On Board s/s "Majestic",
April 30, 1926.

Dear Mr. Harrison:

Unfortunately, I have been wretched on the boat and not feeling up to handwritten letters. I am dictating this reply to your own fine letter of April 23rd. There is not anything that gives me so much satisfaction as just the sort of thing you have written me, whether it is deserved or not. I will defer writing you at length until I feel more like corresponding, but in the meantime I can assure you there will be no doubt about the holiday.

Whether it was just because I was over-tired or because I picked up a "bug" before getting on the boat, I got a rather bad throat, had quite a temperature, and just took to my bed until I felt better. It has interfered a lot with the work we planned to do, but the last two days I have been up at noon and able to take part in the discussion of the hearings in London. But I was pretty discouraged and a little anxious as to just what was ahead of me. My throat seems all right again, and fortunately my temperature has about left, so I am feeling much better, although a little weak.

Immediately that we finish in London, I am going to Paris to spend only a day or two or three, then to Rome, and from Rome just as soon as I can make arrangements I am going somewhere on the shore; so that I doubt if I really get off on business for a month after I settle down. If possible, I want to find a little cottage, but whether there or in some hotel, I am really going to loaf.

We have had a very smooth trip, with average weather, thick part of the time and a bit raw and cold, but it has made little difference to me, as I have hardly been on deck.

The Professors are profoundly interested in the job and seem to be at it morning and night.

I will send you more particulars from London. Please give my very best to all at the bank.

Sincerely yours,

Mr. G. L. Harrison,
Federal Reserve Bank of New York,
33 Liberty Street,
New York.

BS:M

Phond 2

ANSWERED

MAY 21 1926

P. J.

BENJ. STRONG

Hyde Park Hotel,
London, May 2, 1926.

Dear Mr. Jay:

Since reaching London, we have had a long meeting at the Bank with George Roberts. I have also had opportunity for some quiet talks with Norman and with Sir Henry Strakosch and Sir Norcott Warren, the last two being members of the Indian Currency Commission, and the impression I gain is most encouraging.

Roberts made a splendid presentation, partly in writing and partly orally, and broke the ground for us in great shape. I am privately informed that the plan in the particular form submitted is quite groggy, but they are very keen to hear us. There is a new project in the wind, I hear, for the creation of a central bank of issue, with some sort of an approach to a gold standard plan, which of course finds us somewhat unprepared; nevertheless we get more information of what is in their minds every day and by a week from Monday we shall probably be ready for that.

Unfortunately, I was ill all the way over on the steamer and practically unable to do any work, but they have given us a week free here and I expect to be ready by the end of that time. Monday night we are all dining with the members of the Commission at the House of Commons.

I have just had a very pleasant visit with our Ambassador, who knew something of what was going on and has offered his assistance and good wishes.

I am glad to say that I am feeling much better. Please give my best to all at the Bank.

Sincerely yours,

Benj. Strong

Mr. Pierre Jay,
c/o Federal Reserve Bank of New York,
33 Liberty Street,
New York, U.S.A.

Hyde Park Hotel,
London, May 5, 1926.

Dear Garrard:

I was planning to wire you today to go directly to Paris, when your radio came. The strike has stopped all trains and you would have much difficulty coming up from Southampton.

Unfortunately, I was miserable on the way over and unable really to prepare for these hearings. We have spent a week here getting information and getting ready to be heard. The first hearing will be Friday, and I hope we will all be finished by Tuesday of next week. I will leave for Paris just as soon as I can arrange about transportation. It may be necessary to motor to Southampton and cross on one of the liners.

George Roberts made a splendid statement to the Commission, and we gather from various sources that the gold standard plan is very groggy. We hope it will get its "knock-out" blow as the result of our appearance.

I have been so wretched that I do not want to do any work as soon as this job is finished, and my proposal is that we go on down to Italy and stop at some place where I can get some rest. But that we can talk over when I meet you in Paris.

I hope you have had a good trip over. Best regards.

Sincerely,

Hon. Garrard B. Winston,
c/o Morgan, Harjes & Company,
14, Place Vendome,
Paris.

BS:M

Hyde Park Hotel,
May 5, 1926.

My dear Mr. Harrison:

Thank you for your cable No. 2, to which I am replying as per enclosed confirmation.

Miller's recommendations to the Banking and Currency Committee impress me as follows:

(a) Abolishing the Federal Reserve Agents is likely the expression of a desire to transfer more of the activities of those departments in the Reserve Banks to the Federal Reserve Board and may be a repercussion from the loss of Stewart and Warren.

(b) Limitation on the speculative use of Federal Reserve funds is a futile and foolhardy undertaking. The implications of the possibility of such limitations are such that it would spell disaster for us.

(c) The proposal to give the Board complete control over market operations can only be answered by a request to the Committee to consider the competence of the Board, not only intellectually but geographically and in every other way, to exercise such control.

These suggestions are not directed to the betterment of the service of the Reserve Banks, but to the enlargement of the powers of the Board. As someone said to me recently, "All impotent bodies seek to cure their disabilities by enlargement of their powers." I suppose there is nothing to be done about it at once, and in any event my opinions are most incomplete until I read the testimony which you say is coming by mail.

The strike situation is a novel experience for all of us. Publication of the newspapers has been suspended because of the strike, and the

Government has taken over the Press, so that likely some attempt at publication will shortly be made. I am enclosing a sample of the sort of newspaper that now is published, being this morning's "Daily Mail". No busses are running, practically all the train service except food trains has been suspended, the Underground has stopped running, and the congestion in the streets because of the enlarged use of automobiles and various types of motor vehicles, charabancs and the like brought into use, makes street movement very slow. The other morning the streets were crowded with folks walking to their offices, some of them walking no less than six or seven miles to get to their offices and the same to get home. Hyde Park is closed and is the center of distribution of milk. Of course, some inconvenience is suffered, but so far hardly anything that cannot be treated as a joke. I detect in conversation a growing sense of outrage. The Government is prepared for a long "tussle", but sentiment in the City is that it will be of short duration and the men will begin to go back.

The Indian Currency inquiry has taken a variety of unexpected turns. George Roberts presented a splendid paper and made a very good impression when he was heard orally. We have had opportunity to have talks with various members of the Commission at Norman's house, and night before last at a dinner which Hilton Young gave us at the House of Commons. All the members of the Commission were there. They seemed to be very keen, the Indian members pretty well informed and very well educated men, and they really seemed to be earnestly seeking light upon a very difficult problem. There has been so much pounding of the plan that Roberts' statement really made it very groggy, and it is expected that our appearance will deliver the "knock out" blow.

We have had to entirely recast our program, somewhat on this account and somewhat because we have learned privately that another project is being informally considered by the Committee along much sounder lines and one which involves considerable banking reorganization in India. We have decided to open the hearing by my presenting a rather formal prepared statement outlining our general position, following which Professor Hollander will make a more scholarly general statement of the principles of our objection to the plan. My preliminary statement will include an expression of hope that the discussion will take a turn in the direction of something where constructive suggestions may be made, rather than destructive criticism.

Following Hollander, Sprague will take up the questionnaire in detail. After that, I am proposing to review their statements, filling in some gaps and elaborating some parts of it, after which we propose to have a "battle royal". If you are familiar with prize-fighting, you know what a "battle royal" is. In other words, there will be questioning around the table, with all three of us answering. Then I am proposing to conclude with a summary, which will round up in a brief classification the various objections to the proposal for a full gold standard as outlined in the plan and various suggestions which we hope will be constructive.

The first appearance is Friday morning, and then the hearings will be resumed the following Monday morning. I am most hopeful of the results, especially now that we have been rather carefully coached as to the various points in which susceptibilities might be aroused. Tomorrow we expect to have a "dress rehearsal" in anticipation of the hearing.

I wired Winston not to come to London. In fact, I doubt if he could get here if he arrived at Southampton, except by motor, with some doubt as to whether he could get a motor. So I will hope to meet him in Paris next week.

I was miserable all the way over and only the last day or two have felt much like anything. This has delayed my preparation, but also fortified my intention to take a good rest as soon as the hearings are ended. The Professors seem to be enjoying the trip, and I imagine they are in no hurry to go home.

This is all the news. My best to all at the office.

Sincerely,

Mr. G. L. Harrison,
c/o Federal Reserve Bank of New York,
33 Liberty Street,
New York.

BS:M

(5)

London
May 8, 1926.

M E M O R A N D U M of Conversation between Governor Strong and Ambassador Houghton.

Governor Strong set forth the financial difficulties of France which had come to a head during the course of the week on account of the drastic decline in the exchange value of the franc, which threatened the success of the measures recently taken to balance the budget, as well as the acceptance by the Chamber upon reassembling on May 24th of the settlement of the French debt to the United States government. During the morning he had been approached by M. Parmentier, representing the French Treasury, who had requested a loan of $100,000,000 from the Federal Reserve Bank of New York, this loan to be secured by the deposit of $100,000,000 in gold to be withdrawn from the Bank of France. Failing to secure some such loan, acceptance of the debt arrangement by France seemed altogether unlikely, but it was added that the grant of the loan by no means assured the acceptance of the debt agreement by the French Chamber. On the other hand, it was quite clear that the loan by itself would be only another stop-gap and that it would serve the undesirable purpose of facilitating the withdrawal of capital from France by the increasing number of people distrustful of the economic and financial future of the country. It was pointed out that the fall of the franc is apparently not due to speculative activities but rather to the purchase of foreign valuta by French citizens.

In these circumstances, Governor Strong requested a frank and confidential expression of opinion from the Ambassador regarding present political conditions and tendencies. In general, the views of the Ambassador were decidedly pessimistic, perhaps best indicated by his casual and perhaps inadvertent remark to the effect that "Of course, you will not lend them the money". The political and economic situation seemed to the Ambassador distinctly less satisfactory than it had been six or twelve months previously. He noted the failure to put into effect at Geneva the arrangements as to Germany which had been worked out at Locarno. He called attention to the possibilities of trouble arising out of the desire of Italy to secure additional territory for its rapidly growing population, and expressed decided regret that the $100,000,000. loan to Italy had ever been extended. He took a serious view of the general strike in England, anticipating that it would continue for at least two months and would leave in its wake bitterness which would make relations between capital and labor in England exceedingly difficult. As to France, he emphasized the lack of leadership, the failure on the part of any group to develop an effective and comprehensive policy, and the increasing distrust of the people in the present form of government, which had recently manifested itself in a disposition to accumulate property rather than currency on the part of French peasants.

The general attitude of the Ambassador is perhaps sufficiently indicated by his expression of belief that the situation was one which was bound to become worse before it could become better.

OMWS:M
[Sprague]

6

Hyde Park Hotel,
London, May 9, 1926.

Dear Mr. Jay:

We are urged not to burden the mails with unnecessary letters, so I shall give you one brief account of what we have done and await more elaborate reports until I get to France.

There is no chance of our getting away until Saturday, the 15th, and the uncertainty of Channel service will probably make it necessary for us to motor to Southampton, with a lorry for our luggage, and cross on one of the big liners to Cherbourg. They seem to be getting away regularly.

I cabled Harrison yesterday as per enclosed confirmation in regard to the approach by the French Government for a loan on gold. It hardly needs elaboration, and I still don't know enough of the situation to be able to have a definite opinion myself. Yesterday afternoon I had a long talk with Ambassador Houghton, taking Mr. Sprague with me as confrere, and he will prepare a memorandum of our talk. My own mind is turning in the direction of insisting that the time has come for France to have a house-cleaning. As a start, this should include an understanding between Norman, Lamont, Gilbert, Winston, and would now include myself, because of this application for a credit. I think we are now individually agreed that the basis of any project of France must be an agreement of a unified purpose on the part of the Government and on the part of the opposition in Parliament, the most important being the Blum-Herriot group, including likewise the Bank of France and all the important French bankers. They must lay down their squabbles and get together on a program.

As any program must be based upon saving the American debt settlement from wreckage, it may turn out that some sort of a temporary arrangement for a credit to the Bank of France will be justified, but I am not at all hopeful that the foundation for such a credit can be laid at the present time. This is about all I have in mind at the moment, until I have met with the others mentioned.

As to the hearings, the whole story is comprehended in something that happened after lunch on Friday. We had spent the morning before the Commission, the proceedings opening by a formal statement by me, followed by a general argument by Professor Hollander. Immediately afterwards, Professor Sprague took up the silver end of the discussion and at the end of that part of his talk many questions were asked us. We all left a little after one to lunch together at the Carlton. On reaching the hotel, Sir Purshotlandar Thakurdas, one of the Indian members of the Commission and a man of great ability, I gather, laughingly said to me, "I can give you my impression of the hearings this morning by showing you a piece of paper which I passed to Sir Alexander Murray"(he is a member of the Commission and the Head of the Imperial Bank). The paper said "Tell Blackett that his plan has been buried with international honors". At the foot, Murray had written, "And a good job, too". Of course, they want a good record to go back to India, so Monday morning Sprague will finish his statement and then I am proposing to fill in the gaps, submit the formal statement of our views which will summarize the evidence, and then submit myself to an endless range of questions which I understand they are preparing for me.

Hilton Young is a splendid presiding officer. The whole thing is conducted with great dignity and order, everything being carefully laid out in advance, so that it is not a rambling hit-or-miss affair as one of our Congressional inquiries. It really is a joy to take part in a proceeding that is so well organized. Besides that, these men are a fine lot - very earnest, certainly very intelligent, and with the exception of one of the Indian members who is a lawyer and a bit truculent, it has been marked by the very best of good feeling. Their expressions of appreciation of our willingness to come over are unbounded.

While Norman, Addis and George Roberts had made the plan groggy, Sir Henry Strakosch tells me that it needed just the kind of appearance that we have made, with the evidence of very careful preliminary preparation and study, and such reports as we had on silver production and the like, to make a deep impression upon the Commission.

I am dictating this Sunday morning, and just as evidence of the efficiency of the way these things are done, yesterday afternoon we had delivered to us four copies of the record, with all the charts and tables we produced, in beautiful form ready for correction.

Norman tells me a technical situation has arisen in Australia which may enable him to purchase $20,000,000. of gold from the bank of issue. He is proposing to have it shipped to San Francisco for our credit, to add to his present balance in New York, and will want us to invest it for him. It is a very confidential transaction and not yet concluded, so please warn the others in the office.

We have seen a good deal of Norman, but the arrangement of our program for the hearings and the discussion of the material to be submitted has taken no end of time. Dr. Burgess did a grand job for us.

This is about all the news, except that I am feeling a good deal better than I was, but still anxious for my "loaf".

My best to all at the office.

Sincerely,

Mr. Pierre Jay,
c/o Federal Reserve Bank of New York,
33 Liberty Street,
New York.

BS:M

London, May 13, 1926.

NOTES ON CONVERSATION WITH MR. OSBORNE REGARDING BELGIUM.

Personalities

In Mr. Osborne's opinion, one of the greatest complications of the Belgian situation is the lack of persons who combine trustworthiness with capacity to get results. In his opinion, Van Zeeland is rather vain and superficial. Formerly, Van Zeeland was rather wanting in individuality, but since he became a Director, he has assumed considerable initiative. Janssen is academic and doctrinaire and rather inclined to be self-sufficient, which is one of the principal reasons for his overlooking the necessity of securing the cooperation of the commercial bankers. The one man who, in Mr. Osborne's opinion, seems to have any particular strength is Franqui, in whom he did not seem to have a great deal of confidence. Throughout the negotiations, Franqui was opposed to the stabilization of the Belgian franc at 107 to the pound and argued that the rate should be 120 or 125. I asked him whether he believed that Franqui was speaking entirely from a Belgian standpoint, or whether he might have any French affiliations that would complicate his attitude. Mr. Osborne had no opinion on that.

Budget

Mr. Osborne gave me a copy of a memorandum on the subject of the Belgian budget, which seems to indicate that for 1926 the budget is virtually in balance. However, since that time it appears that they have discovered one item of a billion and a half francs which was overlooked; second, the budget assumes that maturities amounting to nearly 2 billion francs of a 5-year loan due in December will be met by banking support or by extension, and of course assumes that the floating debt will continue to float.

The 1926 budget includes a number of extraordinary receipts, and even if the franc had remained at 107 to the pound, could not give definite assurance that the budget would remain in equilibrium once these extraordinary receipts had ceased.

There is in the memorandum a table covering the collections on the heavy arrears in taxation. These tables indicate that comparatively little of these arrears is met with a cash payment. Most of it is paid in the form of a 60 or 90 day mortgage on the real property of the delinquent, but it is claimed that the State has no difficulty in disposing of these mortgages in the event of a failure of the tax payer to redeem them.

Railways.

The whole subject of the budget is greatly complicated by the question of the State railways. These railways during the last few years have covered their operating expenses with a small margin, in spite of the fact that their passenger rates, reduced to gold, are rather below the pre-war level and the freight rates only slightly above. No attempt has been made to meet any form of capital charges, even maintenance, from operating income and these expenditures, where they have been made, have been made by appropriations from the budget. These expenditures for railroad expenditures appear to be classed by Belgian commentators on their own budget under the heading of "Productive Expenditures".

Mr. Osborne presented two memoranda on the subject of the Belgian railways, one by an Englishman, the other by a Belgian. The English report comes to the conclusion that, with the franc at 107 to the pound, an increase of 25% in railroad rates reached gradually over a period of several years, will be adequate to meet the expense of the proper maintenance of the railroads and also to provide a very considerable sum toward capitalizing the floating debt. The Belgian report argues strongly against an increase of more than 10%, on the theory that it is of vital concern to Belgium to maintain extremely low rates both for passengers and freight in order to aid the industrial life of the country and to secure for Antwerp traffic which otherwise would go through Rotterdam or Dunkirk. Naturally, if such a trifling increase were granted, it would offer no possibilities of aiding the Government in the problem of funding its floating debt.

It appears, however, that owing to the combined opposition of the Socialists and of the industrialists, it would be very difficult to alter the plan of railroad economics into such a form that they can be depended upon to supply the State with revenues rather than with deficits. There is no doubt that the railroads are heavily overmanned and that their passenger and freight rates are entirely unsound, but the interests which profit by these conditions appear to be very strongly intrenched in Belgian politics.

Mr. Osborne also presented a memorandum which gives a history of the negotiations between Belgium and the Bank of England and American bankers during the last few months. This memorandum, he stated, was entirely on his own authority and was not to be taken as representing the views of Governor Norman. In the course of this memorandum, there is a considerable account of the dispute as to whether any loan granted to Belgium would be for a long term or for three years only. As a personal opinion, I ventured the idea that I did not believe that any terms mutually satisfactory to the Belgian government and the American Ambassador could be found which would permit the floating of a three-year loan of any considerable size in the United States.

The conversation, both on the budget and on the railroads and the memorandum pertaining to the railroads, was very vague, owing to the fact that all of the data on the subject supposed the franc to be stable at 107 to the pound, as compared with the current rate of about 150. Mr. Osborne also showed me a running confidential statement of movements of certain items in the report of the National Bank of Belgium. It appears that all liabilities in foreign exchange are included under the general heading of "Private Deposits" and that the amount of those deposits is reached by subtracting the figures of assets in foreign exchange from the liabilities in foreign exchange. It has been, however, a common practice for the bank to buy spot and sell forward. When this is done, the spot purchases are added to their assets in foreign currency and so reduce the figure of the liabilities in foreign currency, and no inclusion is made in the statement of any liabilities in foreign exchange arising out of these foreign contracts. On the last date in his record, which was as I recall April 1st, these liabilities amounted to some 35 million dollars.

At the same time the Government, owing to its inability to keep its floating debt afloat, has forced a considerable sum into the commercial banks. Part of this was promptly discounted at the National Bank and is carried under the heading of "Advances on Government Securities", an item which last October Van Zeeland assured us never did contain any sort of a loan, direct or indirect, to the Government. It appears, furthermore, that a considerable sum of these obligations, probably about 600 million francs, is overhanging and should appear in the statement of the bank some time in the course of May, presumably under the item of the loan to the Government - an item which hitherto has included only that transaction which arose out of the assumption of the German mark currency.

For some time Mr. Osborne has had difficulty in getting these confidential analytical statements from the Belgian bank, and in spite of his letters, his record is pretty well in arrears.

Summary

There was very little of an optimistic character in Mr. Osborne's view of the situation. There seemed to be no one with whom they had had any dealings in whom he felt any particular confidence. Their most confidential conversations have occasionally been reported promptly to the Press, on one occasion at least the report appearing almost immediately in a French newspaper. Further, it is hard to avoid the conclusion that on several occasions Janssen very seriously misrepresented the state of the negotiations in his reports to the Belgian Chamber. As for the bank, it appears to be absolutely impotent, and what is worse, it seems to be completely overshadowed by the Societe Generale. One of Mr. Osborne's conversations with Governor Hautain in which the latter expressed his gratification over the receipt of a mildly congratulatory message from Franqui in regard to the annual report of the bank was almost pathetic. There is further not the slightest evidence that any attempt was made at any stage of the negotiations to secure the support of the commercial banking interests, if indeed such support could have been secured if it had been sought. It further appears that the political situation in Belgium was throughout the period entirely unstable and that the Ministry prolonged its existence only with the greatest difficulty. There is further comparatively little evidence as yet that any considerable part of the Belgian population is desirous enough of stabilization to pay the inevitable price which such measures must entail. The one suggestion which has been forthcoming in regard to getting rid of the enormous floating debt is the railway reform, and neither shippers nor workmen seem to be willing to permit this to be made available.

This conversation with Mr. Osborne, while very interesting to me, was throughout rather unreal, for inevitably the data on some of the most important features had become unreal, owing to the recent decline of the exchange. Just before leaving, Mr. Osborne repeated a rumor that Franqui was expected to accept a Cabinet position. He also showed me a clipping from a German newspaper to the effect that Belgium was negotiating for the return of the Malmedy district to Germany as the price of a settlement of German liability in regard to the mark currency left in Belgium, and further that there was some talk of trying to sell a part of the Congo. This reference did not specify that the part of the Congo under consideration might be the Katonga district. It was my general impression that Mr. Osborne did not know of anyone whom he would prefer to have as Minister of Finance to Franqui.

