs. Also, the purchase of these materials deferred to later years can be a helpful factor in stimulating international trade when such a stimulus could be vital.

Disposal of Surplus Property

The same philosophy is carried over into proposals for the disposal of surplus property. The first suggestion made is that the Surplus Property Administrator —

> sell as much as he can as early as he can without unduly disrupting normal trade . . .
>
> We are keenly aware that the next months to come will be the best months for disposal in that they will be the easiest during which to dispose of the things that are needed . . . Market conditions will never be better . . . An immediate start on the problem would reduce enormously the likely surpluses that would be left for the more difficult months after the war . . .
>
> Possession of all of these surpluses at the end of the war will be a most important defense against inflation, not simply in their balancing effect on prices but in that they represent vast usable resources which can be brought into the market quickly to stimulate production and trade.

For efficient operation of the surplus disposal program, the report advises the development of inventory controls; encouragement of agencies to report surpluses promptly and at the termination of the war "to dig persistently" so that hidden surpluses will not accumulate in the agencies; and planning for the handling of future surpluses. Legislation upon disposal of surpluses would wait until the Administrator has had time to gain experience and study the problems. Development of a new central sales force is not recommended, both because the agency might "bog down in the morass" of unrelated items, and because "the precious months for disposal would be lost." The recommendation, now put into effect, is that consumer goods be handled by the procurement division of the Treasury, capital and producers' goods by a consolidation of existing R.F.C. subsidiaries, ships by the Maritime Commission, and food by the Food Administrator.

As principles to govern sales, the report urges, among others: no sales to speculators or promoters; use regular channels of trade; proceeds of all sales to go to reduce national debt; equal access to surpluses for all businesses and all sizes of business, with size of lots to be determined accordingly; no creation of monoply.

With repect to sales of plants, the report recommends a study of what it calls a "tangled problem." First, it is necessary to decide which plants will be maintained for stand-by war purposes and which should be sold or scrapped. Both the Baruch-Hancock report and the George Committee report, in different words, point out that the high dollar cost to the Government of plants constructed under war conditions is not a true yardstick of their real value of use by industry. Both, however, also make the point that it will not serve the national interest to sell any one plant at such low prices as to destroy invested values and displace workers in established industries.

Messrs. Baruch and Hancock would give authority to exchange properties or lease as well as sell, but with the warning that —

> Leasing must not become a hidden device for the government to compete with private plants; it must not become a hidden device for subsidies — by any name — to anyone. Once plants leave the government's hands they must stand on their own feet competitively . . .
>
> As long as fair selling prices or fair rentals are paid — with sales preferable to rentals — local ownership should be encouraged. To repeat, no windfall subsidies should be given anyone.

Both reports state without qualification that there should be no government operation of plants in competition with private industry. Both agree that in the case of the synthetic rubber and other industries whose fate will be decided by disposition of government-owned plants, a formulation of public policy by Congress is called for.

Lessons of World War I

This foresight in preparation for disposal of surplus goods contrasts encouragingly with the experience in the first World War. The Armistice in 1918 found the Government without adequate policy, program or organization for surplus custody, storage or disposal. Methods had to be worked out experimentally at a time when rapid personnel turnover was a continuous problem. There was no chief coordinator of sales until July 27, 1921, the War and Navy departments until then handling their own surpluses independently. The Shipping Board did not even have a sales department until 1921.

The situation was wide open for conflicting pressures, some wanting to hold surpluses, some to dump them. As a result there was vacillation, confusion and unnecessary market disturbance. The historic example is the promise, made soon after the armistice, that the surplus of canned goods would not be marketed "this season." This promise, however, ignored the high cost of living; and public pressure, plus the evident fact that the Army stock was excessive, forced offerings of canned foods by February 1919, the then Director of Sales holding that he was not bound by the earlier promise. Plainly the second decision was sounder than the first, giving consideration to the economic conditions of the time, but because the first promise was made market calculations were upset, and loss and unsettlement were caused in the canned goods industry.

It is clear in retrospect that all possible surplus goods should have been disposed of during 1919 and up until the middle of 1920, a period when prices and the cost of living rose some 25 per cent over the level at the end of the war. Bulk sales of industrial materials to the industries, and sales of desirable goods on which the recovery value was high, were made during that period. Nevertheless, in the depression years 1921-22 surpluses having a cost of nearly a billion dollars were sold for $120 millions. The problem now is to better this timing and to dispose of goods when demand is strongest, which by all signs will be during the war and in the period closely following the war.

Promoting Reconversion

To promote reconversion the Baruch-Hancock report recommends advance planning, jointly by military and civilian agencies, for the X-Day on which Germany is defeated. The plan would seek to estimate in advance the cancellations, the industries affected and the resources likely to be released. It would make tentative selections of the industries and plants to be freed, all for the purpose of speeding reconversion and reemployment and increasing the volume of civilian goods early. It recommends an advance listing of civilian needs which have been restricted during the war and which should have preference in the opening up of civilian supply, giving highest priority to such things as vital repairs, expanded transportation, or improved maintenance. It advises that industries which will need to retool for peacetime work be permitted to secure their tools before the end of the war. It would guide cancellations to permit the earliest release of small concerns which can convert back to peacetime production.