RBW/M

(8)

On board s/s "Aquitania",
May 15, 1926.

Dear Mr. Harrison:

This will be about Poland.

As soon as I arrived in London, the Polish Legation were after me and I had tea with Constantine Skirmunt, the Minister. He is certainly very agreeable, a much older man than Ciechanowski, and I understand an old-timer in the service, speaks English indifferently and knows little about finance. His only interest, on which he had no doubt been instructed by Ciechanowski, was to ascertain whether it would be possible for me to win Governor Norman away from the League of Nations program, which he said was utterly impossible for Poland.

I gave him a general outline of what had transpired as to the Bankers Trust Company and Dillon, Read and Company matters and our talks with Ciechanowski. I also impressed upon him that unless things improved abroad, especially in such matters as the Locarno situation, it would be found very difficult indeed for Americans to do very much in the way of assistance to Europe. I think he quite appreciated that point of view. Then I told him I would have a talk with Norman and let him know the result.

Norman and I had two very full talks and agreed that there were three possible courses for Poland: one was League action, which Norman favored but which he admitted would be impossible until after the Fall meeting and then only if a satisfactory adjustment of the disputes which arose at Geneva was effected. I have explained to him, and he understands, that in the meantime of course the patient might die. The second course which I rather favored, was to have Kemmerer's mission expanded so as to include representatives of England, France, Holland, possibly even Switzerland and Sweden, and if the Poles could be persuaded, a German representative, so as to make a full dress international inquiry, with such official or unofficial support from governments as it might be possible to arrange. If the program could be worked out in that fashion, then the degree of control to be exercized would of course be a matter of negotiation, and the controller would probably have to be an American. To this program Norman said that, while he would not commit himself permanently, he did not object in principle, as he thought it was feasible, might overcome the disadvantages of the League plan, but would involve getting up an organization, which with the League was already prepared to function instantly.

The third program would be a practically American one, built up around Kemmerer's report. With that Norman would not associate himself, as he did not believe that an effective control could be devised by that method.

This was as far as I could get with Norman, so I saw the Minister again just before leaving and explained this position very cautiously indeed, indicating that neither Norman nor I were in any way committed and my function at the present time was simply to discuss what might be possibilities in case they wanted to pursue them further to see whether they could be made realities. But in the meantime he had informed me that there had been a political upset in Poland, the details of which had not yet reached him, but it looked rather serious. In fact, he feared that Pilsudski had gained control of the Army and that the military were taking possession and would oust the present government. Since then, it appears that exactly that has happened, that the

Army has been mobilized about Warsaw, possibly is in possession of the city, and no one knows what the outcome will be.

It had been his expectation to get the Finance Minister to go to Paris while I was there. I discouraged the idea by saying that it was premature. I also told him that it was most unlikely that I would go to Warsaw, although he begged me to do so. Of course, on the second visit all thought of meeting the Finance Minister was dismissed and we agreed that there was nothing to do now but await developments. I am afraid they are in for a hard time.

Sincerely yours,

Mr. G. L. Harrison,
c/o Federal Reserve Bank of New York,
New York.

BS:M

9

On board s/s "Aquitania",
May 15, 1926.

Dear Mr. Harrison:

This will be about France.

As I cabled you, Parmentier flew across the Channel to see me at the request of Finance Minister Peret. His story was that, while they had 80 million dollars left of the Morgan credit, the position of the franc was disturbing and they did not want to attempt to hold it steady and use up that balance without fortifying it with a further credit. My reply was summarized in the cable, but meantime I had a very private talk with Ambassador Houghton, to get some line on what was going on politically. I did not get very much of value, but what I did get was even gloomier than his unfortunate newspaper interview, so gloomy in fact that I am inclined to ignore it, or at least minimize its reliability.

Fortunately, Lamont and Winston came over the following Wednesday and have been with us ever since. You can doubtless get the story from Leffingwell, as Lamont has cabled him very fully. The following, I think, summarizes it briefly.

On returning from Spain, he found a cable from New York expressing Leffingwell's suggestion for a financial Locarno, to include France, Italy and Belgium and to attempt some broad, thorough plan of stability for the three currencies at the same level. Lamont saw some possibilities in the plan and had arranged to talk it over with Briand, when he was approached by Peret for a credit of 100 million dollars. Lamont definitely refused to consider it. There was a lot of misunderstanding because of Peret's inexperience and incapacity, but meantime he saw Briand and laid the scheme before him. Briand saw advantages, and they had a Council meeting to discuss it, but apparently it developed that there was some fear that Italy would be too strong for them. At any rate, nothing came of it.

I think Lamont's attitude was rather that it was necessary to have a thoroughly comprehensive plan and that someone in France must take command who was capable of controlling the French bankers, also the Regents of the Bank of France and the parliamentary situation. There was some discussion of an approach being directly made to France by the Italians for some such arrangement. While all this was being discussed, of course, the position of the lira was regarded as being rather secure. A number of foolish suggestions were made by Peret, such as calling the Ambassadors together for discussion, which of course would have wrecked the plan at the outset. I believe he was asked to talk with Robineau at the Bank, or at any rate he had lunch there with the Regents, and the two points of view there developed which stand out most strongly in his head were, on the one hand Robineau's that the Bank would never pledge its gold, and Edouard de Rothschild's, who said there was no reason why the franc should not ultimately be restored to its old parity.

It seems that the French Government has been sounding out other American bankers. They had a talk with Mortimer Schiff, who very properly said that it was Morgan's business and anyway such credits were of no value to stabilize the franc when the French people were exporting capital. I believe they also had a talk with Blair's representative, who took somewhat the same position, and Lamont has written a very confidential letter to Clarence Dillon discussing the matter in such a way that he thinks will result in Dillon doing nothing.

This report, which is most sketchily outlined here, was made at the Bank to Norman, Winston and myself. Norman took the position that a credit was impossible, and that the Italians should proceed at once to a gold basis, the French being left to come to their senses, even though that did not develop until after a general election. While of course we have nothing to do with the situation at all, except it reaches a point where some bank situation has to be dealt with, I did not hesitate to point out to Norman that there were uncertainties in the situation which made his proposal exceedingly inadvisable. One was that we did not know how well fortified the lira position was. While we were discussing the matter, it seems, the lira broke from 122 to 127 and the spread between spot and forward contracts widened about 12% per annum. Lamont then stated that the proceeds of the Italian loan had been reduced by pegging operations to 33 million dollars, so far as they could tell, although they had been advised that there was some 21 million dollars being transferred to the account.

My attitude towards Norman's proposal was that Italy certainly had not the resources to stabilize it at almost any reasonable figure, and especially while the menace of the French position was hanging over them. There is liable to be a big seepage of goods over the border, because the French price level has not yet advanced, although it is practically certain to do so in the near future, as we are told the peasants are pretty generally pulling out their francs and buying all sorts of things in order to get protection.

While Briand had expressed no immediate hope of being able to accomplish anything along the line of Leffingwell's suggestion, I understand that Herman Harjes holds the view that if they are finally and definitely convinced that no more patch-work credits can be arranged in America, it may be that they would come to a thoroughgoing program. He is cautious lest they propose some sort of a French commission of experts to investigate and report a program which will be no more than a gesture to secure the arrangement of credits, but really fruitless of results.

You will see that the situation is very mixed. I am proposing to see Robineau promptly on Monday or Tuesday and make quite clear to him what our position is. Also, I am having lunch with Simon on Tuesday, who probably will have something to say in behalf of his friend and old associate, Caillaux. Fortunately, Peret, the Finance Minister, goes to London on Monday to endeavor to negotiate a settlement of the British debt, so I will likely escape anything approaching a discussion of these matters with any officer of the Government, for which I am duly grateful. Having escaped a meeting with the Polish Finance Minister and put off Hautain, who wanted to come to Paris to see me, it seems as though I would be free to go away by say Thursday.

I am planning to leave Mr. Warren in Paris, give him letters to some of my friends, make him acquainted at the Bank of France, and also give him a letter to the Swiss National Bank, in case he wants to run up there while I am away, and then leave with Winston, Moore and Ernest directly for Rome by train.

One interesting development of my talk with Lamont was the fact that in every one of his conversations with the French people, especially Peret, it developed that what they really wanted was the means of improving the franc before the deputies meet the end of this month, as otherwise they are afraid of being kicked out in favor of a Herriot-government, which of course would have the backing of the Blum element, who stand so strongly for a capital levy. If they should have such a government, the situation would no doubt become much worse. The French people would be frightened and I fear the flight from the franc would get much worse than it is now. Lamont tells me that they all admit that their present tax program is so badly distributed that it is much less productive than it might be. He says a careful calculation shows that a batchelor of considerable means, if he paid all of his taxes, would pay over about 96% of his income to the State, so of course none of them pay anything! The same is true of some of the other taxes.

This is enough to give you a little picture of the situation, which does not encourage me to believe that anything can be gained by staying very long in Paris.

Best regards.

Sincerely,

Mr. G. L. Harrison,
c/o Federal Reserve Bank of New York,
New York.

BS:M

P. S. - I forgot to cover the matter of publicity. The day that Parmentier flew over, one of the London papers had a little squib announcing that he was coming over on the matter of the debts. It seems the French Embassy had been chasing me all day to find out where I was and advise me that Parmentier was coming with a message from the Finance Minister and to inquire whether I would see him. The following afternoon I received a call from Mr. Edwin L. James, Paris correspondent of the New York "Times", who said that he had come to inquire the object of Parmentier's visit. I promptly told him that I would not tell him the object of the visit, but I would like to know how he knew that I was there. He replied that he had been sent to me by the French Embassy in London, and then it developed by one of my statements which he did not deny that he had gotten his information in the Ministry of Finance in Paris. The same day, the enclosed article appeared in the Paris "Herald", and although this is said to be a cable from New York, it is very likely that it originated in Paris.

BENJ. STRONG

RECEIVED
JUN 1 [illegible]
J. H. C.

Pruned
10

On board s/s "Aquitania",
May 15, 1926.

Dear Mr. Case:

I have written Mr. Jay about the strike, Harrison about Poland and France, and this will be something of our general plans. We have had a most interesting time so far, as you will gather when you read my letter which will be addressed to Mr. Jay in regard to the Indian Currency matter.

I could not see as much as I should have liked of friends at the Bank, although I did get out a number of times to dine with Governor Norman, and he was good enough to drive me down to the boat today, which gave us three hours together. He is very tired and is planning to get away for a holiday as soon as possible, but the pending negotiations for funding the French debt and the strike situation have delayed his plans.

We determined to cross the Channel by the "Aquitania" from Southampton because travel by Dover and Calais was so crowded and disagreeable. No reservations could be made, and the trains were filled, even the corridors with people standing. By this trip we expect to land at Cherbourg at 6:30 - about three-quarters of an hour from now - spend the night at a comfortable hotel there and take the 10 o'clock train to Paris Sunday morning.

Governor Robineau telegraphs that he will have us met. By about Thursday I hope to leave for Rome, and after a short visit there Winston and I will probably motor north to Milan. Mr. Warren will remain in Paris. After a couple of days at Milan, I want to motor down to the Riviera, find a comfortable place to spend a month, and just stay there. What I shall do after that depends on developments. Winston has to be back by the middle of June, so he will probably do little more than complete the Milan trip before returning for his boat.

I am glad to say that I am feeling very much better than I did, as I was afraid for a time that I would be too knocked out even to go on with the discussion of Indian currency. You would be amused at the enjoyment that the two Professors have had on the trip so far. They certainly did "spread" themselves in London, and I must say they have been most delightful companions in every way and did a fine job with the Commission. As it may be the next steamer before I get off anything like a report, I will give you a little sketch of how it was handled.

I made an opening statement, rather carefully prepared, which was really our platform. Then Hollander gave a doctrinaire discussion of the "plan" as distinguished from the "questionnaire", which was very well received, although at times I felt that he was a bit over-emphatic, and later learned that the Commission also got that impression. That occupied all of the first morning except for about half an hour, which Sprague used to develop an outline of what he proposed to say. The following morning, which was Friday, he completed his statement, all of it being directed at a dissection of the questionnaire. In both instances, questions were asked by the members of the Commission at the conclusion of the statement. It was a most orderly and dignified affair, held in the Council Chamber of the Indian Office on Downing Street, the tables being arranged in a square, we sitting at one side, the members ranged with the secretaries around in a horse-shoe and the recording stenographer sitting alongside of the witness. The reporting, by the way, was excellent, and the following day we received four mimeographed copies of the statements, one to be corrected and returned and the other three to be retained. Monday morning was my day, and I dismissed the questionnaire, which was covered fully by Sprague, except as to our gold position, and covered all of that, then went into the banking situation in India, following which many questions were asked. Tuesday morning was devoted to their asking questions. We had no program of original discussion.

The Commission consists of six British and four Indian members. They all have divergent interests, and in general the Indians are arrayed against the British. Three of the Indian members were rather sympathetic, friendly and helpful, although not altogether in agreement and a little difficult to judge. The fourth Indian member, Sir Maneckji Dadabhoy, was an Inner Temple man and trained barrister and has quite a reputation in Bombay as a shrewd examiner of witnesses. He is rather of the Samuel Untermyer type, and at times we had quite a good deal of difficulty with him. Sprague was itching to get after him and could have given him a bad time, for Sprague is not a person to handle uncautiously in such a battle. I have found him shrewd and quick as a flash, but I persuaded him of the unwisdom of that. Only, finally one day Dadabhoy got rather gay and it fell to my lot to deal with him, which I was afterwards told was done effectively.

I am writing all of this aside from the report, as it would not have a proper place there and will rather prepare your mind for the report when it comes. The experience was intensely interesting, especially as we met all the Commission, including the Indian members, a number of times at lunch, when we had a chance to have pretty frank talks.

I also spent an afternoon with Sir Purshotamdas Thadurdas. He is the ablest Indian in the Commission and, they say, one of the ablest and most successful men in India. He told me all their troubles very frankly and proved to be a splendid fellow, but of course a thoroughgoing Indian.

He is a high-class Hindou, whereas Dadabhoy is a Parsee. On the whole, I would put it down as one of the most interesting experiences I have ever had of that character, and the way the proceedings were conducted would be a model and example to our Congressional committees. Hilton Young conducted the proceedings with the greatest dignity and tact, now and then in a gentle way restraining the obstreperous Indian member, and apparently after five months, which I believe is the time they have already been at work, he seems to have all the members of the Commission completely under control. Fortunately, Sprague and I were both able at times to introduce a little humor when the situation was strained, and there were some hearty laughs, especially over Sprague's rather droll but very apt retorts. I must say that without Sprague and Hollander, I would have had a much more difficult time, and doubt if I could have succeeded in getting away with it.

This is just a gossipy little picture of the setting which I thought would interest you and the other boys at the Bank.

Sincerely yours,

Benj. Strong

Mr. J. H. Case,
c/o Federal Reserve Bank of New York,
New York.

(1P

On board s/s "Aquitania",
May 15, 1926.

Dear Mr. Jay:

I thought you would be interested in a few samples of English newspapers under strike conditions. One of them you have already received. Those sent under separate cover include a copy of the "British Gazette" published by the Government, which gained a circulation of nearly two and a quarter million daily in the course of a few days.

I am writing the office by subjects and sections, so will devote this letter to an account of the strike, understanding that possibly some of you at the office have been uneasy and have wondered why I have not cabled.

The fact is that I was so wretched and so busy at the same time that I just forgot cables, letters and everything else except the things most necessary to do, but am much better now and keen for the rest.

So nearly as I can gather, the T.U.C. did not really expect to call a general strike until almost the last minute, but the strike order went out almost coincident with the last conference with the Government, and unfortunately the printers of the "Daily Mail" took the bit in their teeth before the order became effective and refused to print the paper unless the editor modified an editorial on the strike situation. He declined to do so; word reached the Government at once and had the effect of closing the negotiations really before it was finally necessary to close them. The leaders claimed that they were prepared to repudiate the action of the "Daily Mail" printers, but it was simply a disputed point and I doubt if the strike could have been avoided, even though the "Daily Mail" incident had not occurred.

It incidentally developed that the Government had been preparing for a general strike for months and that it had an immense organization ready to take over the various services. For a few days, of course, subways, trams, newspapers, railroads, dock laborers, porters, and even the taxicab service were all unmanned, and London presented a curious spectacle with an enormous traffic on the streets of automobiles and other hastily devised means of transportation, but nevertheless crowds of people walking to work. Some of them whom I talked with had walked in seven miles from the country. Automobiles picked people up wherever they could and a sort of impromptu assistance was rendered in all directions, and gradually conditions were improving. Even the railroad train service was getting better, although still most inadequate, when more developments occurred which brought the strike to a sudden conclusion. Two were described to me in some detail.

In the case of the railroads, it came to the knowledge of the labor leaders that men who were employed by one railroad would quietly present themselves as volunteers at another railroad and there was a general shift taking place, with the men drifting back to work on other lines than the ones where they were originally employed.

It looked as though the strike was caving in at that point. Also, the printers' union went to the T.U.C. the day before the strike ended, told them they did not know much about the causes of the strike, and that they were not in sympathy with it anyway, especially as they had heard that it was illegal, and they decided to go back to work the next day if they could get their jobs back. The following day, without any preliminary notice, Pugh, the Labor leader, and some of his colleagues went to Mr. Baldwin and told him bluntly that the strike would terminate that night. I gather there were no preliminary negotiations to that end. It just ended. Mr. Baldwin showed his splendid character then in the restraint with which he handled the situation, both with the Labor men and in his speech in the House, which had no bitterness and no note of exultation in it. I think Baldwin's attitude made a more favorable impression than anything that has happened, and he has emerged from the trying situation in which he found himself, much the most popular man in England and with his influence and prestige immensely enlarged.

We none of us really suffered any inconvenience. Lack of newspapers and taxicabs was the most obvious thing, but the essential work went on just the same. The traffic made driving rather difficult, but I had a private car during my stay, which relieved me of any fatigue. Unfortunately, one night when it was raining we barged into one of the metal posts that carry the street lamps of Piccadilly, broke off the post and smashed the car pretty well; also gave the driver a pretty bad bump and shook me up a bit, but with no serious consequences to either of us.

Some exceedingly amusing incidents occurred in connection with the strike. One was the parade of food supplies across London in a string of lorries about a mile and a half long, which was escorted by armored cars and tanks. It made a tremendous impression upon the people in the streets and convinced everybody that the Government was going to attend to the movement of food at any cost. I am told that there was not a gun drawn or fired during the entire strike, although three million men were out. At one of the principal seats of disaffection, the police arranged a football game one day with the strikers, the wife of the Chief of Police kicked off the ball, and they played a game through with the utmost good nature; they then all adjourned to a nearby pub for a drink. An immense crowd watched the game.

Can you imagine such a thing happening at home?

Another most amusing story told me by one of the Directors of the Bank related to his brother, who is a manufacturer. When his men struck, one of the men went home and reported the news to his wife, who promptly left the house and was gone all day. When she got back, he upbraided her a bit and she said the family had to have money to live, so she had gone out and gotten a job herself. He asked her what she was going to do, and she said that she had his job. So every morning the wife went to the plant and did the work, while "hubby" stayed at home, took care of the children and did the cooking. He stood this for four or five days and then told his wife the strike be damned, he was going back to work and did.

I saw the Chairman of the Board of Directors of the South Eastern & Chatham Railway, R. H. Martin Holland of Martin's Bank standing on the platform running the cab service. Medical students, students from Oxford and Cambridge, and almost everyone from belted earls down, turned to and did the manual labor for the nation. Walter Whigham's brother served as escort for garbage wagons. Hilton Young's wife was running a cab service at one of the stations.

On the whole, I should say that the strike demonstrated two things. One was that the British are a great people and hard to beat, and the other that there is no such thing as a general strike.

The process of return to work is almost more difficult than the strike period. There are endless difficult readjustments to make because of places being filled and the different kinds of bargains being made by different employers. You can imagine the endless complications, disputes and entanglements that are arising. In fact, the service they say is very little good as yet, but of course the busses are running, the taxicabs and so on, and the food service is almost back to normal.

This will give you a little picture of just how it went. It is hard to say what the consequences will be. I had a long talk with Layton, who says that if the Government exercises sufficient restraint over employers, so that they do not take undue advantage of the men in their present plight, they think the results on the whole will be excellent. The idea seems to be to turn the loyalty of the men to their unions in the direction of loyalty to a principle, and that idea Mr. Baldwin is endeavoring to cultivate. I hope he succeeds. The effect upon the British budget is discussed as meaning 6 d. or a shilling additional to the income tax. A shilling would mean an estimated loss in actual expenditure and lost revenues of possibly from 20 to 30 million sterling. I doubt if it is as much, but only time can tell.

This will be enough for now. Best regards as always, and again many thanks for those fine cigars.

Sincerely yours,

Mr. Pierre Jay,
c/o Federal Reserve Bank of New York,
33 Liberty Street,
New York.

BS:M

Grand Hotel,
Rome, May 22, 1926.

Dear Mr. Harrison:

One of your cables contained a suggestion that you might have had a talk with Dr. Miller about my health, because of the word I had sent about being ill. I am very much better now and think I had better let you know exactly what happened. I must have gotten some infection, similar to what happened in Colorado, possibly my old enemy "streptoccus". At any rate, I was feeling miserable before I got on the boat, and as soon as I got on the boat, managed to get up a pretty good temperature, coughed incessantly and felt like the very devil - in fact, spent a good part of the time on the trip in bed. There did not seem to be any antrum infection such as I have had before, but it was all my throat and chest. The highest temperature was 102 one day only, and then it gradually subsided. After a few days in London it gradually disappeared, but I was still feeling wretched and weak, and the need for preparing for that inquiry and then four days at that and finally a terrible ordeal in Paris, all combined to send me South to Rome a bit of a wreck. Strange to say, as soon as we got out of Paris I felt better, and I am much better today than I have been at any time, so I don't want any of you to bother about me a bit.

We are having some interesting parties here. I expect to meet Stringher, of the Bank of Italy, tomorrow morning. Monday Winston, a man named Fummi and I are motoring North to Perugia and back the next day. We dine at the Fletchers' Tuesday night. Then we are going to take one or two quiet motor trips in the neighborhood. Friday night we are dining with Fummi and Mussolini, just a quiet little informal party at a restaurant.