With respect to government controls, Messrs. Baruch and Hancock state that "all controls and the war agencies administering these controls should be liquidated when no longer necessary." They would relax "nuisance" production controls — affecting only small quantities of materials — early, and would bring all materials limitations under early review. The report points out that because of a natural inertia to overcome, there should be an early start in relaxing controls; also that it will be safe to err on the side of liberality since the natural trend during demobilization will be for shortages to disappear, — the reverse of the trend during the mobliza-tion period. It asks a running survey by O.W.M. of the work of the war agencies, and a running study of the functions of the agencies by the Bureau of the Budget, with recommendations for eliminating overlappings, for merging units, "preparing ultimately to liquidate what is left." Two statements are made:

> As the tides of war ebb, little pools of government functions will be left behind in various agencies, and they should be cleaned up promptly.
>
> We have not wanted to leave the government after the war a jackpot of controls which invite every pressure group to hit it.

The report states that "as far as possible no manufacturer should be permitted to jump the gun on his competitors." But —

> It may not always be possible to do so, and industrialists must understand that this objective cannot be allowed to interfere with war requirements or hold back the production of needed civilian items and so to contribute to inflation and unemployment.

Settlement of Terminated Contracts

The Baruch-Hancock discussion of contract termination covers 25 typewritten pages, and Title III of S. 1730, embodying the proposed legislation on the subject, covers 33 printed pages. They cannot be readily summarized in a brief space. Those who want details may obtain one copy of the full Baruch-Hancock report free upon application to the Office of War Mobilization, 323 Washington Bldg., Washington 25, D. C., while the Senate bill is obtainable from the Senate Document Room. Basic principles of termination and a formula for calculating amounts due contractors had already been established, through the issuance in January of the uniform termination clause for fixed-price contracts and the statement of principles for determining costs. Statements on other aspects of termination, to govern the procedures of the procurement agencies, are being issued from time to time, and many aspects are still under study, including the possibility of overall company settlements, standard termination clauses for subcontracts and cost-plus-fixed fee contracts, possibility of direct settlement of subcontractors' claims, and others.

Three principles for contract settlement are laid down in the Baruch-Hancock report. Settlements should be speedy, to provide contractors with cash and free their plant space. They should be final, to leave no uncertainty in the mind of contractors and to remove hesitation in paying subcontractors. They should protect the government. To achieve these ends, the Senate bill provides that settlements shall be final except for fraud or renegotiation under the Renegotiation Act (subject to the right of the contractor to appeal where settlement is not by agreement). It provides for payment of interest at 3 per cent on amounts still unpaid sixty days after filing the claim. It limits government reviews of contractors' settlements with subcontractors to the minimum compatible with the public interest. It authorizes, subject to regulations, direct settlement of subcontractors' claims, and in case of insolvency or bankruptcy of a contractor provides for payment of fair compensation to his subcontractors. It relieves contracting officers of personal financial liability. It limits the review powers of the General Accounting Office to cases of suspicion of fraud, and to seeing that payments accord with settlements. It validates informal and defective contracts, made in good faith. It provides for record keeping and for appeals.

With respect to government property in private plants, the Baruch-Hancock report recommends that manufacturers be allowed to move it at their own risk at any time, and at the government's risk after 60 days from the preparation of inventory lists. The Senate bill makes this period 30 days.

These are excellent provisions. They deserve unanimous support and speedy action.

The "Financial Kit"

While recognizing that "no plan of interim financing can be as good as final settlement itself", Messrs. Baruch and Hancock have assembled a "financial kit." This provides for immediate 100 per cent payment for completed articles and certain costs easily proved, and of approved settlements with subcontractors, and 90 per cent of certain other costs on which the government is able to satisfy itself. It asks Congress to authorize (supplementing V and VT loans) a "new, simplified" system of T-loans, to be made by local banks with government guarantees up to 90 per cent, and it further proposes direct government loans or partial payments if private loans cannot be obtained in thirty days. It is suggested that Congress might want to authorize the Smaller War Plants Corporation to assume the 10 per cent risks under the T-loans, when local banks find themselves unable to do so.

The Senate bill includes provisions to enable interim financing (in an amount not less than 90 per cent of the contractor's claim less certain liabilities) through advance payments, loans or guarantees, and specifies that no such financing shall extend beyond the settlement of the termination claim. A penalty against making excessive claims is provided.

These provisions accord with the general philosophy of the Baruch-Hancock approach. Contractors will have troubles enough in the post-war period, and their problems should not be made unnaturally difficult by inability either to get payment on valid termination claims or to get interim financing while awaiting payment.

Another recommendation, however, goes beyond termination loans and departs from the principle of getting the government out of business. This is the suggestion that "as a permanent source of credit for small and medium-sized enterprises on a basis of broader risks than banks can be expected to assume," the Federal Reserve System's authority to make industrial loans be expanded and liberalized to permit one-half billion dollars in outstanding loans. In considering the need for such a measure, it should be noted that the Federal Reserve Banks now have authority to make many more of these loans than they have ever had outstanding; they make few because there are few credit-worthy applicants not cared for elsewhere. As evidence of the high degree of risk in these loans, the Federal Reserve Bank of New York in its monthly review for August 1938 stated that a number of the concerns to which it made loans had failed and that "in general the experience of this bank with this type of loan indicates that the income received even at rates as high as 6 per cent is not adequate to cover expenses and losses."