Saturday we motor North to Milan, then from there over to the Riviera, where we shall go to a little place named Beauvallon. From there Winston will go on to Cherbourg and sail for home, and I am planning to spend a month at Beauvallon.

I will write you later about things in Italy. I am getting more information here and there is much more freedom in giving information than one ever experiences in France - always excepting the Bank of France, where they talked with me very frankly.

This is just a little account of what I am doing to make up for the lack of letters since I left home.

Sincerely yours,

Mr. G. L. Harrison,
c/o Federal Reserve Bank of New York,
New York.

BS:M

Grand Hotel,
Rome, May 23, 1926.

Dear Mr. Jay:

I am enclosing translations of various newspaper articles, most of which are amusing, and they will give you an idea of about how we have been received.

I take my hat off to Count Volpi. He seems to sense the situation, and Fletcher tells me that he wrote out of his own hand a little statement for the newspaper men about our visit, which has given them just the right touch. I won't send you any more particulars now, but will write you rather fully after I have had an opportunity to meet more people here.

My best to all at the office.

Sincerely yours,

Mr. Pierre Jay,
c/o Federal Reserve Bank of New York,
New York.

BS:M

(14)

Grand Hotel,
Rome, May 23, 1926.

Dear Mr. Harrison:

Continuing something about France, which was covered to the time I left London in mine of May 15th, on arrival in Paris we were met by Robineau's secretary, and at his request I arranged to go to the Bank at 3:30 the following day, Monday. (May 17)

Robineau was very much agitated about the situation, especially in Parliament. A sharp decline had already occurred in the franc, and he was under great pressure from the Minister of Finance to negotiate a loan on gold. He admitted that there was no plan of a comprehensive sort, and I gained the impression that he had little confidence that any plan could be developed by the present Finance Minister or even by the present Government. I pointed out to him as tactfully as possible how very serious it would be if we made large advances to the Bank of France secured by gold and then no general stabilization plan was forthcoming, or any plan proposed proved to be unsatisfactory to foreign banks so that the Government would be unable to arrange credits and repay our advances. It would result in our taking gold from the Bank which had been pledged as security, and we would be excoriated from one end of France to the other.

It was a long talk. The discussion was very frank and the interpretation excellent, and when I left I had every assurance from Robineau, Picard and Leclerc, the three Directors, that they were in entire accord with what I said and intended to resist any proposal to use their gold at the present time and until a complete plan had been developed. I must say they struck me as being rather helpless and with very few constructive ideas.

We discussed whether it would not be possible for the present Government to get the cooperation of the opposition in the Chamber, for the Bank of France to get the cooperation of the entire banking community, and then have the Government turn the monetary problem over to the Bank, which would call in experts and work up a comprehensive program. They disclosed that there were differences of view within the Bank itself, but practical unanimity in opposition to the use of their gold. They also seemed indisposed to make use of the Morgan credit, which they felt was the "last ditch". They all said that the budget, so long as prices did not advance, was really balanced, but would not remain so unless the franc could be protected. The maturities of the 20th, of which some three billion francs were due to be paid, were really in good shape, and it turned out as a matter of fact that almost all of the holders who had signified their intention to take payment at maturity left the proceeds on deposit with the Treasury and were actually proposing to take new issues of Bons de la Defense.

We did not get far enough along with the discussion to satisfy Robineau Monday afternoon, so I returned Tuesday afternoon. Meantime, I had opportunity for a talk with Monnet, Harjes and Dean Jay, Parker Gilbert and one or two others. I found that the French Government had approached Schiff, Clarence Dillon, and Blair & Company as well as Morgan's and myself for advances of one sort or another, always suggesting the Bank of France gold as security. All had declined on the ground that it was merely temporizing with the situation, that it would not be a cure but a palliative, and that they must get at the cause of the difficulty.

On Tuesday morning I had another talk with Monnet, who had been discussing the situation with Laval, Minister of Justice, who is regarded as the ablest man in the Cabinet, and with Sardou of the Foreign Office. Both expressed somewhat the same opinion that Monnet and all the rest of us had, that these temporizing measures were bad and that a thoroughgoing program was necessary.

Monet wanted to know whether I would have a talk with Briand if he sent for me, his idea being to arrange a meeting through Laval, but I told him that I saw nothing but embarrassment resulting and not to attempt it. Peret being in London negotiating the debt settlement, I felt that I would escape any embarrassing talks with officials. Tuesday afternoon I found that Robineau had had lunch with Briand and that Briand had apparently been urging him to arrange a loan with me. Robineau seemed very dejected, and I gained the impression that he was conveying this message as a matter of form and duty, but without any conviction himself. We went over the same ground very fully, and when he was convinced that I had no intention of changing my opinion, he and the other Directors present exhibited the greatest possible relief. They were very much afraid that I would open the door in some way as a result of Briand's message.

He then told me that Péret had telephoned from London that morning to advise that he was flying back from London on Wednesday and wished to see me at six o'clock Wednesday evening. I did my best to find a way to escape meeting him, but Robineau insisted that it would make a very bad impression and react upon him if I failed to do so. At tea, Baron Edouard de Rothschild came in with Jacques de Neuflize. The latter was in a perfect panic, said that the whole situation was going to collapse the next day, and first seemed to think that we should let them have the credit on gold and then that they should employ the Morgan credit without limit. Rothschild opposed both plans and seemed perfectly delighted that I had declined to make advances on gold.

One little joking remark seemed to catch their attention and I gather that it has passed all around Paris! Behind Robineau's office is the old ball-room of the palace, in which hangs one of the finest Fragonards in existence. I said half jokingly to Robineau in our first talk that I did not want to come in to see him some day years hence and see a picture hanging beside that Fragonard depicting me riding on a camion out of the Bank of France with a cigarette in my mouth and the truck loaded with their gold. Rothschild spoke of it at once and rather agreed with me that if any such thing occurred, Paris would not be a very comfortable place for me to visit hereafter.

The result of all the talk at tea, which was very protracted, was absolutely nothing. They all charge that the difficulty is political. No one trusts the Chamber, they are all afraid of the Socialists and of the capital levy, and they all think the income tax and the tax on securities is too burdensome to be productive and is driving capital out of the country. Their general attitude is to seek external causes for the difficulty, rather than to attribute the difficulties to the real domestic facts. Nothing came of the meeting at the Bank except to convince them, I think, that nothing would be done by us.

The following morning I got hold of Jacques de Neuflize and explained to him the embarrassment which would grow out of my meeting Peret. I asked him to have a talk with Robineau and see if it could not be arranged for me to have a general discussion, but to avoid the embarrassment of being asked for a credit. This they undertook to do if possible. I had stipulated that if I saw Peret, it would only be with Robineau and Warren present, and had a statement conveyed to Peret that I had no authority to negotiate a credit with the French Government either in fact or in law.

It developed that when he arrived in Paris, he went directly home and telephoned the Bank when I was there, about half past four, asking if we would come to his home. On arrival we found Peret with three of the Treasury officers there and great portfolios of documents. Whether he had been adequately advised or not I could not tell, but the stage was all set to convince me that a credit should be arranged. We had the same interpreter as we used at the Bank of France.

Peret started with a long discourse, following which Robineau reported our conversations and their result. The talk lasted about half an hour. I stated repeatedly in response to the only question he asked, namely, a credit, that this had all been discussed with the Bank of France and that we were in complete accord that no such credit was now desirable, and that I was unable to grant one. I also emphasized that our conversations were simply recounting discussions which had already taken place and that I could not negotiate with the French Government; we were simply giving him information.

Frankly, I did not like the man, nor the way the meeting had been arranged, nor the rather adroit way in which he endeavored to leave the door open so that he might create the impression that we were still willing to discuss a credit. I said to him very explicitly that if we advanced money now on Bank of France gold and then they did not develop a plan which would invite cooperation by American and other bankers and which would result in repaying our credit, we would then be obliged to take the gold, and that was something that we were unwilling to do. If the Bank of France wanted to ship the gold, of course that was for them to determine and not for us, and was not a matter for negotiation.

At the end of half an hour, Peret excused himself, and I surmised from his attitude that he rather expected that I would stay and continue the discussion with his associates, although I was not asked to do so. I told him that there was nothing further that I could do, as I was leaving the following day to be gone for a month or six weeks and that my plans after that were uncertain.

He and Robineau went immediately to the Elysee Palace, where the President had called a meeting of the Cabinet together with the officers and Regents of the Bank. I learned afterwards from Baron Rothschild, who was there, that the result of our talk was reported at the meeting, and he said he had discovered no evidence of any animus or bad feeling resulting. This really ended the episode, but it was full of thunder and lightning from the minute we arrived in Paris until we left.

The following day, Thursday, I had lunch at the Bank to meet the principal bankers and the Regents. It was rather a "swell" affair - about forty men present - and I tell you they gave me a very warm welcome. I think every man in the room was immensely relieved at the decision not to negotiate for a credit. They all attributed the difficulties to politics. They none of them have a plan. They are not yet working together, but they were very much afraid that the sinister hand of the Government would again be laid on the Bank. They were even willing to risk the Herriot Government rather than have that happen. I really had quite an ovation. At the conclusion of the lunch, Robineau made just a few remarks about the satisfaction which he had had in my visit and my attitude, and then promptly saluted me on both cheeks, which brought forth great applause.

There has been an immense intrigue going on in the franc and lira speculation. I have not unraveled it all yet, but apparently friend Volpi was operating in lire through francs. He went a little too far, I guess, and accumulated immense franc balances, and then when the franc broke, he shifted in a flash and sold his francs, which of course added to the difficulty. But he has been clever enough to so conduct his operations that his reserves in America were reduced but a very small amount. All of this I will cover in later letters.

As to the franc speculation, the evidence appeared within the last ten days or two weeks that the big French banks were conducting "swaps", that is, lending francs against the security of foreign currencies. This widened the spread between spot and forwards and of course was the equivalent of a sale of francs. There must have been an enormous exodus of balances from France. The stories that were afloat were most extraordinary, many of them possibly groundless, but the mere existence of this mass of rumor was one of the most damaging aspects of the situation.

My own conclusion from it all is that this French Government will endeavor to carry out some such program as has been suggested to them by Lamont and which we have discussed at the Bank, that is, to try and develop an accord in political circles and for the Bank of France to endeavor to do the same thing in banking circles, then for the Government to turn over the monetary problem entirely to the Bank, to invite experts and lay out a plan. The difficulty will come in leadership. There seems no one capable of handling the situation. All that we can do is to watch. Rothschild and one or two others told me that this Government would not last two days after Parliament met, and no one knows whether the swing will be to the right or the left. While the franc has improved the last day or two under the influence of New York support, no one knows how long that will last. If the decline continues and then a general rise of prices ensues in France, the French people are finally liable to be disillusioned, and one hears all sorts of prophesies of disaster, some even saying they will have the streets filled up with mobs in Paris ! Personally, I do not believe that, but I do think there is a good chance, if the present Government or the one immediately succeeding it cannot develop a strong program, that they will drift into worse disorder and only get out of it when some fellow with courage and vision gets hold, with something approaching dictatorial powers.

There is one thing always to be reckoned with in France, and that is the unbounded confidence of the people in the Bank, and there is just a chance that some Bank program might evolve which would save the day. I wish I could be more hopeful of it.

I am enclosing herewith a memorandum made by Mr. Warren of the [See May 19] conversation at Paris, which I have somewhat elaborated and which will give you a more detailed account.

Sincerely yours,

Mr. G. L. Harrison,
c/o Federal Reserve Bank of New York,
New York.

BS:M P. S. - Enclosed is a copy of a message received from Warren yesterday, together with a copy of a message received from Mr. Harjes through Fummi, Morgan's Rome representative, this morning. From the latter it would appear that the Government is really moving in much the direction indicated by the conversations they have had with the various foreign bankers, including ourselves.

[From B. Strong [illegible]

Rome, May 24, 1926.

Dear Mr. Secretary:

Quite apart from the report which is being sent to you from the Bank, I think I should advise you that there is still some danger in any publicity arising in regard to the Indian proposal. I was told very confidentially by the Chairman of the Commission that, while he had no fear of a majority report favoring the adoption of the gold standard, he had had a good deal of anxiety lest there be a strong minority report. But his principal concern was lest the Indian legislative assembly might take advantage of a minority report and adopt the Blackett or so-called Government program for a gold standard notwithstanding that the Commission might recommend adversely. This feeling of the Chairman's was largely based upon the jealousy and suspicion of the Indian people, which has recently fastened itself upon what they regard as a selfish management of the currency to the disadvantage of India and the benefit of Great Britain. Of course it is an aftermath of the disorders and losses growing out of the collapse of the rupee following the war and the collapse of sterling in 1919 and 1920. But the danger has been a rather imminent one, and I think I may say to you privately that that danger was not disposed of until after we had made our statement to the Commission. Even the Indian members expressed the same view.

Winston and I are having a fine trip, of which we are endeavoring to keep you advised from time to time. He will return before I do and give you the story with much more color than can be introduced into a

[From Bk Copy] 16

May 24, 1926.

Dear Mr. Mellon:

Following the determination to make thorough inquiry into the probable effects of the adoption of the gold standard with circulation of gold coin by the Government of India, our studies convinced us, as you have already been advised, that it would be essential to present the result of our investigations to the Royal Commission, then holding its sessions in London.

Investigations at the Federal Reserve Bank of New York were placed in the hands of Mr. W. Randolph Burgess, and at various times we called into consultation Professor O. M. W. Sprague, of Harvard University; Professor Jacob H. Hollander, of Johns Hopkins University; Professor Wesley C. Mitchell, of Columbia University; Mr. Walter W. Stewart, formerly of the Federal Reserve Board; Dr. Chandler, of the National Bank of Commerce; also two eminent metallurgical engineers, Captain H. A. C. Jenison and Mr. Arthur Notman.

In order that you may have a complete record of the proceedings, I am sending you herewith:

(1) A copy of the invitation from the Royal Commission to attend and give evidence at the hearings;

(2) A copy of a plan suggested to the Commission for introduction of the gold standard by the Indian Government;

(3) A questionnaire submitted to American witnesses as a guide in dealing with the proposed plan;

(4) Copy of a statement prepared by Dr. W. R. Burgess for the guidance of those appearing before the Commission;

(5) Copy of the report of Captain Jenison;

(6) Copy of the report of Mr. Notman;

(7) Mimeographed copies of statements made before the Commission by Professor Hollander, Professor Sprague and myself.

Prior to our appearance, it had been arranged that Mr. George E. Roberts, Vice President of the National City Bank and former Director of the United States Mint, should appear before the Royal Commission, which he did on April 30th, and with this I am enclosing:

(8) A copy of the prepared statement which he submitted to the Commission.

Mr. Roberts' oral statement is not yet available.

The members of the Royal Commission are the following:

Commander E. Hilton Young, Chairman
Sir Norcott Warren
Sir Henry Strakosch
Sir Alexander Murray
Mr. A. W. Preston
Sir Manekji Dadahboy
Sir Rajendra Nath Mookerjee
Sir Purshotlandar Thakurdas
Professor J. C. Coyajee
Mr. Baxter
Mr. Ayenga .

Accompanied by Professor Sprague, Professor Hollander and Mr. Robert B. Warren of our office, I appeared before the Commission on May 7th, 10th, 11th and 12th, the hearings occupying each morning.

The scheme of presentation was followed as arranged in advance. I first presented a formal statement of our position with regard to the plan. Professor Hollander then made an extended argument on the economic aspects of the plan. Professor Sprague then dealt specifically with the questionnaire, at the conclusion of which statements, in each instance, members of the Commission asked many questions.

At the hearing on the 11th, I presented a statement as to certain of the gold features of the plan and concluded with a formal statement in the nature of a resume of the points made in the course of the argument during the preceding days.

The last day's hearing, Wednesday the 12th, was devoted to discussion of certain principles relating to the establishment of a bank of issue for India.

While of course no decision has yet been arrived at by the Commission so far as we are aware, I have been privately informed by the Chairman and by practically all the members of the Commission that the American evidence submitted had been convincing and conclusive that a gold standard with a gold circulation and with a fixed price for gold, such as is practiced in Great Britain and in the United States, will be impossible and that it will be abandoned by the Commission. It is of course too soon to indicate what particular plan will be adopted in substitution therefor, but I am satisfied from the statements made to me that little fear need now be entertained that this rather dangerous experiment will be undertaken by India.

Fortunately, as disclosed in the testimony, it was not necessary to present arguments in opposition to the plan solely upon the ground of injury to American industry. Inherent weaknesses in the plan and possible disastrous reactions upon India were capable of presentation forcibly and definitely and were in themselves conclusive to the Commission, without regard to what would otherwise have been regarded as the self-interest of the United States.

Prior to the receipt of this written report, you will doubtless have heard from Professor Sprague and Professor Hollander in some detail exactly what transpired at the meeting, and I shall not now burden you with further details. My own conclusion is that the menace of the plan is definitely past.

I beg to remain

Respectfully yours,

Governor.

Hon. A. W. Mellon,
Secretary of the Treasury,
Washington, D. C.

BS:M

Grand Hotel,
Rome, May 26, 1926.

Dear Mr. Harrison:

This will be about Italy.

I have had very little opportunity since my arrival here to engage in any serious discussions, my first talks with Volpi and Stringher being largely complimentary. Today, however, there was a meeting at Volpi's office of Pirelli, Fummi, Winston, Volpi, Stringher and myself, which lasted a couple of hours and which I felt was most enlightening.

Volpi gave us an excellent account of conditions and expressed his own views as to the uncertainties surrounding a monetary program. He clearly has no program and no plan, and I am inclined to think that he is amenable to advice, but that it will be necessary to give it most cautiously in order to avoid assuming more responsibility than I, for one, would care to assume as to their general policy. I think I may sum up his position by stating that they have ahead of them three possible courses. One is to do nothing beyond moderating fluctuations in the lira with such resources as they have available and wait until the air clears, especially in France. Another course would be to undertake an immediate program of stabilization and return to the gold standard, fixing the value of the lira somewhere around its present exchange value. The third possibility would be to effect some understanding with the French or even the Belgians as well, which would enable them all to undertake a program together. I had a feeling during the course of our talk that the third course appealed to them rather strongly, but that they did not minimize the many difficulties, political and otherwise, to be overcome.

He then asked me for my own views. I may say that the translation by

Pirelli and Fummi appeared to be excellent, as they checked each other.

After first explaining that we had no authority to deal with foreign governments, but only with the bank of issue and that accordingly our discussion was quite informal and unofficial and distinctly non-political, I asked him to consider the following points, which were of course an external point of view.

(1) The adoption of a plan which would be preceded by a careful study of the whole price structure and wage structure in Italy, what the course of both had been for some time past and what effect any new given price or value for the lira would have upon prices and wages, especially in their relations to world prices.

(2) That equally careful study be given to the question of the monetary circulation, what the experience of other countries had been, so as to arrive at some determination of a safe figure at which to value the lira.

(3) A balanced budget with a margin for debt reduction was essential.

(4) The settlement of foreign indebtedness must be concluded - and that has been done.

(5) External resources for use in connection with the return to the gold standard should be considerable, and probably larger now than would have been necessary had the franc been successfully stabilized.

(6) The entire note issue should be in the hands of the Bank of Italy. This has already been provided for by a decree just promulgated.

(7) Some portion of the Government's debt to the Bank of Italy had best be put in salable form, so that any tendency towards inflation could be dealt with by liquidating the Bank's portfolios of Government securities in preference to a sudden and severe advance in discount rates.

(8) Any Government credits arranged abroad would probably be more effective if they could be arranged in more than one gold standard market.

(9) The amount of these credits need not be as large as otherwise would be necessary if the Bank of Italy could be assured of acquiring valuta arising from foreign borrowings of a useful and productive character by private borrowers such as the Italian industries.

(10) If a fiscal program in connection with stabilization could be made satisfactory to foreign bankers who would do the financing, then it might be possible for the Federal Reserve Bank to establish relations with the Bank of Italy as a supplement to Government credits.

(11) It would be essential, as a matter of policy, that the Bank of Italy be free to manage its discount rate and credit policy in the interest of the stability of the lira, without regard to possible expense to the Treasury or without interference by the Treasury for purely fiscal or financial reasons. Failure in this respect might break down any plan that was adopted.

(12) As an emergency precaution, in the event of unsatisfactory developments, it might be well to have in mind some method of controlling luxury imports, although this should not be announced as part of the program, because of the tendency such announcement would have to stimulate imports in anticipation of an embargo.

(13) Foreign borrowings by Italian enterprise should be limited to really productive enterprise which would develop export trade, and the valuta arising from such borrowings should be acquired by the Bank of Italy.

I think the above very briefly summarizes the points covered by my own talk, which was followed by a request from Volpi for information as to whether I thought it would be possible for them to arrange credits for as much as 250 million dollars, in addition to what they now have. I avoided any answer to this, saying that it was so largely a matter for him to discuss with the bankers that I would have no opinion as yet.

Pirelli, Fummi and Winston all felt at the conclusion of our talk that the whole subject had been laid before Volpi in a rather different light from anything that he had considered and that he saw the importance of a carefully studied program and of a very skillfully devised policy following the adoption of the program. The matter was left in this shape, with the understanding that I would see Stringher tomorrow, which I shall do at three o'clock. The following day I will have another long talk with Volpi. My own observation of his attitude during the talk was that he was exceedingly serious and, if I may say so, a bit inclined to deal with the whole matter somewhat less lightheartedly.

I will continue this letter after our further talks, which may not, however, be possible until Friday.

. . . . .

May 28th: Yesterday afternoon Mr. Winston, Mr. Fummi and I spent a couple of hours with Stringher at the Bank of Italy, and the London representative of the Bank of Italy, Dr. Nathan, joined us in order again to have good interpretation.

Stringher explained to us the meaning of the decree just promulgated, under which the Bank of Italy will take over the note issues of the Bank of Naples and the Bank of Sardinia. I also have a translation of the decree and his written explanation of the transaction, all of which I will send forward in due course. The substance of the transaction is that the note issues will be assumed as of July 1st and the entire gold reserve of these two banks, totalling about 80 million dollars, will be transferred at once. The gold is to be valued at the average exchange price of the lira for the month of April, this value however being tentative, subject to adjustment when the lira is devalued, at which time the total amount of gold reserve of the Bank of Italy will of course be revalued at whatever basis stabilization is fixed. The revaluation of the gold of these two banks will furnish something like 400 million lire of cover in excess of the note issue assumed. The gold will be added to the reserve of the Bank at its gold bullion value and the difference, say a billion 600 million lire or thereabouts, will be shown as a special account pending final adjustment. I shall not give the figures, as they are all included in the documents.

The two banks thus deprived of their note issue will continue as purely commercial banks. The transaction is a bit complicated by the fact that they both took part in a large credit to the Bank of Rome when it got into difficulties, the principal amount of the credit having been advanced by the Bank of Italy, so it is to be arranged that the Bank of Italy will also take over those advances and liquidate the whole account, instead of leaving any portion with the other two banks of issue. Stringher advises us that the liquidation of the affairs of the Bank of Rome and of one other smaller bank which got into difficulties and which they assisted will result in a very large profit, sufficient in his opinion to entirely wipe out the special account of a billion 600 million lire resulting from the transfer of the gold, and putting the entire gold reserve on its bullion value basis. The Bank of Rome, you may recall, got into difficulties because of large industrial and real estate loans, and these three banks took over all the frozen assets, leaving the Bank of Rome with a clean balance sheet. It is now being conducted successfully, and apparently that situation presents no difficulties or complications that need embarrass them in going ahead with the program of monetary restoration.

We went over the Bank's balance sheet, and the following items appear to be of some interest.

(1) The gold reserve. Of the amount shown in the statement, which is carried at gold value, 22 million sterling is in point of fact gold deposited abroad, being the amount which is to be returned to the Bank of Italy after 1928 by the British Government in the course of the liquidation of the Italian Government debt under the debt funding arrangement. If that gold is recovered as they expect it will be, as I recall, during repayment, the gold cover of the Bank after taking over the other two reserves will be something like 60% of the note issue, assuming that the gold is valued roughly at 5 to 1.

(2) The Portfolio. This aggregates about 8½ billion lire. They tell me it consists as to over 5 billion lire of prime commercial bills and promissory notes, and as to 3½ billion lire of loans and advances on good securities, principally Government securities, on which they advanced 75% of the market value.

(3) The Special Independent Section. This aggregates 2 billion 700 million lire gross and will be increased when the note issues are consolidated to 3½ billion lire; against it the Bank holds Government securities of roughly

850 million lire which can be applied on any losses if they arise. They not only expect no losses, but a handsome profit. The profit might be claimed by the Government, as I gather the Government guaranteed the Bank of Italy against loss, but as a matter of fact, Stringher is hopeful that the Government will relinquish the profit and permit it to be applied on reducing the adjustment account for the gold reserve above mentioned. Of this reserve, 733 million lire arises through accumulation of the tax on the special note issue made to cover these advances, the tax amounting to the bank rate and therefore accumulating quite rapidly.

(4) Advances to the Treasury. These aggregate 5 billion 400 million lire. Under a decree recently promulgated, the amount may not be increased by the Government, and as a matter of fact they have from time to time made repayments out of surplus revenues. Stringher, I gather, keeps Volpi regularly reminded of the need for reducing the advance account, but there is no definite obligation of the Government to do so, the limitation being as to any increase. I think Stringher is very anxious to have a more definite arrangement.

(5) Securities, - 360 million lire. These are investments of special funds, principally in Government securities, offsetting certain special liabilities, like the money order fund, special reserves guaranteed for Treasury services, etc.

(6) Bankers' Accounts, - 1,200 million lire. These are accounts carried by the Bank of Italy with banks in foreign countries comprising about half of the amount and with other banks in Italy comprising the other half.

(7) The item of 2½ billion of other assets is largely book accounts, which do not especially affect the position of the Bank from a credit point of view. They tell me that there is a very large concealed asset in these accounts,

one item of 78,000 lire being actually worth at a minimum 30 million lire.

(8) The item of "Bank Premises", 88 million lire, is of course now very small.

If the gold reserve should be entirely revalued, say in the ratio of 5 to 1, it will result in a profit to the Bank of about 8 billion lire. There is a suggestion that the Government may wish to use this to reduce its debt to the Bank, as was proposed in Belgium. Stringher hopes to be able to prevent that, but I doubt if he is able to. At any rate, when that transaction is effected, if they go back on a gold basis, it should put the statement of the Bank in excellent shape and I should hope that at least a part of it could be retained by the Bank in order to increase the capital and surplus, which is of course now "on the books" very small in proportion to liabilities, although it would be unnecessarily large if the gold was revalued.

In discussing matters of policy with Stringher, I was much impressed with the fact that he is a thoroughgoing central banker. He has been twenty-five years Governor of the Bank of Italy and "talks the language" in orthodox style. He wants to see the Bank free of too much Treasury domination. He is a very cautious man, and I think he is feeling his way so as to avoid creating antagonisms or dissent. His reputation here is "A-1". Everyone says you can believe every word he says, but he is so careful not to commit himself or not to make any misleading statement that one makes progress with him pretty slowly, especially when everything must be translated. The impression I got from him and from Dr. Nathan was in every way excellent. He was frank, just as soon as the ice was broken, and he felt that we were sympathetic with his point of view, but I am sure he feels the overshadowing influence of the two strong men, Mussolini and Volpi, and possibly somewhat the influence in an advisory way of

Toeplitz, the head of the Banca Commerciale, who is regarded as one of the ablest men in Italy.

While I have not completed reading the mass of literature which has been furnished me about the Bank, so far as I have already gone my impressions are altogether favorable. The Bank is housed in a magnificent building, apparently does a very large business, and I felt very sure from the explanation of the accounts and from my general information about Stringher that it is conservatively managed and probably has large resources that do not appear in the statement.

We are to have lunch today with Mussolini, Count Volpi and some others, and further discussion after lunch, so please consider this the second chapter and I will endeavor to finish the letter this evening. Otherwise it must wait until we reach some resting place, probably at Monte Carlo for a day or two.

. . . . .

(18)

Rome, May 29, 1926.

Dear Mr. Harrison:

Continuing my letter dated May 26th about Italy, Winston, Ambassador Fletcher and I lunched yesterday with Mussolini, Volpi and a party of about 15 men, mostly Cabinet members and Government officials, at the Villa Borghese. Immediately after luncheon, Mussolini, Volpi, Fummi (who acted as interpreter), Fletcher, Mussolini's Chef de Cabinet and I adjourned to a small room for a private talk. It was noticeable that Stringher, Governor of the Bank, was not invited to join us, and it was also noticeable that Mussolini made no move to dismiss the rest of the party, but kept them waiting for about an hour until we had finished.

This meeting started at about half past two. I was told subsequently that Mussolini had planned to leave at ten minutes to three, as he was to be at the Senate at three o'clock, but he was sufficiently interested to wait until about twenty minutes to four. I will not attempt a description of Mussolini now, but will do so in a separate letter later. He is one of the most interesting characters I have ever met.

The meeting started with Volpi giving a long description of the European currency problem, all of which we knew about and which was unnecessarily long. It struck me that Mussolini was a bit restless at Volpi's oratory. He then described the problem which Italy was facing. In the course of his remarks, he referred specifically to the experiences of France, Belgium, Poland and Roumania. He mentioned that he had just received confidential information that the Bank of France note issue was three billion francs in excess of the amount reported in the statement. Concerning this I raised no question, fearing possible misunderstanding. He also mentioned the fact that, in view of the development of industry which had taken place in Italy since the war and the advance in prices which had occurred, there was now in fact a shortage of currency. They did not want to inflate the note issue of the Bank of Italy, but did propose to make issues of small denomination Treasury notes up to a maximum denomination of 50 lire. He also said that he had enough cash on hand to repay the entire amount of 7 billion lire owing by the Treasury to the Bank of Italy. We have been unable to discover exactly how this figure is made up, the people with whom we have talked stating that the Bank balances of the Treasury run about 2½ billion lire, with the Bank of Italy. The difference may be in fact a book credit and not actually cash. It was denied by both Pirelli and Fummi that it was a premium on gold held by the Bank of Italy, and Volpi stated that this was exclusive of the proceeds of the Morgan loan in America.

Volpi then asked if I would express my views to the Prime Minister, believing that I had now had opportunity to form some opinion of the situation in Italy. Mussolini up to that point had said hardly a word.

I disposed of France, Belgium, Poland and Roumania by saying that their situations were not quite comparable with Italy's, as it seemed as though confidence in their currencies had been largely destroyed, both at home and abroad, and that in fact it was lack of confidence more than anything else which was causing their troubles. By that I meant lack of confidence in the fiscal and financial policy of their Governments and lack of confidence in political conditions, and that the Italians themselves could judge better than anyone else whether Italy with a balanced budget, with some debt reduction taking place, with no currency inflation occurring, with the American debt funded and with a strong Government, was necessarily in position where it need experience the same difficulties that those other countries experienced. I then suggested that Italy might follow one of three courses:

(1) Temporize and moderate fluctuations in the lira;

(2) Boldly adopt the gold standard at once;

(3) Endeavor to do so whenever France and possibly even Belgium were prepared to do likewise.

I felt that the difficulties to be encountered were such as would require most careful preparation and study of various points, which I enumerated as follows:

(1) A study of the whole problem of prices and wages, to be conducted by experts in order to be certain that readjustments would not be forced upon the country as the result of monetary reorganization;

(2) Careful study should also be made of the whole subject of the balance of payments, to determine whether Italy was in position to resume gold payment after making allowance for foreign resources.

(3) Careful study should be given to the value to be placed upon the lira, and this should be determined partly with regard to maintaining its exchange value and not attempting to create an artificial value, but even more in order to avoid inflation at home, which was simply a means of reducing wages and the incomes of people least able to sustain the loss, thereby causing social and political unrest;

(4) Consideration should be given to the external difficulty arising from the disordered currencies of their neighbors; of course, concurrent action by Italy and France would be most desirable, but might not be politically possible - that would be for them to decide;

(5) They should insure that the Bank of Italy was left free from Government control; without that, the subsequent policy of the Bank might break down the

lira again, that is to say, the desire to borrow cheap money or to borrow directly from the Bank or to maintain too low a discount rate or to restrain gold exports - all of these things might result in a failure.

While Volpi had in a former conversation made a long explanation of the growing pressure of excessive population, which now reaches 42 millions, an increase of 3 millions since the war started, this subject was only mentioned in the course of the meeting with Mussolini, but I noticed from Mussolini's instant reference to the population of 42 million that it was much in his mind.

I explained how our policy for the last three years had been to rather encourage loans by American citizens to foreign borrowers, that many bond issues had been placed in America by European Governments and corporations, and that the total of our investments abroad in long time loans had been running at about a billion dollars a year. It was a new business and Americans were tempted to invest their money in that way because of the high rates, but they were nevertheless timid and any shock to confidence would result in their declining to take foreign loans, the consequences of which would be disastrous. I felt that their confidence had been somewhat shaken, partly by the developments in Poland, but considerably by the disappointment that the Locarno treaties had apparently failed of their purpose because of the outcome of the last Geneva conference; that anything that developed uncertainty in America as to continued peace in Europe would result in their buttoning up their pocketbooks. Mussolini then said that there was not going to be any war - that none of the European nations could afford it, being too exhausted by the former war. I mentioned that that was one of the chief elements of security for loans made by American investors, that they sub-consciously felt that there could be no war in Europe, and if that confidence was destroyed, that would be the end of placing loans in America.

He replied that it would take 25 years - at least until 1950 - before we need think of that as a possibility. Meantime, he said there would be a certain amount of snarling at each other but that it would not mean anything.

I explained to Mussolini that it was not necessary for me to discuss all the technical details of the program. I had already done so with Count Volpi, but merely suggested that the principal requirements for stability were:

(1) Confidence both at home and abroad;

(2) A substantial credit, which I thought could better be arranged in all the gold standard countries rather than just in America;

(3) As complete freedom by the bank of issue from any sort of Government control as could be arranged;

(4) Good management of the program after it was adopted and set in motion, and fort hat large reliance would need to be placed upon the Bank.

In the course of the talk, Mussolini interrupted a number of times with questions, and it was quite plain to be seen that he wanted some guide as to whether they should act promptly and at once, or delay awaiting developments in France. I told him that once fundamental conditions, such as I had described, were sound and justified going ahead, I thought a bold course was preferable to a timid one. He said "Yes", he believed in that himself, so long as they were certain that the fundamentals were sound and the preliminary conditions as I described had been accomplished.

Mussolini referred to monetary reorganization and a bold course as being in the nature of a surgical operation, but if one was to be performed, he would like to have the patient survive it. I told him we had an American expression for that when we said that "the operation was successful, but the patient died." He said that exactly described it. He wanted to be sure that they were right and then go ahead boldly.

Special importance was urged in the course of the talk upon the three points that there must be peace in Europe if they were to enjoy outside aid, that the program must be a sound and complete one in all particulars with good prospects of success, and that its success would not depend upon just a credit but even more upon subsequent capable, strong management of the plan, and for that management great reliance must be placed upon the Bank.

Count Volpi in the course of the discussion commented upon Stringher's independence of Government control and upon his experience as a central banker. I interrupted to ask who controlled the bank rate, and Volpi admitted that by law the Treasury did, but as a matter of practice they did not interfere very much.

At the conclusion of the talk, which lasted about an hour, my impressions were that Mussolini was anxious to do whatever was necessary to stabilize the currency, that he was ignorant of the technique of these matters, and that he would need assurance that the plan had been carefully considered, and I thought he was inclined towards getting outside advice. He wanted to know whether it would be a good plan to have a Committee of Experts at work at once, and when I said I thought it would, he replied that one had already been secretly appointed.

On the whole, my impression from the interview was satisfactory. They asked me when I would be back, and I told Volpi I would be glad to come back when he sent for me, but I hoped to be back next year. He replied that would not do, that they might want to go ahead inside of two months.

The only thing to do now is to await developments, which I shall do with much interest.

Sincerely yours,

Mr. G. L. Harrison,
c/o Federal Reserve Bank,
New York.

Hotel du Cap d'Antibes,
Antibes, June 7, 1926.

Dear Mr. Harrison:

I have been promising you a letter about general conditions in Italy. Of course, it must be no more than rather vague impressions, because I was there such a short time, but after all, the impressions that I would get from such a visit are not those of a casual traveler, who forms ideas from conversations with waiters, cab drivers and casual acquaintances. The people Winston and I talked with were of course the most responsible in Italy.

First, about Mussolini. He is undoubtedly a man of very unusual qualities, though of very humble beginnings - his father was a blacksmith. He had most radical socialistic views in his youth, lived a life of more or less irregularity, and a rather tumultuous one; was many times in prison, was driven out of Switzerland and I think later out of Austria, took part in radical meetings and associated with a pretty radical crowd. All the time, however, it is observable that he was living almost in poverty and struggling to gain an education. I believe he admits himself that the greatest influence on his life were the writings of Machiavelli and Nietzsche. He is a very forceful speaker, has a wide range of knowledge of literature, and so far as money goes and his ways of living, is a bit of an ascetic. He lives, I am told, in a very small apartment and very modestly.

His manner has the appearance of arrogance and an exaggerated "ego", but both Winston and I were impressed by the fact that this was simply facade and that when he got down to business, this all dropped away. He has one of the most penetrating eyes I have ever seen, and a good sense of humor. I would size him up as being honest but rather ruthless, and absolutely adamant in his demands of service from his associates.

He has undoubtedly worked a revolution in Italy. I think it was in October 1922 when he made his famous march on Rome. At that time he had the support of an enthusiastic body of young followers who were in revolt against the Communistic effort of the organized labor of the country to take possession of the country's industries and ruin them. What his following lacked in numbers and strength was compensated by its great enthusiasm. The introduction of reforms was really a whirlwind campaign and everything gave way before his energy and his imagination. I should say that for about a year or more now he has had opportunity to settle down to a more normal management of things, where the spectacular elements are no longer as necessary nor as desirable. In the early days there was a very persistent undercurrent of opposition and criticism, and I have no doubt many things were attributed to him for which he was not responsible. During the last year, he seems to have gained enormously in strength. Classes which were opposed to him are now gradually swinging into line. I think almost every Italian with whom I talked mentioned this as the outstanding characteristic of the recent period. There are of course many bitter enemies of his regime, but they are not vocal and their numbers have undoubtedly been reduced. Some have left the country; others have learned to keep quiet.

There are a few matters where it seems to me grave difficulties may arise in the future. One is the policy of suppression of the press. People really do not know what is going on. I imagine the whole press of Italy is pretty much under control. Under these circumstances, the imagination is liable to picture many things as occurring or give credence to rumors of occurrences which are exaggerated or which do not occur at all. If he could gradually lift the embargo on free speech and free expression in the press, it might let off the pressure of opposition without impairing his authority.

The second possible difficulty is in this new scheme which has just been adopted for organizing all the industries of the country, all the working men - practically everybody in Italy - into sorts of syndicates. I had little opportunity to gain any views about this, the only talks I had being with Pirelli and with the head of the Fiat Company. Some doubts were expressed as to the way it would work. In such a plant as the Fiat Company, where they employ 38,000 people, the workers are organized, have their representatives to deal with the owners, and so in all the trades and industries. They say even the doctors, lawyers and other professional people are subject to the operation of the decree.

The third obvious danger is lest Mussolini leave no method for the selection of a successor. Italy seems to have a Government comparable to that of Japan under the Shoguns, but there the Daimios selected the Shogun, whereas here there is no method of class selection. One Italian told me that he was convinced that Mussolini had left a political will, as was done by the monarchs of the Middle Ages. If Mussolini should die or be assassinated or incapacitated, it might be that the Fascisti organization could agree upon a successor at once, or the King might take charge, or the Army. The danger would lie in the ambition of individuals to succeed Mussolini, which would divide the country into factions.

These strike me as being the three outstanding menaces at the moment.

My talk with Mussolini was rather reassuring as to his point of view. He struck me as being desirous of knowing only what was the best thing for Italy. He never referred to himself in the course of our meeting. He strikes me as being an enthusiastic patriot with a great ambition. I am frankly not greatly impressed by the "imperialistic" talk which we hear so much of at home. It is very liable to turn out to be a bluff. Most of the men associated with him are comparatively young. At the luncheon, where there were about 15 or 18, I was the oldest man there except Stringher, of the Bank of Italy.

One interesting development while we were in Rome appeared to be a tendency on Mussolini's part to make peace with some of his political enemies, which was being commented upon.

As to conditions in Italy, they are no doubt better than in some parts of Europe. I think they have been having a little business set-back in recent months. There is constant reiteration of the pressure of over-population and discussion of various means of dealing with it. Italian pride seems to object to export of population into countries where Italians lose their nationality. There is a feeling that Tunis is a natural outlet; 75% of the foreign population there is Italian, it is the nearest point to Sardinia and seems to be naturally tributary to Italy, but of course is controlled by the French. The French population is largely that of the Army and the "fonctionnaires". Tripoli is further away and less desirable for colonization.

I was much interested in the visit to the Fiat plant, where the Managing Director took us over much of the works. They have 8 or 9 separate plants in Turin, where they employ about 38,000 people, of which 8,000 are women, many of whom work at lathes, assembling and various mechanical operations. They tell me that they are paid a standard day's wage, with a bonus for output in excess of a standard amount. As nearly as I could figure, the men earn from $1.25 to $1.50 a day, and the women quite a bit less. They have an 8-hour day. Wages are paid weekly. The plant was in magnificent condition, appeared to be equipped with the most modern machinery and made practically everything required for a motor-car, including the heavy steel, the castings and the accessories. The working people certainly had the appearance of being contented, and they were obviously industrious. The Director explained that they had some difficulty with housing and a great deal of difficulty with the transportation of their workmen, but they were gradually solving this by their own efforts. What impressed me most was the appearance of discipline in the plant.

The roads were in only fair condition, as there is a great deal of traffic by motor bus, and conditions in Italy for railway transportation are difficult anyway; the long range of mountains and the fact that so many of the cities are perched up on hills complicate railroad construction and operation a good deal.

One thing that impressed me a great deal was the general confidence in the Government. There was not the same insistent discussion of the exchange here as in France, nor the endless criticism of the politicians. The attitude of people generally was rather to state with considerable pride that Italy was going steadily ahead. Even Mussolini's enemies express admiration for his great ability. You have all heard rumors about his health, which undoubtedly was badly impaired some time ago. I am told that he suffered from a complication of difficulties, but what was most menacing to his life was an intestinal ulcer, which is now under control or cured. He exercizes vigorously every day, either fencing or horseback riding. I noticed that he enjoyed his lunch, ate heartily and did not want to talk much while the business of eating was on. He took very little wine mixed with water.

His abrupt way of approach indicated a very direct mind. For instance, without any preliminaries he told me that he was 44 years old and asked me how old I was. When I met him, he said "How do you do. Welcome to Italy. What do you think of Italy?" He is not at all loquacious, but very direct. I suspect that some of his associates flatter him a bit, but I also suspect that he sees through it.

My general conclusion is, about Italy, that the man Mussolini has a great imagination and a constructive mind, that he is free from venality and is really inspired by a keen desire for the welfare of Italy; that he is ambitious, likes public applause, is impatient of opposition, but very free in seeking advice. I should imagine that he would not hesitate to cut off a man's head instantly if he failed to deliver what was expected of him. They say his relations with the King are excellent. One curious thing about him is that he never goes out to parties or entertainments. In the early days he was seen occasionally at official receptions or dinners at the Embassies, but now he does not permit himself to accept any invitations, but works practically all the time.

This will give you a few high-lights on my impressions. They are very fragmentary, as it would take me weeks to have gotten as much behind the scenes as would be necessary to have a real opinion. Take it for what it is worth, with my best.

Sincerely yours,

Mr. G. L. Harrison,
c/o Federal Reserve Bank of New York,
New York.