The recommendation in effect asks the Reserve Banks to provide industrial capital on a loan basis to the business groups among which risks are largest and failures highest. Apart from the question whether the System's assets should be so used, and whether enterprises of dubious efficiency or utility can be nursed to good health by lavishing credit upon them, the effects on other enterprises are to be considered. Subsidies to one uneconomic producer, keeping him in the field, may reduce the business of half a dozen others, more efficient, to a marginal status and make them in turn applicants for public credit. There is conflict here with another statement in the report, which says:

> Let us not provide credit to the returning soldier or small businessman which will only chain him like a galley slave to a loan he can never repay.

In Summary

Some observers will find flaws and inadequacies in this demobilization and reconversion program, and some details doubtless will evoke sincere controversy, which will help perfect them. The program, however, has two great merits which are vastly more important than flaws or disputable details. One is its practical value, — the emphasis that is put upon speed of reconversion and reemployment, and the effectiveness of the proposals to achieve speed. The second is the fact that the authors of these documents are animated by a belief that this country should continue to seek its progress through a system in which private competitive enterprise is the generating force; and that they reject any idea that the imposition of the government regulations and controls, which have been necessary to enforce priorities and concentrate energy upon the war effort, constitutes a permanent change-over from a free to a government-directed system.

The letter of transmittal with the Baruch-Hancock report declares: "With peace . . . each has the right to make what he pleases. Governmental direction and aid disappear. The markets become free and each individual is dependent upon his vision, his courage, his resourcefulness and his energy." The report adds:

> There has been too much loose parroting of the slogan, that if individual enterprise fails to provide jobs for everyone, it must be replaced by some one of the other systems that are around. The war has been a crucible for all of the economic systems of the world, for our own, for Communism, Fascism, Nazlism — all the others. And the American system has outproduced the world.

The Senate Committee, for its part, says, "The paramount consideration in the handling of all demobilization problems should be the preservation and strengthening of the American system of free competitive enterprise."

Business men should find confidence and reassurance in these declarations, and in the steadfast adherence of the specific proposals to them. It is equally significant that the program does not offer to business subsidies, favors, or anything but fair and just treatment. It does not offer to prop up enterprises which cannot support themselves, or to bear risks which business itself should bear. Its concern is only to clear the way.

Commentators of leftist persuasion may say that the proposals deal with business with too open and generous a hand, and that they would reduce the economic activity of government too much. At the opposite extreme, some may think that the treatment proposed for private enterprise is still unduly restrictive and insufficiently generous to restore economic health. Labor unions are protesting that they lack representation in the plans. Such diverse views are probably the best evidence that the proposals do not cater to any special interest, but are concerned only to serve the general interest.

Because the principles of these reconversion proposals are sound and wise, the country stands to gain inestimably by supporting them. The power of public opinion behind them will be the best assurance that the principles are adhered to and applied effectively.

Industrial Corporation Earnings

Annual reports of leading manufacturing companies now becoming available reflect rising industrial costs at a time when the rate of increase of industrial production was tapering off toward the close of the year. Reports for 730 companies so far published for the full year 1943 indicate combined net income after taxes and reserves of approximately $1,137 millions, an increase of 2 per cent over 1942, compared with an increase of 13 per cent in the first nine months of the year, as shown by tabulations of quarterly reports.

Practically all companies experienced advances in costs, but those still having large increases in volume of sales were able to offset these additional charges. Many manufacturers, however, reported actual curtailment in volume, due to changing needs of the war effort and to effects of priorities and scarcities of materials. While earnings on a consolidated basis were slightly in excess of 1942, the number of companies showing decreases exceeded those showing increases in the ratio of approximately four to three.

The steel industry presents an outstanding example of the effects of rising costs against ceiling prices last year. There was an increase of 3 per cent in ingot production to a new high record, an increase of 12 per cent in wages and salaries paid, and a decrease of 7 per cent in the net income of 30 leading companies.

Other important groups showing lower net income last year included food products, cotton goods, paper and paint, while those showing increases included distilled beverages, rubber products and petroleum refining.

For most companies, the 1943 earnings are subject to the renegotiation of government contracts, which may reduce the earnings finally realized. While many companies have set up reserves against estimated refunds, such reserves may or may not prove adequate.

The tabulation is composed mainly of the larger industrial corporations having in 1943 an aggregate net worth of $12,333 millions — an average of about $17 millions per company — compared with $11,926 millions in 1942. Because of the increase in net worth, the average rate of return thereon declined from 9.4 per cent in 1942 to 9.2 per cent in 1943. Our accompanying summary shows, by major industrial groups, the comparative figures for the two years.