BS:M

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Hotel du Cap d'Antibes,
Antibes, June 7, 1926.

Dear Mr. Harrison:

Thank you for yours of the 27th.

I am sorry that the newspapers have been so bothersome. There is not one shred of foundation for all the stories, as I have not talked politics with anybody outside of our immediate friends.

It is a curious thing that the only word that I said to Parmentier was that everybody should get together, including the Government and Parliament, and that not one word was said to Peret on the subject of politics, and yet the newspaper stories have taken that slant; and the reason for it is that,without exception, every Frenchman that I have talked with in Paris abused the Government and the Chamber of Deputies. I think I have never heard such unsparing criticism as the Frenchmen themselves indulged in. The atmosphere is surcharged with that kind of feeling.

I am glad the Bank Polski situation is cleared up, as I felt sure it would, from Mr. Stetson's letter.

I will write Jay about the Advisory Council meeting.

What you say about Mr. Case's situation is as I surmised. I really cannot take the responsibility of deciding the matter for him, and I hope that he does not surmise more from my letter than is justified by what I really feel.

I am having a good rest here, but it is good to keep in touch with what is going on. Your letters are most illuminating and helpful.

The situation in France is very puzzling. Winston will tell you the last word that he gained before leaving, of which he has just written me. Herman Harjes now writes me that it may be desirable for them to consider giving the French Government a short credit. They do seem to be facing the situation more definitely, but I am always troubled at the failure to develop constructive plans. Even the Bank of France seems to be floundering in that respect.

Best regards, and again many thanks for your letter.

Sincerely yours,

Mr. G. L. Harrison,
c/o Federal Reserve Bank of New York,
New York.

BS:M

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Hotel du Cap d'Antibes,
Antibes, June 7, 1926.

Dear Garrard:

Many thanks for your letter, which is indeed illuminating. I have written Robineau as you suggest, as per enclosed copy, but of course could make no suggestion to him about a credit. Lamont cables me that a suggestion for a credit has been made or is about to be made, and I assume further particulars will reach me in due course, but how will this fit in with the ratification? It might indeed raise Cain at home. I have cabled Lamont that you have some views and doubtless you will hear from him. One disconcerting bit of information from Warren is to the effect that there is dissension within the Committee itself, and then if the Bank of France hasn't any confidence in the Committee, what hope is there of getting a constructive program? One difficulty about the Bank of France arranging a credit independently and subject to its own control is that it would be administered under conditions where the Bank is not wholly independent and where indeed Government policies might render the beneficial results of such a credit wholly ineffective, whereas it might be not only necessary but effective if granted in conjunction with a constructive plan.

Under the present circumstances, I would regard it as distinctly unwise, even impossible, for us to extend a credit to the Bank of France and would advise our people against doing so until the end of the road was within sight. But my views may change before I leave.

Sincerely yours,

Hon. Garrard B. Winston,
Under Secretary of the Treasury,
Washington, D. C.

BS:M

Hotel du Cap d'Antibes,
Antibes, June 8, 1926.

Dear Garrard:

I have written you separately in reply to the business part of your note, and this is to thank you for the personal part of it.

I enjoyed the trip immensely. It was just the sort of a visit that I like to have, and your good company was essential to its success. At times I thought possibly you were disappointed in not having more opportunity for play and less demands regarding business; but if you enjoyed it all, I am more than satisfied.

Best regards to you and the others at the Treasury.

Sincerely yours,

Hon. Garrard B. Winston,
Under Secretary of the Treasury,
Washington, D. C.

BS:M

OBSERVATIONS ON THE ROLE OF THE BANK OF FRANCE
IN A PROGRAM OF FINANCIAL RECONSTRUCTION .

(by Robert B. Warren) June 10, 1926.

Selected Items from Bank Statement (000,000 fcs.)

	Comm'l Loans & Discounts	Advances to State	Notes	Deposits
1st week June 1925	6,887	25,200	43,648	2,040
" " " 1926	8,034	36,900	53,390	3,114
Increase	1,147	11,700	9,742	1,074 .

Compared with the corresponding week of 1925, the statement of June 3rd, 1926, showed an increase in the combined items of commercial loans and advances to the Treasury of just under 13,000,000,000. francs, or about 40%. In the meantime, wholesale prices (#) have risen about 32% and retail prices about 20%. Sterling and dollar exchange have risen about 60%, but as much of this rise has occurred in comparatively recent weeks, the full effect has not yet been felt in the price structure and consequently in the demand for currency. The "gold indexes", whether wholesale or retail, are substantially below the level of a year ago.

As was shown in the series of price indexes mailed tonight, after several months of stability wholesale prices began to rise in April, accompanying the drop in the exchange. This movement has been accompanied already by considerable borrowing from the Bank of France, which has expanded its combined loans to the Treasury and the market by nearly 3,500,000,000 between the end of February and June 3rd. Part of this increase has been due to increased loans to the state, presumably in connection with the maturities of May 20, the state having borrowed about 1,700,000,000 between the end of April and the 3rd of June, although some 500,000,000 was repaid

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(#) Primary articles mostly imported or importable, as indexed by the Statistique Generale; wholesale prices in general have risen much less.

on the 10th June statement. But the market has also been a heavy borrower at the Bank; even after clearing up the position of the end of May, the portfolio of the Bank is up over 1,000,000,000 in the last three months, an increase of about 30%. In short, it appears that the recent break in the exchange has provoked a rise in prices which is already forcing the Bank into a fresh inflation.

The word "forcing" is not too strong, because the Bank is virtually helpless against it, owing to its peculiar relations to the market. It is sometimes said that the Bank of France now conducts open market operations, and, technically, this is perhaps true. Actually it is far from being the case.

The Open Market Operations of the Bank of France.

In theory, the Bank of France has two operating media:

(1) It can raise or lower its rate

(2) It can protest a signature on a bill offered for discount.

The Bank never buys nor sells any securities in the market, and for this reason, it is said that it does not engage in open market operations. As a matter of fact, since 1924 there has been a development in the Paris money market that puts the Bank in a position in which it is obliged to concede credit to the market at the will of the commercial banks, without being able to withdraw credit from the market in any reciprocal manner.

This innovation is the Treasury's deposit account with the commercial banks. The commercial banks can deposit money on demand with the Treasury, at $2\frac{1}{2}$% interest, inferior to the rate on 3-month Treasury Bills, but, of course, superior to the rate on a deposit account with the Bank of France, which pays nothing. Since the events of March 1924 and perhaps more especially since last Fall, when there was some talk of a forced conversion of Treasury Bills into an issue not eligible for discount at the Bank of France, the commercial banks have made it a practice to carry considerable sums on deposit with the Treasury. If pressed for cash, the commercial banks can either

(1) Discount at the Bank on usual eligible paper or

(2) Draw down their deposits with the Treasury, forcing the latter to borrow at the Bank.

While, as was stated above, the Bank may at its option refuse any bill offered for discount, it cannot refuse to grant the demands of the Treasury, at least up to the legal limit of advances. In other words, in possessing a deposit at the Treasury, a commercial bank possesses a claim against the Bank of France which the Bank is unable under any pretext to refuse, and which is not directly influenced by the discount rate. At the same time, the Bank in accepting this demand from the market, is totally unable to counter by selling an equivalent amount of securities. Within limits, therefore, the Bank of France does conduct a species of open market operations, with this important qualification. It can be forced into the position of a buyer of securities from the market; but it cannot become a seller of securities to this market.

In other words, the Bank is liable to give credit to the market in three ways:

(1) Discount of commercial bills

(2) Discount of Treasury bills held by market

(3) Advances to the Treasury

(a) because of Government needs

(b) because a commercial bank wishes to draw on its Treasury deposit.

It can withhold credit from the market in only two ways:

(1) By advancing its discount rate

(2) By protecting a signature, that is, by refusing a bill- even a Treasury bill - presented by a commercial bank.

Under present conditions an advance in the discount rate imperils the floating debt; and while it is always possible to protect a signature, it is evident that a three months Treasury bill, if offered for discount by a commercial bank, cannot be refused without causing very great alarm in the market.

These observations lead to two conclusions and one question. The observations are:

(1) Any thoroughgoing plan of stabilization which I can imagine implies firm control of the Paris money market by the Central Bank

(2) That market is now in full train of inflation. The drop in the exchange has already been felt in higher prices and a demand for further credit for industry. There is reason to believe that the full effect of the decline in the exchanges has not yet been felt, that a further rise in prices is to be expected, with further demands for credit for industry. To this may be added a renewed demand from the Treasury, as the rise in prices upsets the budget, and as the withdrawal of Treasury deposits and the discounting of Treasury bills by commercial banks forces the Treasury into the Bank.

The question is: How effectively, with the means at its disposal, will the Bank of France be able to control this situation?

In my opinion, the Bank does not at present possess the means of handling the situation, and there is some reason to apprehend that a scheme of reform may possibly fail owing to the inability of the Bank to carry out the role which may be assigned to it.

As was stated above, the means at its disposal are only two. It may refuse to accept bills by protesting the signature or it may raise its rate. But in opposition to this line of defense, the market possesses two very heavy pieces of artillery, so to speak:

(1) The market holds something like 12,000,000,000 francs of 3 month Treasury bills, plus perhaps 3,000,000,000 in Treasury deposits. While the Bank might

protest every commercial bill offered, it could hardly refuse categorically to accept Treasury bills without virtually forcing the Government to one of two alternatives:

(a) It would be obliged to redeem these maturing bills as they were offered by the commercial banks, which would throw the state into the Bank on an even larger scale, or

(b) It would involve the state in some sort of repudiation.

At any rate, a categorical refusal to accept these Treasury bills <u>at a price</u> would inevitably create a panic.

(2) There remains, then, virtually only the discount rate. But the structure of the Paris money market is such that at present the discount rate is effective (insofar as it is effective at all) only against the Government's floating debt. With swaps at 30% gross and say 26% net, and three month local collateral loans well over 10% at least, it would appear that to be effective in the commercial loan market, the bank rate would have to be set at a figure which would make it extremely difficult to keep the floating debt afloat. In effect, with the floating debt as it is, I do not see that much reliance can be placed on the discount rate in carrying through any plan of reform which involves tight money, and it is a question in my mind if any plan of reform can be successful which does not involve either tight money in fact, or the effective threat of tight money. As it is, it seems to me that the Paris money market is in a position to snap its fingers at the Bank.

<u>Conclusion</u>

For this situation, the only solution that I can see involves giving the Bank of France a weapon which will make it the master of the Paris market - that is, to effect a change which will

(1) Make the Treasury bill rate subservient to the Bank rate, instead of the reverse condition which obtains at present

(2) Give the Bank the means of conducting open market operations, which

will enable it to bring the market under control by permitting it to take out of the market at its will as much credit as it finds necessary; in other words, put the market at the mercy of the Bank, instead of the Bank at the mercy of the market.

I would therefore offer for your consideration the following proposals:

(1) That any scheme of financial reform must involve a radical change in the relations of the Bank of France to the Paris money market - a change which will make the Bank the unquestioned master of the market.

(2) That in order to effect this change a means must be provided whereby the Bank can engage in open market operations at its will, regardless of the financial wishes of the Treasury.

(3) That to accomplish this end a market in Treasury bills should be created in Paris, in which the Bank could operate both as a buyer and as a seller.

(4) That in order to provide protection for such a market, the Treasury deposit system be discontinued, and the present type of 3 month Treasury bills and Bons de la Defense be converted into a new type, not bearing a fixed and artificial rate, but paying the going market rate for that type of paper - like the British Treasury bills.

(5) That in order to provide the Bank with ammunition at the outset of the campaign, a part of the present "advances to the state" be immediately converted into the new type of negotiable Treasury bill, so as to enable the Bank immediately to undertake operations calculated to make its rate effective and bring the money market under control.

These remarks are not submitted for the sake of the conclusions, but because they discuss, however imperfectly, one phase of the problem of financial reconstruction, which so far as I have observed, seems to be overlooked in Paris - namely, the mission to be assigned to the Bank of France in the campaign and the capacity or incapacity of that institution to carry out such a mission. When one recalls the dominant parts taken by the Bank of England and the Reichsbank in the British and German reconstruction programs, and the extent to which success depended upon the fact that the Central banks were the undoubted masters of their respective money markets, one is forced to question if, under the present organization of the Paris money market, the Bank of France has at its disposal the means of playing a similar part, should developments render it necessary, to the success of the program of financial reconstruction in France.

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THE BUDGET POSITION

Paris
(by Robt. B. Warren) June 11, 1926

In view of the fact that the principal feature of the Government's program of financial reform announced to date is a series of tax reductions, I am enclosing an article from tonight's "Information" by Maurice Kellersoen, perhaps the best financial journalist in Paris.

Kellersoen calls attention to the fact that the Loucheur taxes, which were specifically voted for the purpose of retiring the currency issued to meet the maturities of December 1925 have been applied on the current expenditures, and that notwithstanding this fact the Government has so far this year been steadily borrowing at the Bank - and is now proposing tax reduction.

To supplement M. Kellersoen's article, it is worth while to notice that although the Government has announced that current receipts are comfortably in excess of current expenditures, and that the maturities of May 20 necessitated borrowing only 800,000,000 from the Bank, the Government's debt to the Bank on June 3rd stood at 36,900,000,000 francs, the highest figure ever reached. In the third week of January, which was the low point of the year to date, the figure was 34,200,000,000. Between those two dates, the state had found it necessary, in spite of the "highest surplus", to borrow 2,700,000,000 from the Bank. To be sure, 800,000,000 of this was specifically attributed to the May 20 maturities and 500,000,000 was repaid on the statement of June 10; but the fact remains that the state has by and large been pretty steadily borrowing from the Bank.

At the same time, the market is dipping its bucket in the same fountain. At the end of February, commercial loans at the Bank stood at 5,760,000,000 francs; by the end of March they were up to 6,592,000,000 francs; end of April, 6,603,000,000, and end of May 8,029,000,000 francs. To get over the end of May, the market had to borrow 1,174,000,000 francs, although most of this was repaid the next week.

It is my opinion that it is the market which is forcing the Government into the Bank at the present moment, and during the Spring. I am far from doubting that through April and probably through May current receipts have showed a comfortable surplus over current expenditures. But I believe that the market has been drawing down its current account with the Treasury and probably letting its Treasury bills run off at the same time in order to get currency to meet the demands of industry operating under a rapidly rising price level.

On the third week in January the note circulation stood at 50,617,000,000 francs; at the end of May, 53,390,000,000, an increase of 2,673,000,000 francs. The following week although the market repaid 1,000,000,000 and the state 500,000,000 the note circulation did not decline perceptibly and the deposits only a trifle - illustrating the importance of movements under the heading "divers".

The fact is that the fall in the exchange is having its inevitable effect - rising prices, intensified demand for credit. And owing to the structure of the market, with its current account at the Treasury and its pockets full of eligible Treasury bills, it looks as if there was no way by which the Bank could refuse this demand, unless it is prepared to refuse to honor the Government's signature. The effect of such action upon the market would be so grave, that it can be left out of account. My conclusion is that regardless of the proposals of the Committee of Experts, the Bank is in for a period of further inflation.

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Paris, June 18, 1926.

MEMORANDUM - SOME COMMENTS ON THE TEXTILE SITUATION

(by Robt. B. Warren)

The index of the textile materials is by far the highest of the groups of the Statistique Generale, and is fully up to the world level - which is not surprising in view of the fact that its major elements, cotton and wool, are imported. But from my inquiries in shops, department stores, etc., I find that the retail price of textiles, in such forms as women's clothing, is at least very nearly up to the level of the best stores in Washington. For example, American "Interwoven" socks, the standard 35¢ grade of Washington, retail here at 25 francs, and are cheap at the price compared with the competing French lines. This increase in common retail textiles, which has raised them to virtually the American level, is the more striking because before the war they were decidedly cheap.

So, making some purchases this evening, I engaged the salesman in conversation about the haberdashery and knit goods trade. He argued that relatively the line was the highest in Paris, and that even then they had a hard time making a profit. The manufacturers now insist on quoting prices to the domestic trade in sterling, so that apparently the manufacturing and wholesaling end of the textile business is now on a sterling or gold basis. This is the first instance of this that I have been able to find. Further, the export business is so strong that in some lines orders are accepted only for delivery 8 months ahead, although ordinarily this line turns over quite rapidly. As a result, this particular shop, which is distinctly a luxury shop, has abandoned some of its standard lines, and is carrying only those on which it can get delivery within 2 months of the order. The salesman's idea was that export orders were ruling the price, for he said that the local retail trade in haberdashery was dull, which is not surprising in view of the local price and salary situation.

From this conversation, I gathered that the textile industry in France shows all the dangerous elements of inflation:

1. Heavy selling for export on a cost basis which involves a steady decline in the exchange.

2. Forced buying by the local retailers at a price scale recognized to be above the purchasing power of a good part of the customers.

3. Forward placing of orders by retailers in order to secure any deliveries at all, at a time interval recognized to be in excess of the usual practice of the trade.

4. Thatthe manufacturers are carrying their books in sterling and forcing the retailers to accept the risks of the exchange.

5. That in this shop, at least, prices are frequently adjusted to the exchange, even in the process of disposing of a given consignment. In other words, so far as possible, this particular shop is fixing its prices on the basis of expected replacement costs. I am not sure that this practice is yet general in retail trade here.

From these facts, I infer that the textile industry would immediately be adversely affected by stabilization. If it is quoting prices and accepting orders in sterling 8 months forward, it is in one sense committed to a lower and constantly decling value for the franc, for under a stable franc it would quickly be caught between its firm forward contracts and a rapidly rising cost of production, from advancing wages, etc. Of course, this is not a discovery; but it is concrete evidence of a condition that has long been generally known to exist.

The question is, how many industries are, so to speak, committed to continuing inflation and how much political influence can they command. Obviously, the deputies from Lille and Lyons will think a long time before they accept a program which will put their constituencies in a situation similar to what prevails in Manchester and Oldham, as well as the German textile centers.

In this connection, it is worth while to remember that some of the most influential men in the Chamber come from those areas- Loucheur from the Nord, Herriot from Lyons.

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Paris, June 19, 1926.

MEMORANDUM BY R. B. WARREN

THE NEW MINISTRY

The appointment of M. Herriot as Premier could hardly be called a surprise, for it had been recognized from the beginning that M. Briand's plan of a coalition ministry was more the expression of hope than of expectation.

In appraising the situation, M. Herriot's biggest asset is the probability that he can count on more votes to support any policy he elects than any other premier that could have been chosen. This is of first rate importance, for one of the weaknesses of the situation lay in the fact that no matter how good a program the ministry might formulate, it would be vain if it could not command a working majority in the Chamber. And, as the Infantry Drill Regulations say, even a poor plan resolutely carried out is better than an ideal plan which cannot be.

On the debit side, the Ministry is confronted with the fact that a certain number of persons are afraid of M. Herriot's socialism and that this will, or rather may, accelerate the flight of capital. Personally, I am inclined to doubt the validity of arguments based on his alleged radicalism. Both he and M. Blum are personally rich, very rich; and their worst scheme - the capital levy - was after all only a property tax about as heavy as that which rests against real property in New York or Virginia, for instance. While a certain number of bourgeois investors probably spent last night in figuring out how to get their capital out of France this morning, I do not believe they are a dominant element in the problem.

I give far greater weight to the decisions which will be taken by large concerns, banks, exporters, etc; and I believe that the memory of M. Herriot's relations with the Bank of France disturb such interests far more than his predilection for a capital levy. These memories will be particularly disturbing during the next three weeks, for the end of June settlement is extremely heavy and will surely occasion large movements in several items of the statement of the Bank of France. While these may be simply the normal reflection of the inflation which has been in steady progress for a year, they may very well look quite alarming, and appear to show new factors in the situation, whereas in fact they may merely be the evidence of economic facts for which M. Herriot is not responsible. I should not be surprised if between them, the market and the Government had to borrow upwards of 2,000,000,000 fr. from the Bank to get over the end of June, for prices have been rising very fast, and I have previously explained how a demand for commercial credit can show itself in an increase in the borrowings of the State from the Bank.

Another very disturbing factor is the attitude of the Ministry on the American debt. Both the Socialist and the Radical parties in caucus have announced that they would support the Mellon-Berenger agreement only with reservations which, I fear, would not be acceptable to our Senate. These two groups, together with the Louis Marin clique from the extreme right, could probably muster enough votes to defeat the agreement; but there was some prospect that under a Briand Ministry they would simply abstain from voting and so permit the agreement to go through by default, so to speak, because they were anxious enough to help the Government get a loan, but did not want to go on record as supporting the accord.

In that way, the prospects of a ratification of the settlement were pretty fair up to last night. Now they are uncertain, because it is not clear whether or not the new Ministry will sustain or oppose the programs of the caucuses of the parties which it represents.

So, altogether, one can hardly say that the outlines of the situation are very clear. As far as the Government's finances are concerned, they are in fair shape, and would be in rather good shape (relatively) if it had not been for the magnitude of the decline in the exchange since the budget was formulated. The real obstacle to financial reform is not the Government finance, but the possible attitude of industry toward any policy which will change the prosperity of inflation to the hardships of deflation; and the very real question whether the machinery for deflation now exists in France or is likely to be introduced by the Experts' Committee. And, by the way, the attitude of the new Government toward the Committee has not yet been declared.

Speaking of deflation, it may be well to mention that the type of statement which has been appearing in the British press, demanding not only deflation in France, but even proposing that France should have a Dawes Plan and be placed under some sort of foreign control or surveillance, is doing immense harm. It is certainly weakening the position of those very elements in the French population who desire reform, and who recognize that such reform must inevitably work some hardships to certain industries. It is probably true that France would prefer to go to hell financially sooner than accept salvation from the hands of a group of foreigners, if this involved anything like foreign control or even surveillance.

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Hotel du Cap d'Antibes,
Antibes, June 19, 1926.

PERSONAL AND CONFIDENTIAL

Dear Mr. Harrison:

When I wrote you about Dr. Miller's statement to the House Committee, I omitted to mention one thing which startled me. At one point, in discussing the gold standard, he referred to the fact that the Reichsbank had 40 or 50 million dollars of gold in our hands. This is a very serious violation of confidence. As a matter of fact, the Reichsbank has very scrupulously avoided disclosing just where its gold is held, and also by arrangement with the General Board it does not disclose the amount of invested foreign balances, which are considered to be a hidden reserve. [No investments carried in a foreign bank, such as with us, which are not subject to immediate check are counted as a part of the Bank's reserve of "devisen". Consequently all the bills that we buy for the Reichsbank are a part of the hidden reserve.] For us to disclose the amount of these balances in a public statement is a serious breach of confidence. I am sure Dr. Miller would be a good deal mortified if the bank where he keeps his account should publicly state what his balance was and how many securities they were holding for him, and there is no difference in his making this statement and such a statement by his own bank.

I am a bit uncertain as to what we should do about it, but these things cannot be passed unnoticed. Do you think it would be possible to work out an arrangement by which the foreign balances in our hands are reported only in the aggregate?

It is only fair to say also that when Governor Norman was in New York, he expressed a good deal of anxiety as to the possibility of such a disclosure being made as to their balance. I know what his plan is in building up this

(#) second from last page of last hearing .

balance in our hands, and it would embarrass him very seriously to have it publicly known, or in fact known to the Chancellor.

If these foreign banks of issue get the impression that we cannot be trusted to surround their private business with safeguards against publicity, they just won't do business with us. You will recall that before I appeared before the Committee, I had a talk with Mc Fadden on this very subject, and as I recall, also with Wingo and Goldsborough, and they all agreed that information of that character would not be called for by the Committee, nor was it in the course of my appearance. Dr. Miller's statement was voluntary, as no question called for such a statement, and I am now wondering what other members of the Board may say in case they appear. I am sorry to bother you with this, but it has troubled me a good deal.

Billy Phillips, our Ambassador at Brussels, arrived here yesterday and we had a long talk about the Belgian situation. He tells me that the antagonism felt towards America in Belgium is greater now than at any time, and it is very largely based upon statements made in connection with our attempt to put through their stabilization plan, that it failed because of the exactions of the American bankers. There was the greatest amount of misrepresentation in Belgium about it, and Phillips seemed to be in the dark as to the whole story. Fortunately, I had our cables with me, and he read them all yesterday. I told him a good deal of the story. He expressed astonishment that the facts were so different from those that had been stated to him.

Phillips tells me that Dr. Miller is proposing to visit him in Brussels and that he is in receipt of letters from Vandervelde, who is really the political leader in Belgium, from Francqui, the new Finance Minister, and from Hautain, all desiring to see him. Undoubtedly they are proposing to recount all of the iniquities of the American bankers. Phillips was a good deal disturbed about it, realizing the possibilities of Miller's visit doing a good deal of harm and that he may come home filled with all sorts of absurd stories, but I think he will do what he can to deal with the matter. As Miller may be back before I return, this is just a warning to look out for trouble on his return.

Incidentally, Francqui is one of the most anti-American of all the Belgians and has the reputation of being a bit of a buccaneer and a bit unreliable.

June 21:

I can now finish this letter, after a further talk with Norman and Phillips. It seems that last week Francqui and Cattier visited Norman in London and they spent a whole day going over the Belgian program. Francqui said that he hoped to be able to carry out a program, but the minute he found that he could not get the needed cooperation, he would quit. He is first directing his attention to the internal debt and the budget. It seems that within 18 days of taking office, he has added some billion and a half francs to the taxes, 1 billion 200 million being indirect and the other 300 million being direct taxation. He has completed the outline of a scheme to turn over the railways to independent operation, issuing preferred stock for most of the value and the equity being retained by the Government in the form of a billion francs of common stock. The preferred stock he proposes to use in some way for the reduction of the domestic debt. A similar plan is under way for the Telegraph & Telephones. In both instances, rates are to be gradually increased.

The amount of floating debt placed abroad has been reduced from about 35 million dollars to roughly one-half of that. The Bank's obligation for forward exchange has been reduced correspondingly, and I believe that a considerable reduction has been effected in the amount of the bankers' credit of 27½ million now in use. Francqui has arranged in London to extend this until September 30th, but they have not yet received word from the New York bankers as to their attitude.

He has disclaimed any intention of joining hands with the French, although Norman believes that the French have approached him. He says after he has gotten a good understanding of the domestic situation he is going to take up the question of the foreign debt. He frankly stated that when he went into the Treasury, no one could tell him how much the Government owed. Apparently he is going at the job hammer and tongs, and he made an excellent impression upon Norman, who seems to think he is the only man who can successfully put through a program.

Still there is great antagonism in Belgium to the American bankers. Vandervelde frankly said that they demanded a pledge of the railroads and a lot of unreasonable conditions. This is so at variance with the truth that Phillips was a good deal disturbed about it. His job is to preserve good relations, and he has seen them grow steadily worse since the "blow-up" of our plan. He has advised against my visiting Belgium until things get a little more comfortable. My present notion is to arrange to see Francqui somewhere else before I return, if conditions justify doing so. You might have a talk with Owen Young about this, as he knows Francqui well and may have some definite views.

Of course this letter is most confidential, especially the first part of it. It all bears on misunderstandings that may develop at home which I would greatly regret.

Another thing in the situation is the apparent inaptitude of the State Department in keeping people informed. I told Leland Harrison the whole story about the Belgian negotiations, and naturally inferred that he would keep Phillips informed, but apparently Phillips had not a word as to our side of the story. I do wish we could have a better relationship with the Department in these matters.

Norman's last word - which is not, however, my own - is to express considerable doubt as to whether Francqui can put through a program when he will have great difficulty in gaining the Socialistic support that is essential for its success, and he is also doubtful of the ability of Belgium to put through a stabilization program now independent of the French. I am not well enough informed to have an opinion, but am not ready to accept his without reserve.

If you can send me any more information about the hearings before the House Committee, I would appreciate it. Also, I have cabled asking what is being done to follow up the pension bill. It will never do to put the bill in a hopper and then not keep the crank turning!

Best regards as always.

Sincerely yours,

Mr. G. L. Harrison,
c/o Federal Reserve Bank of New York,
New York.

BS:M

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Paris, June 23, 1926.

MEMORANDUM BY R. B. WARREN

SAMPLES OF BOOKKEEPING UNDER INFLATION

Just in the course of conversations and desultory reading, I have come across three samples of French bookkeeping, which show how little has been learned from the experiences of Central Europe.

(1) Annual Report for 1925 of Paris-Orleans Railway:

"The continued decline in the market of fixed income securities was obliging us to pay a very high rate on our capital issues. For this reason, we have temporarily ceased to cover, through the floating of debentures, the entire charges for expenditures on capital account and of the claims against the State for deficits in 1925 (under the guarantee law, N.B.) The amounts necessary, principally for this latter purpose, were obtained by Treasury operations, until the condition of the market permits us to resume the issue of our securities at a more moderate rate of interest."

All of which is a circumlocution for saying that as earnings were insufficient to meet necessary capital expenditures and the guaranteed dividend on the shares and debentures, and as the State was unable to advance the sums guaranteed as they fell due, the railroad let its capital expenditures go, and paid its interest and dividends by borrowing on 6-month notes from the banks, presumably against its book claims against the State.

(2) A company in which a friend of mine is a director tells me that at the directors' meeting to consider the dividend on 1925 profits, they proposed to write up the inventory to a level corresponding to the increase in value represented by the price changes resulting from the decline in the exchange, call the result operating profit and distribute it in dividends.

(3) A paper mill in which some friends of mine are stockholders. The company since 1914 has been regularly recapitalized to follow the advance in prices. It

now has a capital structure of 1,500,000 fr. bonds and 80,000,000 fr. stock. Very moderate earnings have been reported since 1920, and dividends have been variable; the company imports its raw material, but sells the product in France. The statement shows about 6,000,000 fr. of current assets and current liabilities, the balance of 220,000 fr. representing working capital. The company paid no dividend last year and earned only 5% on the stock, which is currently quoted at 240. That is, the market value of this concern is about $1,500,000; its indicated earnings last year were $120,000, and its working capital at the end of the year, in which no dividends were paid, is something under $7,000. Probably the "earnings" represent inventory appreciation.

And yet people say "Economically and industrially France is sound as a bell; it is only the Government finances that are unsound." I do not know how far these instances are typical, but I have no reason to believe they are exceptional. The daily railroad wreck is one comment on the financial position of that industry.

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Paris, June 23, 1926.

MEMORANDUM BY R. B. WARREN

COMMENTS ON POLITICAL OUTLOOK

The extreme difficulty which has been experienced both by M. Herriot and M. Briand in finding a Finance Minister is not without its encouraging implications. It may be interpreted to mean that French politicians have at last come to realize that the Ministry of Finance is something more than a mere political routine job. While no doubt the reasons advanced by the numerous gentlemen have been many and diverse, I think several may be imagined for them by a bystander.

(1) The Budget is certainly unbalancing. After showing a surplus, at least on paper, for the first part of the year, it will very possibly show a substantial deficit the last half. The next Finance Minister will have to bear the burden of the superficial accusation that he unbalanced the budget.

(2) Should the deficit mount rapidly, it could only be met by printing notes. As I have several times remarked, it is by no means improbable that the end of June settlements will necessitate a marked amount of borrowing at the Bank, which, like as not, will show up in the State's account, even if it represents commercial borrowing. The man whois Finance Minister on June 30th will be held responsible, even though he takes office only the day before.

(3) The next Finance Minister, inheriting an unbalanced budget, will be obliged to advocate increased taxation; which will be in disagreeable contrast to M. Peret's valedictory promises of tax reduction.

(4) The debt settlements. These are universally unpopular. Both the Socialist and the Radical groups in caucus have stipulated reservations. If the agreement passes the Chamber, I think it not unlikely that it will be by a minority vote of the total deputies; and those who do vote for it will probably make it quite clear that they regard it as a species of bargain - no settlement, no loan.

M. Briand tried to form a coalition and failed; M. Herriot tried the other tack - to form a party government of Radicals, and to purchase the support of the Socialists by some sort of a capital levy. But, knowing the attitude of those two groups on the debt settlement, it is not surprising that he could not get one deputy of distinction to join him in forming a Ministry - even regardless of the capital levy scheme, which was, as usual, quite nebulous, and perhaps on that account doubly terrifying.

Now M. Briand is trying again. For the Ministry of Finance, Poincare, who accepted last week has now refused. The rumor is that after he looked into the condition of the Treasury he decided that he did not feel equal to the responsibility for what he saw. Now Caillaux has refused. As far as I can make out, Caillaux is the one man in France who clearly sees that stabilization means deflation - deflation of the stock market, where speculation has become the great Parisian pastime, deflation of the great export industries, unemployment, political discontent. When I say he is the only one who sees it, perhaps I exaggerate. I think there are a number of deputies who see it - and who are for that reason covertly opposed to stabilization.

The Financial Situation

I do not know the details of the Experts' program, which has not, in fact, been formulated, although some elements are leaking out, as you will see in the Herald. But from all that I hear, I am accumulating the impression that the Committee is approaching its task as a problem in Government finance, pure and simple, rather than as a problem of national economic readjustment from inflation to normalcy, in which problem the Government finances are only one element. Before I came to Paris, I had the former view. After being here two weeks, I came to the conclusion that it was a dual problem - Government finance and economic readjustment. Now I have reached the conclusion that of the two elements, the problem of economic readjustment is infinitely the more difficult. French industry no more realizes the extent to which it is inflated, than the "Statist" would admit in 1919 that British industry was inflated, or than the Manufacturer's Record would admit it in our country in early 1920. I question if even the banks, with all their opportunities for observation, appreciate how thoroughly sick French industry is, although I think they have been operated very conservatively as a group.

And even the Bank statements are not too reassuring. Loans and deposits have roughly risen with the fall of the exchange. Certainly they have kept pace with the rise in prices that has so far occurred. But capital and surplus is usually about where it was in gold francs in 1913. Now unless one assumes that the banks have been able to accumulate enough hidden assets(x), so that after stabilization they can write up their capital and surplus proportionately, it is clear that there will be some house cleaning in French banking, some day. I am willing to make such an assumption for the big metropolitan banks; I am not able to make it for the smaller banks.

So with industry diseased from head to foot, and the banking system certainly none too robust in places, I do not see how the economic readjustment can be made unless the Bank of France is able to extend the scope of its operations by developing an open market policy; and in the absence of an organized market for commercial paper, this means the sale as well as the purchase of Government securities. That is why I regard the floating debt as the principal means of salvation - the one <u>potentially</u> bright spot in the whole situation. It is not the magnitude of the floating debt that bothers me, it is its hideous form and unwieldy shape. As a matter of fact, the true floating debt is none too large - perhaps it is even too small for the magnitude of the operations in which it might be employed, if it were put into a form which would make it available for such operations. It seems

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(x) in realizable assets, not in bank buildings, furniture and fixtures.

to me that the whole history of England for the last seven years shows this; and that the experience of Germany confirms it. Gov. Schacht's task, it seems to me, was rendered doubly difficult by the fact that he had no floating debt with which to operate - on the contrary, he had to contend with the floating credits originating from the Government surplus.

It is true that in its present form the floating debt - that is, the Bons de la Defense - is a menace to everybody. But it seems to me that it would be relatively easy technically to harness it, and bring it under control, so that it could render invaluable aid in pulling France through the period of readjustment. In fact, I fear that any program which does not incorporate this idea, in one form or another, will be incomplete, and to that extent uncertain of success. I do not by any means wish to go so far as to say it would fail; it would simply be more uncertain.

And there are enough uncertainties in the situation anyway to make it desirable to eliminate every one that can be eliminated. I understand that next year there is another maturity of 7,000,000,000 fr.

The dominant fact to me - and it is becoming an obsession, a monomania- is that the Bank of France does not have effective and thorough control of the money market for which it is responsible. It is not enough, in a stabilization period, for the State to agree to keep its hands off the Bank; the Bank must be able to lay its hand on the Government, when the latter, like any other borrower, enters the precincts of the money market. Whatever be the theory of central bank control of the money market in normal periods, in abnormal periods it must be the unquestioned master of the market - just as when the King goes to the City, he must recognize the local primacy of the Mayor. It is not derogatory to the sovereignty of the State, that, when its delegate appears in a civil capacity as a borrower in the money market, it should recognize the rights and authority of the organ which has been charged with the responsibility of maintaining good order and discipline in that market. It is perhaps true that successful programs can be devised which do not involve extending and fortifying the control of the Bank of France over the money market. But it is my conviction that such programs would contain hazards and uncertainties which could readily be eliminated if the Bank of France were given those means of market control which are commonly attributed to other great central banks.

Hotel Chatham, Paris,
June 24, 1926.

MEMORANDUM BY R. B. WARREN

One of the biggest factors in the stabilization program is the attitude of the Bank of France. I am forced to say that from what I gather from conversations, the Bank of France does not enjoy the confidence of any important element.

(1) The commercial banks, that is, the big banks, can either get along without it, or force it to grant credits by presenting directly or indirectly claims on the Treasury.

(2) The Treasury regards it simply as the note issuing agency of the State, and under the "plafond unique", this relation is now virtually the law of the land. The Treasury regards it as its creature, which in fact it is. It may protest against the Treasury's demands, but it invariably accedes to them - and the Treasury knows it.

(3) Its rate is entirely ineffective except against Treasury paper, and for that reason it cannot use its rate. It has no other market machinery of any real value.

(4) In regard to a program of reform, it has none of its own; and has so far been unable to support any of the other schemes presented - as I think, with good reason. But having no plan of its own, and always appearing to oppose any other plans suggested, it is put in the light of not being interested in the reform movement. In fact, a most horrible rumor has begun to circulate in circles where you would last look for it - that the Bank is willing that the franc should go the way of the mark, so it could reorganize its position on a fresh foundation. I repeat this rumor, horrible as it is, because it circulates not among communists and radicals, where you might expect it, but among serious people. It is, of course, false; but it illustrates as nothing else does, the very low esteem in which the

Bank is held by the people who should have the most implicit confidence in it.

(5) The Bank is regarded as a miser, hoarding its gold, and neglecting all its responsibilities toward the currency.

(6) The fact that the Bank has falsified its records on one known occasion is not forgotten. Every time the movement of the "divers" in the statement is at all noticeable - and it frequently is large - the old suspicions arise. The Bank cannot regain confidence until something is done which will decisively erase that terrible blot.

The simple fact is that the Bank is unable to render effective aid in any program of monetary reform. It has no plan or program of its own, except to hoard its gold; it has no machinery to make a plan effective if it had a plan; and no will to demand from the Government the modifications of its relations which would enable it to function as a true central bank. The Bank of France is not a central bank; it is a commercial bank, acting as the note-issuing department of the Treasury. It does not hold the reserves of the commercial banks; the Treasury holds them; its only weapon of control is its rate, which is dictated by the Treasury, and is not very effective under present conditions anyway.

I am personally ashamed to write such an unkind letter about an institution where I have been received with more than courtesy, and where, I hope, I have made some friends. But I cannot disguise my conviction that financial reform in France should begin with the Bank of France; that until the Bank of France is restored to the position of a central bank, other reforms are uncertain and precarious. This conviction is an obsession with me. But until such a change occurs, I feel grave doubts as to whether the Federal Reserve Bank of New York would be justified in entering into such relations with it as with the Bank of England. Such relations with the Bank of England were possible, because the Bank of England was willing, ready, and capable of assuming the responsibilities that went with the advantages. Governor Norman could guarantee that he would and could control the London market, at least against every contingency short of revolution. The Bank of France can guarantee nothing, can promise nothing except its wretched gold.

And it is very doubtful if the Experts' Committee will advance any plan calculated to give the Bank the position in the market which seems to me requisite before relations can be assumed between the Bank of France and the Federal Reserve Bank of New York similar to those with the Bank of England. But this is another matter on which I shall write later, discussing the new Ministry.

Further, I hear a rumor that Picard has made a most unfortunate impression on the Experts' Committee. He has had absolutely nothing constructive to offer, and has generally appeared in opposition to other proposals. The Experts' sessions are supposed to be confidential and secret. But a good deal has leaked out, and in a day or so I think I can send an advance statement of their program. In conclusion, I may say I think I understand the attitude of the Bank of France, and that I appreciate the reasons for this attitude. But what I am most afraid of is that their report will assume, either explicitly or implicitly, that, following the adoption of their program, if it be adopted, a credit will forthwith be opened in the Federal Reserve Bank of New York. Perhaps it will; but until this becomes an assured fact, it will be most unfortunate if it becomes a public assumption, as a refusal then could only disturb the whole situation.

I shall keep you in close touch with the situation, which, I think, I am following fairly closely.... The longer I stay in Paris, the more convinced I am that the problem of the Government finances is the simplest of the lot. The attitude of industry and the enormous speculative public, happy drunk with inflation; the impotence of the Bank of France both in act and will, both seem to me far more dangerous than the Treasury situation. Compared to the difficulties of carrying the country through deflation, the problem of fixing up the Government finances seems like child's play. Of course, it is all one problem, but with three angles -

like a fort with three salients - industry, the Bank of France and the money market, and the Treasury. A program which will successfully arrive at a course of action for the Bank will, automatically almost, be adequate for the whole. A program of Government finance only is likely to be very inadequate.

Paris, June 24, 1926.

EXTRACTS FROM LETTER OF MR. WARREN TO GOV. STRONG

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Through its current account with the big banks, the Treasury has become the holder of bankers' deposits, largely supplanting the Bank of France in that respect. I cannot get a trustworthy estimate of the sum, but I understand that it is usually over 3 billions. The total private deposits of the Bank in the last statement was 2,780,000,000, of which a large part were not bankers' balances, but commercial deposits. I have inquired at the Bank of France regarding this item, and they assure me that the current accounts of the Treasury are insignificant. I think they believe it. "At the Bank of France", by that I mean the Statistical Department, where I have become well acquainted. I must say, however, that they know very little about the Paris market there. The so-called Bureau d'Etudes Economiques is simply a clipping and translation department, supplying M. Descamps with data and files. It does no real research and has no active contacts with the commercial banking field in Paris, and, I may add, takes little live interest in it. Most of what I know about the Treasury account I learned at the Bankers Trust.

It originated this way: The Paris market has few facilities for the employment of short time funds. There is no bill market, but there was formerly an active over-the-counter inter-bank market in Bons de la Defense. In 1924 (March) during the squeeze, the Equitable Trust presented some of these Treasury Bills for discount at the Bank of France and was refused. That pretty well killed the market in Treasury bills in the banks; and trading in them stopped. Then last year, there was so much talk of forced conversions that the banks became afraid of them. But the Treasury will accept a deposit at call, paying 2½% gross and 2¼% after taxes, while the Bank of France pays nothing on deposits; so the commercial banks leave their funds with the Treasury, and the latter employs them to repay its loans from the Bank of France. When a commercial bank needs currency, it can either discount at the Bank of France, or draw on its Treasury balance. In the latter event, the Treasury increases its borrowing at the Bank of France to get the necessary funds to meet the draft. As things now stand, I am sure that the demand liabilities of the Treasury exceed its unused margin of advances at the Bank. In this way, the State's loans at the Bank may show an increase unrelated to the position of the Treasury, and this probably explains why the State has had to increase its borrowing at the Bank during a period when the Budget has shown a surplus. It is another example of the way in which the Bank has abandoned or lost its function of a central bank - it does not hold or control the bankers' balances.

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I have seen the Bank of France from cellar to attic. They were more than polite in showing me the mechanical details, but I found that, when it came to asking questions, there were areas with "No Trespassing" signs all over. In an expansive moment, M. de Valette, who had just introduced me to one of the branch examiners, asked me if there was any question I should like to ask about anything in the statement. I took him at his word and asked about the "divers". Instantly, I knew I had asked one question too many, so I offered a suggestion as to what I thought it contained, in part, namely those accounts they call "ecarts". The examiner, with obvious relief, seized upon this explanation and improved on it. But the explanation he gave - he can tell it to the Marines. It would not account for a tenth of the movements; but I was glad that a pretty embarrassing moment went by without a casualty.