Increases in Tax Reserves

Reserves of the 730 companies for federal taxes upon income — estimated on the basis of tax details given by companies accounting for around nine-tenths of the total net income — were $2,170 millions in 1942 and $2,650 millions in 1943. This liablity is computed after deducting from gross taxes payable the 10 per cent postwar or debt retirement credit. Such net taxes took approximately 70 per cent of the net income before taxes in 1943, compared with 66 per cent in 1942 and 48 per cent in 1941.

With the same basic tax rates in effect during the past two years, the somewhat higher average overall rate in 1943 may be attributed to (1) the increase in total net income before taxes, with most of such increase subject to the 90 per cent excess profits rate rather than the 40 per cent normal and surtax rate; (2) the prevailing rates having applied to fiscal year companies only upon their earnings after July 1, 1942, prior to which the lower 1941 rates applied; and (3) the exhaustion, by 1943, of excess profits tax credits carried forward in previous years by some companies.

The current high tax rates tend to stabilize net income, since taxes offset to a large extent increases or decreases in operating income. Thus the Treasury takes the position of absorbing the major share of any improvement or deterioration in earning power.

Industrial Earnings in Recent Years

The course of industrial earnings during recent years is indicated by the following summary of our tabulations giving net worth and rate of return for leading companies since 1928, together with the Treasury Department "Statistics of Income" for all manufacturing corporations in the United States through 1941 (preliminary), the latest year for which official figures have been issued. Although the number of companies included in our own tabulations is not exactly the same each year, because of variation in the number of reports publicly available, the general course of earnings is indicated by the annual average percentage rates of return on net worth. These rates for both series are given in the diagram also.

Net Income of Manufacturing Corporations
(In Millions of Dollars)

	All Mfg. Corp. in U. S.*			Leading Mfg. Corp.**			
Year	Net Income aft. Tax	Net Worth Jan. 1	Per Cent Return	Number	Net Income aft. Tax	Net Worth Jan. 1	Per Cent Return
1928	$3,935	$48,050	8.2	827	$2,087	$16,261	12.8
1929	4,537	50,017	9.1	827	2,444	17,266	14.2
1930	1,424	52,695	2.7	717	1,499	18,223	8.2
1931	D-521	52,122	D-1.0	712	456	14,642	3.1
1932	D-1,616	47,640	D-3.4	670	D-36	13,565	D-0.3
1933	237	43,976	0.5	653	359	12,152	3.0
1934	1,166	43,342	2.7	676	532	11,564	4.6
1935	2,122	38,152	5.6	734	822	12,251	6.7
1936	3,116	37,611	8.3	789	1,413	13,623	10.4
1937	3,069	38,467	8.0	940	1,545	14,705	10.5
1938	1,228	41,239	3.0	940	672	15,202	4.4
1939	2,946	41,260	7.1	960	1,281	15,181	8.4
1940	3,775	42,438	8.9	925	1,554	14,803	10.5
1941	5,492	44,163	12.5	825	1,539	12,931	11.9
1942	—	—	—	710	1,210	12,585	9.6
1943	—	—	—	730	1,137	12,333	9.2

D- Deficit. *From Treasury Department annual "Statistics of Income". **From National City Bank annual tabulations of published shareholders' reports.

For the large manufacturing corporations, the average rates of return on net worth in

NET INCOME OF LEADING MANUFACTURING CORPORATIONS FOR THE YEARS 1942 AND 1943

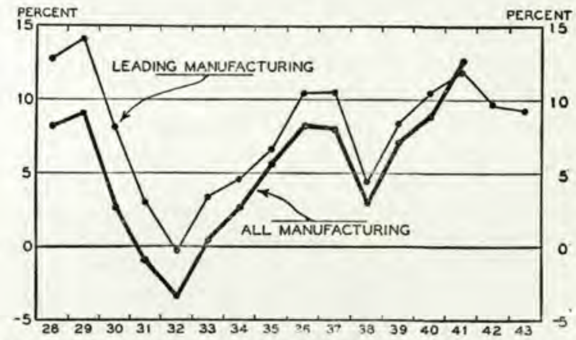
Net Income is Shown after Depreciation, Interest, Taxes, and Other Charges and Reserves, but before Dividends.— Net Worth Includes Book Value of Outstanding Preferred and Common Stock and Surplus Account at Beginning of Each Year.

No. of Cos.	Industrial Groups	Net Income Years 1942	Net Income Years 1943	Per Cent Change	Net Worth January 1 1942	Net Worth January 1 1943	Per Cent Return 1942	Per Cent Return 1943
13	Baking	$ 21,742	$ 21,987	+ 1.1	$240,360	$232,379	9.0	9.5
12	Meat packing	50,552	48,794	— 3.5	595,152	618,353	8.5	7.9
62	Misc. food products	54,878	49,243	—10.3	497,882	522,189	11.0	9.4
14	Soft drinks	8,163	7,282	—10.8	51,476	58,683	15.9	12.4
18	Brewing	5,523	6,072	+ 9.9	44,833	46,832	12.3	13.0
9	Distilling	28,373	34,012	+19.9	224,332	230,158	12.6	14.8
12	Tobacco products	51,912	49,562	— 4.5	462,163	483,018	11.2	10.3
33	Cotton goods	24,482	20,810	—15.0	231,113	242,022	10.6	8.6
5	Woolen goods	7,875	7,788	— 1.1	85,314	89,322	9.2	8.7
11	Knitted goods	3,881	3,832	— 1.3	42,789	43,701	9.1	8.8
29	Misc. textile products	20,773	21,630	+ 4.1	214,958	224,155	9.7	9.6
18	Clothing and apparel	10,037	10,043	+	90,258	94,441	11.1	10.6
5	Leather tanning	4,237	3,674	—13.3	35,918	36,390	11.8	10.1
15	Shoes, etc.	15,371	14,839	— 3.5	169,770	173,916	9.1	8.5
17	Rubber products	41,569	57,617	+38.6	416,021	435,369	10.0	13.2
15	Lumber	7,574	5,935	—21.6	71,387	74,387	10.6	8.0
4	Furniture, wood products	3,568	2,976	—16.6	58,991	60,342	6.0	4.9
29	Paper products	31,751	28,450	—10.4	391,363	394,599	8.1	7.2
32	Chemicals—industrial, etc.	110,910	115,407	+ 4.1	1,081,902	1,123,465	10.3	10.3
9	Drugs, soap, etc.	32,231	32,768	+ 1.7	198,511	202,862	16.2	16.2
10	Paint and varnish	10,136	8,275	—18.4	114,937	119,042	8.8	7.0
11	Petroleum products	36,425	45,722	+25.5	549,472	564,105	6.6	8.1
12	Cement, gypsum, etc.	14,819	11,260	—24.0	192,713	199,208	7.7	5.7
17	Other stone, clay and glass	26,410	24,726	— 6.4	250,335	261,612	10.5	9.5
30	Iron and steel	195,502	181,499	— 7.2	3,207,408	3,275,222	6.1	5.5
8	Agricultural implements	14,515	15,671	+ 8.0	138,214	143,074	10.5	11.0
21	Building equipment	13,602	13,798	+ 1.4	151,758	163,280	9.0	8.5
27	Electrical equipment	84,325	91,972	+ 9.1	688,014	713,721	12.3	12.9
22	Hardware and tools	13,533	13,962	+ 3.2	62,967	71,681	21.5	19.5
11	Household equipment	4,436	4,236	— 4.5	31,504	31,914	14.1	13.3
66	Machinery	48,595	47,593	— 2.1	266,892	292,775	18.2	16.3
8	Office equipment	13,483	9,451	—29.9	83,319	90,142	16.2	10.5
9	Nonferrous metals	11,632	13,881	+19.3	165,937	155,933	7.0	8.9
30	Misc. metal products	31,370	36,729	+17.1	331,892	344,164	9.5	10.7
41	Autos and equipment	32,657	38,028	+16.4	214,077	230,555	15.3	16.5
12	Railway equipment	17,403	16,813	— 3.4	184,925	190,988	9.4	8.8
33	Misc. manufacturing	15,243	21,012	+37.8	87,128	99,374	17.5	21.1
730	Total manufacturing	$1,119,488	$1,137,349	+ 1.6	$11,925,985	$12,333,373	9.4	9.2

1942-43 were below 1940-41, and while above the prewar years 1938-39 were below the years 1936-37.

During the thirteen years 1928-40, the rate of earnings of this group of leading companies ran roughly parallel to but consistently higher than the average for all manufacturing corporations, numbering some 86,000. In 1941, however, the rate on the Treasury series covering all companies rose above the rate on the "leading company" series.

One reason for this reversal of relationship is that the Treasury statistics, compiled from corporation income tax returns, show the net income as defined for tax purposes, and make no allowance for the various general reserves—contingency, postwar, conversion, etc. Such reserves began to assume substantial proportion only in 1941, and are not permissible deductions in computing taxes. Only when and



Annual Rate of Return on Net Worth of All Mfg. Corp. and of Leading Mfg. Corp.

if such losses and costs are definitely "established" are they allowed as deductions from income for tax purposes. This treatment causes the "statutory net income" in many cases to be higher than that stated by the companies' auditors in the annual reports submitted to shareholders, employes and the public.

The same distinction should be noted in connection with the earnings series for "all corporations" now being reprinted or estimated by the Department of Commerce and carried in the "Survey of Current Business", which uses the statutory definitions and thus disallows, or adds back to net income, the various general reserves.

No one can forecast very accurately just what should be the size of corporate reserves against the liquidation of wartime expansion. Many industrial companies prominent in the last war were unable to survive the liquidation that followed, and the extent to which industry has been transformed and expanded is much greater during this war. Clearly the conditions justify unusual precautions in building a backlog of reserves against unforeseen charges and possible losses. Considerable leeway in the matter obviously must be left with business management and accountants.

A second possible reason for the sharper increase in the Treasury series in 1941 is that they are based on all manufacturing companies in the United States, including large numbers that are operating at deficits or in reorganization and that issue no reports to the public. During the period of wartime business expansion, the reduction of deficits or sharp rise in profits of these companies will tend to raise the combined earnings of business as a whole, even though taxes and operating costs may be leveling off or reducing the earnings of most "leading companies".