It was the same way at the Credit Lyonnais. I went all through the Bank, which is really wonderful, and their Statistical Department, which is really a combination of a Credit Department and a Bureau of Research for their stock exchange operations, and I was greatly impressed. ..... The best man I met there was the head of their Portfolio Department, with whom I had a long and very enlightening conversation on the rate structure of the market. I asked him about the position of the Bons in the market. At first he took the position - the usual one here - that the floating debt floated on confidence and not on its yield; but when I quoted to him the 1923 report of the Credit Lyonnais itself, which stated flatly that the floating debt would not float after the demand for commercial credit expanded, he turned his position and agreed that that was just about what had happened during the last two years and was more or less happening now. So altogether, that was a good morning - and the principal reason was that the franc was up ten points at the opening. If the franc had been down ten points, I would not have gone so far. My reception among French people varies with the rate of exchange; but certainly Americans are not popular here, by and large. Although we are not hated as enthusiastically as the English.

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I have learned so many contradictory facts about the Bank of France's portfolio that I don't know as much about it as I did before I came. The American banks in general do not rediscount at the Bank of France. At the Bankers Trust they assured me that it was not good form. Further, since the experience of the Equitable, mentioned above, they do not feel safe in relying upon that possibility. Further they assured me that the big French banks did not rediscount - and the next day I was in the Discount Department of the Bank of France when a stack came in from the Credit Lyonnais totalling upwards of 500 million, I should judge. Trying to reconcile these statements, I asked if these were mere collection items, but they assured me they were not, although they said it was the standing practice of the Credit Lyonnais to palm off on the Bank the small bills, especially those whose total interest would hardly pay the cost of collection. So I asked them their average maturity for their portfolio as a whole and they gave it as 28 days, if I recall correctly. They formerly published the average maturity in their annual reports, and it used to run about 25 days. But I don't know how they compute their averages. The minimum limit on places where there is no agency is 13 days, and they probably have a good many of them. Generally speaking, however, I do not believe that with the Government pouring currency into the market as it has for 12 years, that the big banks have had much occasion to discount at the Bank of France, and I think for that reason that their best customers are the smaller country banks and their direct commercial accounts. I understand that ever since the charter of 1897 the Bank has been hard put to it to keep up its earnings; and this is given as the principal reason for the abandonment of central banking and the expansion of their purely commercial banking efforts. These latter would not be worth much if they had to pay any interest because on a good many of them, the interest does not pay the cost of collection. A bill for 1,000 francs is pretty fairly good size, from what I saw, and assuming that this runs the average length of 1 month, the interest on it would be about 15 cents. As it has to be collected by hand, the cost would run up formidably if it were not for their low operating costs, for example salaries. If the Governor of the Bank only gets 62,000 francs a year, how much does the collector, the "garcon de recettes", get?

I think it is true that the better part of their business comes in from the agencies, at least the more profitable part, and this is given as the reason for multiplying the number of such agencies. The conclusion in the above paragraph is, I think, no overstatement, namely that the Bank rate is effective over only a very small volume of bills, and those mostly not coming in from the big banks. So far, the one subject on which I have found unanimous accord is that the Bank rate has no influence on the money market.

I can get no idea of the magnitude of the swap market. Because the bank I went to first is very active in that field, I got the impression that it was the dominant rate in the money market. This is incorrect; but no quantity figures are given out, and opinions are at both extremes, ranging from "enormous sums" to "insignificant amounts". My guess is that the field is mostly occupied by the foreign banks, but that the whole thing is small enough to be under control of concerted action - at least the Credit Lyonnais said it was under control, just as the report market on the stock exchange is under control.

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Paris, June 25, 1926.

MEMORANDUM - BY R. B. WARREN

THE NEW CABINET

The new Cabinet was announced late in the evening of June 23. It is called the Briand-Caillaux Cabinet, for good reason. As the price of his adhesion, M. Caillaux insisted that he be admitted on a parity with M. Briand, and he calls the combination government by "the two consuls". Further, M. Caillaux himself named a good part of the other members, including, as may seem strange, the War Minister, Gen. Guillaumat; the General, I believe, who replaced Gen. Sarrail at Salonika, and who was Commander of the Paris Area in the desperate summer of 1918. While the new Cabinet has not stated its program, it must be admitted that it would not take much to make it a dictatorship.

The personnel meets with general approval. Beside M. Caillaux, no less than 5 others, among the Ministers or Sub-Secretaries are men of high reputation as financial experts. Pietri for example was offered the Finance Ministry by M. Herriot, and several others might properly have been considered for the post given M. Caillaux Altogether it is a financial Ministry, and certainly an extraordinary group of men.

Its policy is still to be announced, and certainly one cannot guess it from the vague discourses of M. Caillaux, which, however, do show that he realizes more than most people - certainly more than the public - that stabilization means deflation.

The two questions that will immediately confront the Cabinet are the debt settlement and the report of the Experts. As was stated in other letters, I am sure that the Experts intended to recommend the Berenger Agreement, because their program rested on an American credit. Now, personally, I do not believe that M. Caillaux gives to an American credit anything like the importance which M. Peret did, and, in fact, I doubt if he wants it. Further, if I am right in assuming that the desire for American credit was the sole reason for expecting the Agreement to pass, it logically follows that the chance of its passage is reduced. The Socialists and the Radicals, and the Marin group of the extreme right, are either opposed or are for passage with amendments. Now Pertinax has launched his campaign. So I find myself obliged to differ from Mr. Winston's prediction in the "Herald". I do not feel confident that the agreement will pass, except with substantial reservations, of a character which certainly will provoke opposition in our Senate, if that body is in session at the time. My guess is that the question will be deferred here until our Senate has adjourned, and that then, if it is passed at all, it will be passed only with heavy reservations. I should not be surprised if it failed. I should be astonished, now, if it passed in its original form.

As for the relations of M. Caillaux to the Experts. Although there was some talk, not unplausible, that M. Caillaux would ignore the Committee, I have come to the conclusion that this will not be the case. I have been obliged to correct my earlier view, which was based upon my belief that the Committee rested its program on M. Peret's belief in the need of an American credit, and my conviction that M. Caillaux did not feel the need of asking anybody's advice in formulating his program. But, after all, the Committee has considerable prestige. M. Caillaux is too shrewd a politician to throw this asset away. He will, I think, whole-heartedly endorse the program submitted by the Committee - and he will see to it that it submits the kind of a program that he can endorse. As you will see from the accompanying clipping, the Committee is pretty well packed with his men. Thus there will be perfect cooperation, accord and unity. This is, of course, only my guess, and it may be pretty far astray. But it is hard for me to believe that the Government will put itself before the public in opposition to the report of the Experts' Committee, and it is much easier for me to imagine M. Caillaux bending the Committee to his will, than for me to imagine the Committee having the slightest influence on M. Caillaux.

The program of the Committee will be announced shortly. I enclose a summary from the "Quotidien", which is entirely unofficial, but which may be taken for what it is worth. Its elements are as follows:

1. Ratification of debt settlement for purpose of obtaining foreign credits.

This was certainly their original program. I have given my reasons for questioning if this part of their program will not be modified. My questions arise from my estimate of the attitude of the Chamber and my guess as to the attitude of M. Caillaux, who has spoken in a way which leads one to expect his opposition to ratification. I must say that my views on the debt ratification are at variance with the best opinions on the subject. My belief is that the Committee will recommend ratification now - but with reservations.

2. Stabilization at about the present level of the exchange, say 170. There is little doubt in my mind that the exchange could be put back to 150 without much effort, but as this would add to the immediate difficulties, I see no reason to expect that the exchange will be moved much from its current level. This probably involves a further rise in prices, which have been going up pretty fast. The remaining advances, if any, may be quite gradual.

3. The floating debt. This part of the program as given in the paper is a very sore point with me, but I think I get the idea. The limit of advances to the State is 38,500,000,000; the figure on June 24 stood at 36,600,000,000 with a normal expectancy of going much higher at the end of June. The circulation figure is 53,000,000,000 (June 24) with a legal maximum of 58 billion. In other words, under present laws, the remaining margin on the advances to the State is less than 2,000,000,000; while the margin on circulation is nearly 5,000,000,000. Under the scheme given in the "Quotidien", a new item would be introduced into the Bank statement, termed advances to the Consortium of French Banks, which would permit, or rather would oblige, the Bank to advance money to the State, indirectly, up to a limit of 5 billion or more without changing the circulation law, while under the present arrangement only 2,000,000,000 can be advanced directly. As you will see, this is merely a device for confusing the Bank statement in such a way as to force the Bank of France to put 5 billion francs at the disposal of the

Treasury without its appearing frankly as a loan to the State, and without the necessity of altering the law covering circulation and advances to the State. From this, you can imagine why the Bank's representative on the Committee was unable to show much enthusiasm for the scheme. It is simply more inflation, very thinly disguised. When I wrote the letter criticizing the Bank, I did not wish to imply that I did not entirely endorse their position of opposition to schemes like these; but I doubt if I made myself clear. What I criticized was their inability or refusal to assume the initiative in proposing a good scheme of reform, and the fact that they limited their opposition to mere verbal remonstrance and in the end invariably accepted measures which they knew, or believed, were dangerous. If this is really the Experts' program, I do not think M. Picard should have opposed merely verbal objections. I think he should have come out flatly in opposition and then if he could not carry his point, that he should have resigned. But, of course, what I really believe is that the Bank should have taken the initiative from the organization of the Committee, in all matters directly concerning the note circulation and the control of the money market.

Now all this confirms my worst apprehensions, namely, that the Experts' program will put upon the Bank the probability of further inflation; that instead of its separating the Bank and the money market from Treasury control, it increases the hold of the Treasury on both, and that it continues the vicious system which forces the Bank to put credit into the market, whether at the instance of the Treasury or of the market, without in any way providing a means by which the Bank can withdraw money from the market, except possibly through the operation of a discount rate of dubious efficacity. In short, if this is the program, it does not enhance the prestige of the Bank, it does not give it a more independent position vis-a-vis the Treasury; it reduces the prestige of the Bank because it again imposes upon it a condition which it has verbally and impotently opposed, and it emphasizes again that the Bank is the creature of the Treasury. Further, more than ever, it makes the Bank the servant of the money market rather than its master. My criticism of the Bank is not that it objects to this sort of thing. Far from it. My criticism is that it objects only verbally, and always after a futile remonstration, reluctantly concedes. The issue is to me perfectly clear - black and white. If the Bank of France is going to be a State Bank, let it be a State Bank, whole-heartedly and unreservedly, let it candidly surrender itself into the hands of the Minister of the Treasury and always loyally and enthusiastically obey his dictates, itself divested of all responsibility except obedience. But if it is not going to be a State Bank, if it is to be an independent organism, fully responsible for its note circulation and for the control of the money market - that is another story. If the Bank of France wishes to be a State Bank, and if the people of France wish it to be a State Bank, no foreigner has the slightest right to object. But I question whether the F. R. B. of N. Y. can then assimilate its relations with such an institution to those of an independent entity like the Bank of England. Possibly identical relations <u>of fact</u> could be assumed toward a State Bank of France as toward the independent - I almost said sovereign - Bank of England, but it is clear, I think, that the considerations leading to such relations would have to be examined de novo. The cases would not be parallel, nor would either one serve as a precedent for the other.

Probably I am wrong in wearying you with this long diatribe on a program which has not yet been announced from any responsible quarter; which has not even been completely formulated, in fact. But I have reason to believe that the program of the Experts' Committee, however meritorious in other respects and however valuable in improving the critical position of the Government finances, will not magnify the position of the Bank of France, but will leave that institution more than ever the creature of the Treasury and the servant of the money market. Under present economic conditions in France, I cannot regard such a prospect with anything but profound - perhaps exaggerated - concern.

(32)

Paris, June 26, 1926.

MEMORANDUM BY R. B. WARREN.

PARIS MONEY MARKET

I have now arrived at a point where I can make some observations on the Paris money market.

When I arrived here in the middle of May, I deluded myself with the idea that I already knew something about it. So my first task was to unlearn the things I thought I knew, and my second was to get the facts without offending anyone in the process. The third was to fit the facts into the general situation.

I have been fortunate in the people whom I have met; especially being indebted to M. Pagnamenta of the Bankers Trust Co., to M. Verdier of the Credit Lyonnais and to Mr. Aragon and M. Manice of Morgan Harjes, and to M. Laroux of the Bank of France.

There is, properly speaking, no money market in Paris. There was formerly - that is, up to one or two years ago - a kind of market in Bons de la Defense. But for reasons previously stated, this was dealt a severe blow in March 1924, and was utterly destroyed last year by the threats of forced consolidation of the floating debt. There is not and there never has been a market in commercial paper for two reasons. First, it is not considered good form for the banks to sell their clients' paper. Perhaps that is putting it too strongly; but the fact remains that it is considered better form not to, even to the Bank of France. While the big banks do it, on occasion, it is only under considerable pressure, and then only to the Bank of France. Even then, they mostly try to limit their rediscounting to collection items. Second, there is still a strong tradition in French business that it is an evidence of weakness to resort to bank credit in any form. There are firms with whom it is a matter of proud tradition that they have never discounted a scrap of paper.

For such bank credit as is employed, the conventional form is the three month, three name bill. While the total deposits of all French banks, reduced to gold, are at about the 1913 figure, the ratio between the types of assets against total liabilities has profoundly changed. Before the war, the deposits usually were represented by the portfolio, and the capital and surplus by investments, reports, and collateral loans or overdrafts. These proportions are still maintained among the commercial banks; but since capital and surplus of such banks as the Big Three stand at nearly the same figure as in 1913, it is evident that, so far as their statements show, these items, together with the assets that conventionally stand against them, have shrunk to about 1/6 of their pre-war value in gold. On the other hand, deposits have roughly increased with the depreciation of the franc, and the portfolio of bills has increased in much the same proportion.

For example, the combined balance sheets of the Big Four showed at the end of 1925 reports of 173,000,000, against 193 at the end of 1913. Overdrafts were 3,704,000,000 against 1,516,000,000 in 1913; that is in francs they had doubled, but in gold they were about one-half.

The reason for this movement is the fact that in recent months, the first consideration of the banks has been liquidity. This has completely dominated their action, for three reasons. First: to lend paper money for any length of time in a period when the franc was declining or likely to decline in purchasing power, was a certain way to lose real money value, as the rate of interest obtainable could never equal the actual or threatened loss in the value of the principal when the latter was repaid. Second: the banks were apparently aware of the fact that any arrest of inflation, even if it took a form no more severe than stabilization, would destroy the solvency of many of their clients, and considered that a three-months bill was less likely to freeze up than any other type of commercial asset. Third: the threat of consolidation of the floating debt forced the banks to dispose of their Treasury bills, or at least frightened them into doing so, and obliged them to seek for commercial bills in order to find employment for their deposits. As this coincided with a time when prices were rising and business expanding, the consequences were two-fold. The market dumped upon the Government about 10 billion francs of floating debt causing the equivalent expansion of the currency in 1925; and sought to replace the equivalent of this amount of Treasury paper with commercial paper. As the amount of acceptable bills, even at present, is scarcely up to this intense demand, the result was that the commercial bill rate sank to extraordinarily low levels. The ensuing situation was a paradox, in that there was an enormous demand for first class commercial paper at very low rates, in a market which was refusing short-time Government paper by the billion, although it bore nearly the same rate; a market which was asking very high rates, prohibitive rates, on overdrafts, even the best that the market afforded; and which virtually refused to accept new capital issues in the form of franc bonds at any price whatever. So there was offered the astonishing spectacle of a market refusing 1-month Treasury bills at 3% and 3-month Treasury paper at 4%, free of taxes; and eagerly putting its money into the Treasury current account at 2¼% net, and doubling its cash reserve into the bargain. At the end of January 1924, the combined deposits of the Big Four were about 16 billion; at the end of 1925, they were still less than 20 billion. But their cash (#) had doubled from 1,600,000,000 to 3,100,000,000 francs.

So there, in a nutshell, is the French money market in 1925, - a threat of repudiation, a scramble for cash or something convertible into currency, a low rate on a type of paper convertible into currency at need, a high rate on any other kind of bank credit, and capital in the form of fixed interest securities unobtainable at any price. It is all perfectly simple, perfectly logical, perfectly clear. I suppose I was pretty fairly stupid to take so long in getting the picture focused. But for one who arrived with the preconception of interest-rate relationships familiar to our market and the British market, it took a long time to realize that here was a market in which funds did not flow freely from one compartment to another, because of

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(#) I cannot discover whether these banks carry their Treasury balances under cash or under bills, or both.

special considerations - the special considerations being the almost complete absence of credit - credit in the sense of a belief in values.

Now to an American or Englishman, the question immediately arises, "What is wrong with this pretense? Where is the Bank rate?" The answer is that the Bank rate last year was not in the picture. Early in the year, the Bank rate was 7%,(#) and possibly was having some effect upon the maintenance of the floating debt. But after the Government had made its threat of conversion, and subsequently had begun to pour currency into the market, what little influence the Bank rate had was lost; it was dropped to 6% in July; but it plays no part in the story. The Lombard rate was kept at 8% and probably had a negative influence; that is, a lower rate would have induced borrowing at the Bank to carry Government bonds for their income.

But all this is more or less water over the mill. If the peculiar position of the money market in 1925 and the first half of 1926 was due to lack of confidence-lack of confidence in the worth of the currency and lack of confidence in the State's contract with its security holders, what will happen if this confidence is restored, if the exchange is stabilized and the threat of forced conversion is removed? To some degree, it seems to me that as the cancers are removed, the results will be removed. There will be less urgency for the banks to employ their funds in bills at say 5½% and more desire for them to permit overdrafts at twice that rate. Since there is indubitably a real demand for credit, and a demand for credit which is not unlikely to grow as stabilization sets in motion the forces of deflation, the tendency would naturally be for the commercial paper rate to rise. But this rate cannot rise much without Treasury cooperation, for it is only a short distance from the Bank rate, which, which if it is not effective as a restraint to inflation can certainly become effective as a restraint on deflation; and the Bank rate can hardly

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(#) Treasury paper does not enjoy a special rate at the Bank; it discounts at the official rate.

be raised without Treasury permission, as it might provoke a flood of redemption. As these redemptions can only be met by forcing the Bank to issue currency, the increase in the currency would tend to bring the money rate down again, and so on ad infinitum. It may be that there are other solutions, and there probably are; but so far I cannot see any answer to the problem except to grant the Bank of France the power to control the supply of credit in the market by allowing it to turn back into the market the securities which it does not wish to keep, that is to enable it to take credit out of the market as easily as the market takes credit out of the Bank.

It appears that I have only one chorus to all my songs. No matter what subject I elect for a memorandum on the various aspects of this political-financial-economic situation, it always seems in the end to lead to the same conclusion, even if I start out with the intention of saying nothing about it.

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Hotel du Cap d'Antibes,
Antibes, June 26, 1926.

Dear Mr. Harrison:

The enclosed letter from Dean Jay, of Messrs. Morgan, Harjes & Company, explains itself. These are the cables which I sent to you personally, and I am going to ask you if you will be good enough to remit a draft for the amount to Messrs. Morgan, Harjes & Company, addressing the letter to Mr. Jay and explaining what it is for. This will enable you to do the needful in regard to the vouchers, as it may be that you will not want the copies of the cables to be attached.

I can send you no news, for there is practically none to send. Governor Norman is here and enjoys the place. The weather is gorgeous, and I am putting in the time loafing and feel better for it.

Please give my best to all at the office, and the same to yourself.

Sincerely yours,

Mr. G. L. Harrison,
c/o Federal Reserve Bank of New York,
New York.

BS:M

Paris, June 30, 1926.

Dear Mr. Governor:

Immediately upon arrival here, I went to see Col. Harjes. I had pretty well anticipated their reaction, and had tried to prepare for it. Briefly, Mr. May said that they would have no part in any credit operation in which the F.R.B. did not participate; and that M. Caillaux would not go ahead with the debt negotiations unless he had some assurance of credit, and that unless the debt negotiations had the full support of the Ministry, they had not a chance in the world, or rather in the Chamber. I told him this was a mere bargaining attitude; but I did not add what was on the tip of my tongue, that such an admission was anything but encouraging for the success of a comprehensive and long-run program of reform; by his own account, the keystone of the arch was the debt ratification, and this could only be secured by a precarious vote in the Chamber and on terms which might be disrespectfully termed C.O.D. Instead, I went to great length to explain your position and that of the Bank. This was not a little difficult, for Mr. Jay believed that there was some sort of moral obligation resting upon the American people and the American Government to intervene in this situation, and that this moral obligation rested specifically on the F.R.B. of New York. I took a different view, told him that the Bank was bound by many considerations, that it would be quite impossible to think of going into any scheme which, after thorough and detailed consideration, did not give almost perfect assurance of success; that the English arrangement had been questioned by Congressional Committee, but had been endorsed because it had been eminently successful; that, so to speak, its success had justified the operation before Congress. On the other hand, the slightest fumble would bring down the wrath of Congress. In short, I argued about one hour, and in the end was satisfied, for Mr. Jay said that he now understood thoroughly the attitude of the Bank.

In the course of the conversation, it was asked if, since you did not wish to see a representative of the Treasury, you would be willing to see a representative of the Bank. I replied that you were absolutely unwilling to see any representative of the Treasury, and urged that no representative of the Bank should come to see you until you had expressed your readiness to receive them or him; and then only with the assurance of the most perfect discretion. I told them I would rather make fifty trips to Antibes than have a repetition of the Parmentier episode. They seemed to believe that M. Moreau or M. Rist (who has replaced M. Aupetit) were likely to rush off to Antibes at the first excuse. I told them that I did not know M. Moreau, but that I had met M. Rist in Washington, and, from a very brief impression, I saw no reason to place too much reliance upon his discretion. Mr. Jay then asked if I would personally see M. Monnet or M. Rist to explain the position of the F.R.B., to which I replied that I knew you had great confidence in M. Monnet, and that I did not know what you knew of Rist, but that personally I had no great amount of confidence in him, and that I was unwilling to see either except with your permission. As they (I mean Mr. Jay) were very anxious that I should explain the position of the F.R.B., I said that if you would authorize me to, I should be very glad to have a conversation with them and that I would immediately ask you if you wished it. For that reason, if you do or do not wish me to speak with some representative of the Bank, will you please telegraph at once. If the answer should be affirmative, I assure you that I will use the utmost discretion.