Still another factor which affects long-term earnings comparisons is the substantial reduction in aggregate net worth during the depression years as a result of operating deficits, payment of dividends in excess of earnings, and writing-down of asset valuations and of capitalization. As this reduces the base upon which return is computed, it automatically raises the percentage rate.

Although the indicated rate of return for "all manufacturing corporations" in 1941 was higher even than in 1929, due in part to the lowering of net worth, the margin of profit per dollar of sales—another standard measure of business earnings—was slightly narrower. Exclusive of intercorporate dividend receipts, which are not related to the volume of sales, the 1929 gross income of all manufacturing corporations was $71,640 millions and the net income (after taxes) $3,954 millions, or 5.5 per cent of sales; in 1941 the gross income had reached $92,940 millions, upon which the net income (before allowance for the general reserves described above) was $4,990 millions, or 5.4 per cent.

Some of the recent controversy over wartime profits undoubtedly is due to the drawing of generalizations from bulk statistics of business earnings without recognition of their diverse composition. The limitation as to the usefulness of aggregates in this connection is that they imply a "pooling" of earnings which does not take place. Results for individual companies can hardly be judged accurately on the basis of aggregates for "all corporations", including railroads (solvent and insolvent), banks and investment companies, trade and service companies, etc.

There is also the danger of drawing generalizations from isolated cases of allegedly excessive profits. It is difficult to write tax laws that will catch the last dollar of excessive profits in all cases without crippling effects upon industry as a whole. Cases where profits are excessive are supposed to be dealt with through continuous price reviews and contract renegotiation.

Balance Sheet Changes

A composite balance sheet and income account is given for 110 of the larger manufacturing companies, with sales or total assets over $5 millions and with fiscal years closing December 31.

Composite Income Account and Balance Sheet of 110 Manufacturing Companies with Sales or Total Assets over $5 Millions

(In Millions of Dollars)

Income Account	Year 1940	Year 1941	Year 1942	Year 1943
Sales	$3,324	$4,470	$5,525	$6,575
Net income before taxes	361	616	693	835
Income & exc. prof. taxes	107	321	447	569
Net income after taxes	254	295	246	266
Dividends paid	174	190	155	160
Retained net income	80	105	91	106
Assets, Dec. 31				
Cash	365	351	427	528
U. S. Govt. securities	36	119	298	441
Receivables, net	343	459	561	583
Inventories	961	1,198	1,389	1,408
Total current assets	1,705	2,127	2,675	2,960
Plant and equipment	2,305	2,362	2,352	2,391
Less depreciation	1,080	1,116	1,150	1,227
Net property	1,225	1,246	1,202	1,164
Other assets	238	249	260	291
Total assets	3,168	3,622	4,137	4,415
Liabilities & Capital, Dec. 31				
Notes payable	41	86	102	106
Accts. pay. & accruals	204	274	449	456
Reserve for taxes	151	370	520	655
Total current liabilities	396	730	1,071	1,217
Deferred liabilities	313	329	393	392
Reserves	90	105	128	160
Capital and surplus	2,369	2,458	2,545	2,646
Total	3,168	3,622	4,137	4,415
Working capital	1,309	1,397	1,604	1,743
Current ratio	4.31	2.91	2.50	2.43

It will be seen that last year there were substantial increases in cash and in government securities. Receivables and inventories, which had risen sharply between 1940 and 1942, were little changed last year despite the further expansion in volume of sales, indicating more rapid turnover of merchandise and prompter collection of accounts. Depreciation reserves in both 1943 and the three-year period were increased more than gross plant and equipment, so that the net property account was lower. The "other assets" include the increasing claims for tax refunds after the war.

Current liabilities increased further last year, due to larger reserves for taxes payable. The "current ratio" of liquidity (current assets/current liabilities) was little changed in 1942-43, and although considerably below the prewar level would be almost as high if tax liability were offset against holdings of cash and government securities, principally tax notes. Net current assets or "working capital" continued to increase last year.

Capital funds were built up in every year 1940-43 from earnings retained after payment of dividends, which were considerably lower in 1942-43 than in 1940-41. While the 1943 sales of this group were 98 per cent higher than in 1940, dividends paid were 8 per cent lower. Reserves have steadily increased, but amounted to only 4 per cent of total assets at the end of 1943.

This composite balance sheet comprises a sampling from numerous different manufacturing industries, listed in our earnings tabulation already given, and includes consumers' goods as well as capital goods. For this reason it is not typical of the special situation of many companies concentrating on war production, which have expanded tremendously in the output of airplanes and parts, electrical and radio supplies, marine engines and equipment, machine tools, guns and ammunition, and other military goods. The unusual current and postwar conversion problems of such manufacturers will of course require much more attention than those of most organizations in the consumers' goods lines.

Fourth War Loan Results

While final results of the Fourth War Loan are not available at this writing, indications are that total subscriptions from all sources included in the quota will be in the neighborhood of $16½ billions. This compares with a goal of $14 billions, and a total of $18.3 billions raised during the third drive. The difference is largely accounted for by the curtailing of speculative subscriptions, and smaller purchases by life insurance companies and savings banks which had less available funds.

In addition to subscriptions eligible to be counted towards quota, the Treasury is believed to have received over $500 millions under the provision permitting commercial banks having savings deposits to invest a limited portion of such deposits in F and G savings bonds and the longer-term marketable 2¼s and 2½s.

Recognizing that the core of the inflation problem lies in the spendable funds in the hands of individuals, the Treasury and various State War Finance Committees have placed major emphasis upon broadening the distribution in this area and getting more people to save. They have been outstandingly successful in achieving this goal as shown first by a large increase in the number of sales, and second by larger sales of Series E bonds which represent chiefly the purchases by smaller investors.

While country-wide figures are not yet available, it is estimated that in New York State sales were made in the course of the drive to 5 million people out of a total population of under 14 millions, or better than one out of every three. If the same ratio is maintained throughout the nation, as seems probable, it means the sale of bonds to 50 million persons.

With respect to Series E bonds, sales are expected to reach approximately the $3 billions quota. This is far ahead of any previous drive and may be compared with $2½ billions in the third loan and $1½ billion in the second.

The effort was made particularly to encourage the purchase of bonds by individuals who would buy them "for keeps", and to discourage speculative purchases financed by bank loans and undertaken in hopes of subsequent resale at a quick profit. Such transactions had been an increasing factor during previous drives — particularly the third — and a substantial portion of such resales to the market found their way into the commercial banks. The Secretary of the Treasury in a letter to all banks in January requested their cooperation in reducing such speculative purchases, while presidents of the Federal Reserve Banks asked the security dealers and brokers in their territories to limit their subscriptions to such amounts as were actually needed for their own and their customers' permanent investment. The New York Stock Exchange addressed a similar communication to its membership. This policy of eliminating the "padding" had the effect of limiting many subscriptions of individuals and greatly reduced subscriptions of brokers and dealers.

Notwithstanding the closer scrutiny of subscriptions during this drive, it is expected that the sum total of sales to individuals will come close to the sales of $5,377 millions in the Third War Loan, though short of the ambitious $5½ billions quota.

Additional factors of increasing importance as one drive follows another are the rise in taxes and the advance in living costs, which have restricted the amounts of current income which many people have available for investment, while accumulated savings can be invested only once. This year there has been the burden of the 12½ per cent "unforgiven" tax due March 15, as well as current taxes.

Effects on Bank Credit

Before and during drives there is always a certain amount of portfolio readjustment by investors, involving sales to the market, and substantial portions of such sales are taken up by the commercial banks and the Reserve Banks. Purchases of the new government offerings by investors selling other securities to the banks, and by investors borrowing from the banks, are of course as expansive of bank credit as would be direct purchases by the banks.

During drives, banks are willing buyers by reason of the temporarily large excess reserves created by government bond subscriptions by the public, which result in a shift of private deposits into war loan accounts requiring no reserves. During the fourth drive the reduction in reserve requirements amounted to about $1 billion, in addition to which banks gained substantial reserves through Treasury disbursements from its balances in the Reserve Banks.

The following table indicates the change in weekly reporting member bank holdings of government and other securities and in loans, also in Reserve Bank holdings, for the four weeks comprising the drive, and compares these with the changes that took place during the third drive.

Expansion of Bank Credit During the Third and Fourth War Loan Drives

(In Millions of Dollars)

Weekly Reporting Member Banks	Change Sept. 8 to Oct. 6 (4 weeks)	Change Jan. 19 to Feb. 16 (4 weeks)
Treasury bills	+ 641	+ 971
Other short-term	+ 855	+1,162
Bonds	+ 506	+ 654
Total govt. secur.	+2,002	+2,787
Other securities	+ 28	+ 66
Loans to dealers on govts.	+ 892	+ 317
Loans to others on govts.	+ 774	+ 613
All other loans	+ 680	+ 179
Total loans	+2,346	+1,109
Total loans & investments	+4,376	+3,962
Federal Reserve Banks		
Treasury bills	— 45	— 903
Other short-term	+ 95	+ 339
Bonds	+ 2	+ 44
Total govt. secur.	+ 52	— 520

It will be seen that in the four weeks of the fourth drive reporting bank holdings of governments expanded $2,787 millions, or $785 millions more than in the third drive. This was mainly due to repurchases of Treasury bills from the Reserve Banks and to increased short-term open-market purchases. Expansion of loans directly secured by governments was less by about $700 millions, reflecting the reduction in speculative purchases, and the expansion of all other loans was less by about $500 millions. The smaller increase in the latter figure in the recent drive is a part of the picture, in that there has been evidence — particularly during the third drive — that considerable borrowing to finance government securities has been classified under other headings. Total loans and investments of the reporting banks expanded by $3,962 millions, or $400 millions less than in the third drive. Federal Reserve Bank holdings were reduced by approximately $500 millions during the fourth drive, as against an increase of $50 millions in the third.

In comparing these figures, several points need to be borne in mind.

(1) The pre-drive liquidation of governments by non-banking investors apparently was considerably smaller in the case of the fourth drive than in the third. While this tends to cut down new subscriptions, it makes them more representative of new investment. As evidence of this, reporting bank absorption of governments (net purchases plus loans), together with Federal Reserve absorption, amounted to around $450 millions in the six weeks prior to opening the fourth drive, or 40 per cent less than in the corresponding period before the third.

(2) Commercial bank purchases during the fourth drive include, in addition to securities bought in the open market and bills repurchased from the Federal, the limited purchases of F and G savings bonds and longer-term Treasury bonds made eligible under the terms of the drive.

(3) The weekly reporting member bank government security holdings represent only about two-thirds of the total for the commercial banking system, although a considerably larger share of the loans against securities.

Need for Still Greater Effort

This showing of the extent of bank credit involved in the lates drive indicates that, despite the real progress made in getting the right kind of sales in larger volume than ever before, there is still much hard work to be done in reaching more people and in getting larger individual purchases. Great masses of the people are not accustomed to buying bonds, and it requires a process of education to get them into the habit of the systematic purchases which are needed to finance the war and to reduce the danger from inflationary spending. No system of taxation that would be bearable could be wholly relied upon to eliminate this inflationary danger. The bond drives, together with regular purchases between drives, afford a flexible means of reaching people in relation to their means. The results of this drive reemphasize the lesson of previous drives that the American people will and do respond to this democratic voluntary form of approach.

Foreign Dollar Balances and Gold

Foreign owned dollar balances have increased steadily since we entered the war, despite substantial sums converted into gold. The growth of both foreign-owned deposits and the gold earmarked here for foreign central banks is shown in the table that follows

Foreign Deposits, Earmarked Gold and Monetary Gold Stocks

(In Millions of Dollars)

Foreign Deposits	Dec. '41	Dec. '42	Dec. '43	Feb. '44
In Federal Reserve Banks	$ 774	$ 806	$ 1,512	$ 1,551
In Reporting Member Banks	883	736	824	810
Total	1,657	1,542	2,336	2,361
Earmarked Gold	2,215	2,674	3,477	
Gold Stocks	22,736	22,726	22,004	21,802

It will be seen that foreign-owned deposits rose in the two years 1942-43 about $680 millions, while gold earmarked for foreign account advanced $1,260 millions to $3,477 millions. Because of the domestic production of some $170 millions of gold and the net imports of about $380 millions in these two years, the actual gold loss was but $732 millions. However, during the first seven weeks of 1944 the Treasury monetary gold stock declined by another $200 millions, to $21.8 billions.

While details as to the gold flow are lacking because of war censorship, it may be assumed that gold is being lost to the countries which have export trade balances with us. Figures recently published by the Department of Commerce indicate that the excess of our merchandise imports over our cash exports amounted to about $600 millions during the first nine months of 1943. Of this excess the Latin American countries accounted for about $370 millions. For the full year 1943, the excess of total imports over cash exports aggregated about $780 millions.

On the basis of available information, combined gold and foreign exchange reserves of the 14 principal Latin American republics (including the dollar notes circulating in Cuba) rose during 1943 by the equivalent of almost $1 billion to more than $2.4 billions. Of this total, one-half, or $1.2 billion, is known to be gold at home, with the balance in gold abroad, dollars, pounds sterling, and other currencies.

Gold Reserves of European Neutrals

Gold holdings of European neutral countries have likewise shown considerable increase. In the case of Switzerland and Sweden, the conversion of foreign exchange into gold has caused a steady rise of gold reserves. Portugal has benefitted from a large expansion of its transit trade and the sale of such valuable strategic materials as wolfram. Much the same has been true about Turkey, which has been selling chrome ore to both Allied and Axis countries; and to a lesser extent about Spain. All European neutral countries have continued to receive refugee funds. Furthermore, following the freezing of dollars, the transactions in that currency on the continent have practically ceased, and increased use has been made of gold in the settlement of international transactions. The Germans are believed to be using some of the gold seized in the occupied countries, which accounts for the recent refusal of the leading Allied Powers to buy or recognize the sales of the Axis-tainted gold.

Gold Holdings of Certain Foreign Countries

(In Millions of Dollars)

Gold Holdings	Dec. 1939	Dec. 1941	Latest
Switzerland	$ 549	$ 668	$ 964
Sweden	308	223	384
Portugal	69	59	59
Turkey	29	92	161
Spain	....	42	85
Total European neutrals	$ 955	$1,084	$1,653
South Africa	249	366	685
Total	1,204	1,450	2,338
Foreign Exchange Reserves			
Portugal	29	189	529

Whatever the sources, European neutrals and South Africa have in the last two years increased their gold holdings by nearly $1 billion, as will be seen from the table above. Portugal acquired in the same period a huge foreign exchange reserve, some of which is unquestionably gold. As in various Latin American countries, the inflow of funds into Portugal has led to an expansion of purchasing power, giving rise to a now notorious black market. Since the public has remained unresponsive to a government loan which was to mop up the purchasing power, the government is reported to have considered putting a large part of the country's gold into circulation. The proposal was deemed unwise, since the gold might be needed after the war for settlement of international payments.

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