I have seen an explanation, evidently a translation and probably from an authoritative source, of the proposed Caisse de Liquidation. Briefly, the Commission would receive $150,000,000 borrowed in the U.S. As the Bons de la Defense were presented for redemption in currency, the Commission would pay an equivalent sum in gold or dollars into the Bank of France. In this way, the circulation could be expanded about 5,000,000,000 fr. but the additional currency would be completely covered by gold or its equivalent. The document admitted that it was a variation of the "plafond unique" idea disguised to avoid disturbing public confidence (I may add personally, the idea of the "plafond unique", after the experiment with it last year, quite terrifies the public). I told Mr. Jay that I doubted if this scheme of inflating the currency would meet with any great enthusiasm on your part, and he agreed.

Mr. Rist has succeeded M. Aupetit or M. Picard, I am not sure yet which, and seems to be regarded as M. Moreau's right hand man. I have met M. Rist, as I said above, about a year ago in Washington, where he paid a brief visit to the Division of Research. It was my impression that he had only a superficial understanding of banking and monetary economics, and that, personally, he was obsequious to official attention, by which he seemed flattered. Although this was before the days of the "plafond unique", he expressed opinions tending in that direction, and absolutely the opposite of those which seemed reasonable to us, and at variance certainly with the ideas expressed to me recently by M. Verdier of the C. L. Further, some of the monetary and banking theories which appeared in the Layton-Rist Report on Austria of last August, were certainly his, and I must admit that, while ingenious, they seemed to me absolutely unsound. I have little right to form an estimate of his professional attainments from so slight a knowledge; but until I know more, I must form my working opinion on what little I do know.

Under separate cover I am sending the morning clippings. As you will see, the report of the alleged conversation between M. Moreau and yourself and Gov. Norman is denied. It is none the less clear that the story originated in loose remarks from headquarters, either at the Bank or the Treasury, and the denial is worded in such a way as to convey the impression that negotiations are going forward. In short, little seems to have been learned from the Parmentier episode.

As you will see from the clippings, the announcement of the Ministry met a response in the Chamber which can at best be described as luke-warm. The swap rate has widened out again.

(sgd) Robert B. Warren.

Hotel du Cap d'Antibes,
Antibes, July 1, 1926.

Dear Mr. Harrison:

This is to reply to your long letter of June 18th.

(1) As to Miller's visit, I think if he gets in touch with official people in Paris and with the Bank of France at the present juncture, he is going to have a merry dance. The last I heard he was in London. He is proposing to visit the Phillips' in Brussels if they are there when he arrives, but I learned today from Mrs. Phillips that her husband is arriving here on the 6th, which means that he will leave Brussels on the 4th of July, and I much doubt if Miller is able to connect with him during his visit, as Phillips will be here for a month.

The real danger point is in France, but it may be a good thing for someone else to get a dose of the kind of publicity that one cannot escape over here and get a little better realization of the difficulties of dealing with matters in an atmosphere that is neurastenic and high-strung to the last degree. Dr. Miller knows Professor Rist, who is now "Sous-Gouverneur" of the Bank. He is almost certain to see him, and I suppose Professor Rist will invite discussions of a credit; I am just wondering what attitude Dr. Miller will assume.

(2) It was a good scheme to make the statement to the Board. I am delighted that it was done, and there was very little in my letters which need have been withheld. It would be equally important, if anything starts in France, that the Board be forewarned, as indicated in the cable I sent yesterday via Paris.

(3) I am very sorry that the Indian Currency Commission matter was

entirely omitted. It might appear to the Board to be a bit disingenuous, and I really think that something should be done right away to correct it. If you decide to have discussion with the Board, I should suppose that it would be very easy to get Professor Hollander over from Baltimore, if he is still there, and after giving him needful caution as to how far the discussion should go, have him give a personal account of the procedure in London. Or possibly Sprague may be equally available.

(4) Am writing Jay about the compensation, which is eminently satisfactory to me.

(5) The outcome of the Mc Fadden bill, I am afraid, is going to be nil. On the basis of your report, I am very sorry that it cannot pass.

(6) As to Poland, please do not let the Minister get the wrong slant as to my discussion with Norman. It was the only alternative that seemed likely at the moment to interest him in taking a hand in a large and general way in the Polish situation, but everything was so distinctly tentative that it was no more than sounding him out. Since then Clarence Dillon has seen him, as I wrote you, and the whole project seems to have passed under the bridge.

If Kemmerer's work is satisfactory and produces real results, I should hope that Dillon would be able to interest the London bankers, and then there would be little difficulty in getting Norman to extend somewhat his relations with the Bank Polski along the lines that we would. I think he is in the frame of mind to do that if the results are satisfactory and doubtless it is no more than that that the Poles would desire. But of course I cannot speak for him, and this is no more than a surmise.

It really is distressing to learn that Crissinger is so ill, and now a letter from Winston indicates that Cunningham is also quite ill. As you know, I am very fond of Governor Crissinger indeed. He has been an earnest supporter of sound things in the Board, and I know he has had an unhappy time, to some extent on our account, for a good while.

You will gather from my letter to Mr. Jay and my cable of this date that I am hoping to see Mellon and talk over all these difficult matters. Also, I am enclosing copy of a letter I am writing Winston in reply to one received from him.

With best regards,

Sincerely yours,

P.S. - Am enclosing a letter from Dean Jay which will give you a little slant on the situation in Paris.

Mr. G. L. Harrison,
c/o Federal Reserve Bank of New York,
New York.

BS:M

Hotel du Cap d'Antibes,
Antibes, July 1, 1926.

Dear Garrard:

Yours of June 16th is just received, and I have read it and the enclosures with the greatest possible interest. Your interview struck me as all right, and Mr. Mellon's letter is a masterpiece. Of course the effect was salutary, and the Mc Nary-Haugen bill, I understand, is dead.

It was inevitable that the sidewalks would be a bit slippery while you were in Paris. I think you got out of the situation admirably, but I am wondering what you are saying to the Senate Committee about debts and about all the mischief that I am up to here, none of which has happened! You can speak for me now with authority, and I am sure you have kept in close touch to learn of developments subsequent to your leaving.

The situation in France today has certainly undergone a radical change, so far as one can gather from a distance. I think the Government has, so far as appearances go, reached a real determination to do something, but I fear the practical difficulty is going to be in formulating a detailed plan. Some way or other, they do not seem to have the knack or faculty of getting together in mass formation for a common purpose, formulate and put through a plan.

I have felt obliged to remain here for a longer rest than I had thought was necessary, and may not leave until just time to meet Mr. Mellon in Paris, if he sails as planned, about the 15th. It is really rather important that I should have a talk with him, in part about some of my personal matters and of course about the Board situation, and in part about the situation over here. If you find he is willing to do so on receipt of this letter, would you kindly asking the boys at the office to cable me about arrangements for meeting him, when and where he arrives, etc. and I will make my plans accordingly.

About the constructive suggestions, I heard of the Forgan proposal, but frankly, it does not appeal to me. I have never regarded him as a man of much ability. He, like his brother, has always been a person of very rigid views, such as we expect from the Scotch. He is getting well along in years, and he has not made a very striking record as a banker, as you know.

I have long had a strong feeling that Sydney Anderson would make a splendid man on the Board. He did a great piece of work in the Agricultural Inquiry, has a fine mind, is a lawyer by profession, has a fine knowledge of the Federal Reserve System as a result of the Agricultural Inquiry, and is a man of the highest possible integrity and character. Besides that, he is from the Minneapolis district, which is not now represented on the Board, and he is not of a type who would be regarded as "high-brow" banking talent. He is a Republican, and if either of the present members of the Board who might retire leaves a vacancy, both of those being Republicans, a Republican could be appointed. One difficulty might be the question of money. I think Anderson is probably getting a considerably larger salary just now.

Why don't you take the job? You like Washington and public life, know the ropes better than anybody, and I would not mind you as a boss - in fact, I think we might be able to collaborate in some very important matters over here. If Hamlin is reappointed, as seems likely, your appointment would depend entirely upon whether Cunningham continued or not. On the other hand, if Crissinger's illness necessitated his retirement, then it might be necessary to make an appointment from either the Philadelphia or Cleveland district, those being two of the largest and most important districts which would be unrepresented.

Of course, if Newton Baker could be appointed, it would be fine, but he a Democrat, and then he is a highly political person, and those are serious defects, as we know. But the Democrats have been almost eliminated from the Board and it would be a fine independent move at present to appoint a Democrat in the place of a retiring Republican.

I have puzzled a little about a possible candidate from the Philadelphia district and cannot think of a suitable one. Norris was one suggestion. He is also a Democrat, but I am not sure that my colleagues, nor am I sure that I myself, can give satisfactory evidence of his qualifications. Sorry that I cannot send you something more definite, but this may set you thinking on the subject.

You did not enjoy the trip any more than I did. I would like nothing better than to have another few weeks in Rome with you and then make another motor trip in Italy. Possibly we can do it next year, but all sorts of things are liable to happen before that.

Please give my best regards to Mr. Mellon and Dewey, and the same to yourself.

Sincerely yours,

P. S. - Mr. Moore tells me that you owe me some money. I thought I owed you some. I am not going to render an account, but we can match for it when I get home.

Hon. Garrard B. Winston,
Under Secretary of the Treasury,
Washington, D. C.

BS:M

MEMORANDUM BY R. B. WARREN   Paris, July 4, 1926.

THE EXPERTS' REPORT

This report was published in the evening papers of July 4, 1926. It includes a program, with reference to Annexes which have not yet appeared. In the absence of the Annexes, it is impossible to criticize most of the detailed statements, especially the figures. The following are merely notes on certain phases.

The Budget

(1) The report is rather vague on the method of meeting the 12-14 milliards estimated still due for reconstruction.

(2) While it is stated that some 20,000,000,000 fcs. of expenditures and only some 10,000,000,000 fcs. of receipts rise with an advance in the price level, the effects of this upon the budget position are not precisely indicated; nor is it explained how the estimated deficit of 2,500,000,000 fcs. in 1926 and 5 billion in 1927 is reached.

(3) The principal source of increased revenue is the railroads, and it is stated that a 15% increase in rates would not only make them self-sustaining, thus relieving the Treasury of the present subvention, but would supply a surplus available to the State in the form of taxation. As the pre-war railroad investment was in the form of bonds or stocks which are now virtually fixed-interest bearing, it is clear that with the franc at 1/6 of its pre-war value the relation of capital charges to potential operating income has been enormously reduced. On the other hand, it would seem as if the railroads were so badly run down that very considerable new investment was necessary. In the absence of the detailed annex it is impossible to criticize the estimated results of a 15% increase in rates; but it hardly seems adequate in view of the current and prospective rise in prices, the cost of living and wages. It would appear however that the traffic can bear a much heavier increase.

The Treasury

(a) Current accounts: the figure given is 1,600,000,000, but it is stated to have been much more considerable recently. This figure is, under the estimate of 3 billion which I gave Governor Strong, but it confirms the conjectures expressed in previous memoranda, that the market, in preference to rediscounting at the Bank of France, has been drawing down its current accounts with the Treasury, thereby forcing the latter to borrow at the Bank. While it is recommended that the system be modified, no plans are offered.

(b) Bons de la Defense Nationale: It is proposed to limit the amount of these Bons de la D. N. to the present figure of 49 billion, with a more flexible rate of interest. The handling of these is to be turned over to a Commission (autonomous), with the following provision:

(1) Interest charges to be met by the Budget

(2) Annual amortization provided in the Budget of 500 million (viz. 1%)

(3) An initial endowment of 4 billion (roughly $100,000,000) provided by a foreign loan. This will be placed to the credit of the Caisse de Gestion with the Bank of France, and will be increased from other sources until it reaches 20% of the Bons or roughly 10 billion francs. If the Bons are presented for reimbursement at maturity, currency will be issued to meet them, such currency having a 100% cover in gold or its equivalent.

(4) The receipts of the Tobacco Monopoly are specifically affected to meet the demands of this scheme on the budget. In case of need, the Caisse will be able to borrow against this income sums which might be needed.

They will continue to be discountable at the Bank of France. The Caisse is to publish a detailed fortnightly statement.

(NOTE: This scheme is, of course, the familiar "plafond unique" with three very important modifications:

(1) It gives the Bons a better status and so should free them from a panic rush to convert into currency, such as occurred in 1925.

(2) The currency issued against them will have a full cover of gold or equivalent.

(3) The Bons are to pay the market rate of interest, which may be changed once a fortnight. This fact is extremely important for 2 reasons:

(a) It relieves the "plafond unique" of 99% of its objectionable features

(b) And more important, in one way, it creates in the Paris money market an agency with very large powers of controlling the market; it is an agency entirely capable of open market operations of very considerable magnitude, since it can buy from the market up to 4 billion francs at the outset, but cannot sell to the market any sum which will put the total above 49 billion. However, it must be remembered that of the total amount of these Bons outstanding, nearly 3/4 are of the 1-year type, and the remaining 1/4 of the 1-month, 3-month type. The 1-year Bons are largely held by investors, and it is hoped that these can be reached by conversion operations and induced to exchange part of these 1-year Bons into Rentes. It is clear however that by manipulating the rate of interest a large proportional amount of switching might be effected, with corresponding effects on the money market. The combinations are almost limitless. This commission is to include a representative of the Direction of the "Mouvement General des Fonds" and of the Bank of France, who will furnish the assurance that the fixing of the maturities and of the rates will take into account all the elements of the market, and, specifically, existing conditions for the other Treasury engagements and for commercial operations.

In other words, the Paris money market is offered an agency for conducting open market operations, and this agency is placed under the joint control of the Bank of France and the Treasury. Provisions are also made for using this agency to inflate the market by (a) the 4 billion credit at the Bank of France and (b) by borrowing at the same quarter against the receipts from the Tobacco Monopoly. At the same time, from its control of the rate of interest on the varying maturities, it is clear that it has wide implied discretionary powers in contracting the market. It seems clear that here is an agency which has greater power over the money market than has the Bank of France; but which is after all under the joint management of the Bank and the Treasury. Because it is a dyarchy, it is clear that the two heads can be either in harmony or discord; but while i it is clear that in harmony they can cooperate, it is equally probable that if they are in discord, it would be quite possible for the Caisse de Gestion to have greater control of the market than the Bank can, acting in opposition.

In view of the possibilities in this, it seems to me to merit the closest scrutiny.)

(c) Bons du Tresor: These to the sum of 2,600,000,000 will come under the Caisse de Gestion. They are to be replaced by another type; but it is not clear exactly how they are to be eliminated or exchanged.

(d) Short-term bonds (3-10 years): The report envisages without concern the optional maturity of 3,018,000,000 Credit National Bonds in February 1927, and 4 billion Treasury Obligations in September 1927. It is proposed to concentrate purchases of the Caisse de Depots et des Consignations on these, evidently because that institution can be obliged to carry over or convert. Altogether, while 7 billion is not a very alarming proposition (say $200,000,000) it must be admitted that the report handles it pretty sketchily. They say that there is enough time between now and February to make dispositions.

(e) Advances to the State: About half of these will be written off by the revalorization of the gold reserve; the Bank will operate a sinking fund as at present and to this will be added a budgetary sinking fund of 1 billion.

New Type of Treasury Bill

While it is planned to keep the budget in balance, the irregularity of receipts at various seasons necessitates the creation of a vehicle for short-time Treasury borrowing in the money market, and since both the Bons and the present type of Treasury Bill are to be arrested at their present figure and the Treasury current account reduced, an entirely new form of Treasury Bill is to be created, with flexible interest, to a maximum legal limit of 5 billion francs. Further, that a foreign loan of 3 billion fcs. (nearly $100,000,000) be floated, and used to repay that amount of the advances to the State.

(NOTE: From this it appears that while the legal limit of advances to the State will thus remain at 38,500,000,000, the capacity of the State to borrow at the Bank of France will thus be expanded by 3 billion. As there is a present margin of rather over 1 billion, this phase of the report proposes to authorize the State to borrow something over 4 billion fcs. from the Bank and 5 billion fresh money from the market. As the Caisse de Gestion is authorized to buy 4 billion of Bons, it is clear that this scheme provides for giving the Bank about $200,000,000 in gold or its equivalent against which would rest a demand liability to issue 8 billion fcs. in currency, covered by gold or its equivalent to the extent of about 7/8; and in addition authorizes the State to borrow 5 billion in the money market.

In other words, the proposal is to authorize the State to take 4 billion from the Bank, and the market another 4 billion through the operation of the Caisse de Gestion, and then to authorize the State to borrow 5 billion from the market. It gives the State, assuming it wishes to work the Caisse de Gestion, a claim directly or indirectly upon the Bank of France for at least 8 billion fcs., and more against the market if it forces the Caisse de Gestion to borrow at the Bank of France against the Tobacco Monopoly. Under such circumstances, I do not wonder that the maturity of 7 billion (of which part will be converted anyway) in 1927 causes very little concern.)

Stabilization

The part of the report dealing with stabilization is less precise than the remainder. The subject is discussed under the questions of time, rate, method and means.

(1) Early stabilization is recommended.

(2) The rate is not indicated, but it is suggested by a bracket, of which the bottom would be the purchasing power parity based on the cost of living, and the top the effective rate at the moment chosen. As the bracket would work out based upon the cost of living index for the first quarter of the year (the last I have with me), the proposed rate of stabilization would be somewhere between 2¾ and 5-3/8 cents per franc - a rather wide bracket. "The rate of stabilization should be sought between these limits, taking into consideration all factors, and especially the necessity of retaining or attracting outside funds, and of provoking the rapid return of expatriated French capital. From this point of view, and from many others, the selection of a rate for the franc higher than the present rate would be desirable."

(3) The method recommended is by three stages: (1) in which the rate is allowed to find its level; (2) a period of stabilization in fact; (3) legal revaluation and issue of new monetary unit. It is recommended that the first period be short, in order to hasten the time when the money rate will be internationally effective.

(4) The means suggested are (1) foreign loans, (2) credits to be obtained by the Bank of France, (3) private commercial credits.

The report at this point recommends the acceptance of the Washington agreement "as soon as possible", and an arrangement with England. To attract funds from abroad (whether French or other), it is proposed that the Bank of France accept foreign money on deposit; the law on the export of capital to be repealed or at least "simplified". Such deposits in foreign currency to be sold to the bank, with or without repurchase agreement, or used as collateral for loans in francs.

It must be admitted that this part of the report is full of uncertainty, for under the first option, there is certainly a very fair possibility of inflation, while under the second it is clear that the Bank is asked to conduct on a vast scale the worst type of business in the swap market, for there would be a big inducement for firms to put as much of their capital into foreign currencies, and borrow their working capital from the Bank, with an obvious interest in a decline of the exchange. This scheme was tried in Austria, of course; but against capital for the most part borrowed abroad, I believe. I fail to see the advantages to be gained by opening these deposit-loan accounts in France and I can see very grave disadvantages. However, granted skillful management and clever employment of effective interest rates, no doubt most of the objections could be overcome. But it must be remembered that this is placing upon the Bank the responsibility for operating in a very difficult field in which it has had no previous experience.

First Period

As a corollary of these schemes, the advances to the State having been arrested at their present figure, all legal limits on the maximum figure of the circulation should be repealed. Such a limit "presents in fact serious inconvenience to commercial activity, and can hinder the Bank of France in its purchases of gold and foreign exchange, necessary to strengthen its reserve." In other words, the dangerous consequences of a sudden expansion of the repatriation or import of funds from abroad seem to be overlooked in the report. But, after all, possibly they were merely omitted to avoid encumbering the report with details of Bank operation which can be met as they arise.

Second Period

The final rate having been determined, the Bank goes on to the gold exchange standard, or modified gold standard. From this point "a return to internal convertibility could be quite rapidly effected. It would be possible to take precautions against possible embarrassments arising from this return by deciding that gold convertibility should only be provided at the head office of the Bank. We may say here that an early return to internal convertibility for the banknote is, in our opinion, without practical importance; but its demonstrated possibility could have a considerable effect in restoring confidence in the banknote."

Third Period

Legal devaluation and issue of a new unit. Personally, I fail to see how a gold coin could have been put into circulation in advance of a legal determination of its value, weight, etc. But that again is a detail.

The report concludes with a warning that stabilization will be followed by an industrial crisis, but very forcibly argues that the hardships of stabilization now will be much lighter than the ruin which will follow postponement of action, and a further fall in the franc. In conclusion, the report gives some specific recommendations on measures to be adopted by industry and the State to facilitate and shorten the passage through the crisis.

General Observations

While I have tried to approach this report in a critical spirit, this is not the result of ill-will, but simply from a desire to analyse and explore certain of its provisions. All things considered, it is a remarkable document, and provides the Government and the people with a program of thoroughgoing reform. Some of the details are far from clear, and it is of course obvious that the success of the program as a whole or of any of the parts in detail will depend upon the honesty, courage and technical skill of those charged with their execution. This would be true of any program.

The presentation of the report is not wholly successful. It bears some evidences of having been hurried to a conclusion, without sufficient time being given for its editing. Many of the chapters, such as that on the Treasury, resemble detached memoranda placed in sequence, but not tied together. In others, such as the comments on the Budget and on taxation, the same thing appears; certain means are elaborated in considerable detail without any clear statement of the specific end desired. Such shortcomings can be viewed as the result of pressure and haste; or the whole thing can be regarded as a series of brief memoranda on particular topics designed to assist the Government in formulating policies.

In general, I find in this report a confirmation of my views that the problem of the Budget is simple, that of the Treasury a little more difficult but not especially troublesome, and that of readjusting industry very hard.

As for the Budget, the Committee finds that it is at present only a little out of balance. It proposes shifting the burden of taxation somewhat; but its main new resource is the railroads - a page obviously taken from the Dawes scheme.

As for the Treasury, it offers two proposals - to restore confidence by a strong declaration against schemes like forced conversions, etc; and to keep the floating debt afloat by paying the market rate.

But when it comes to industry, it seems to me I find a somewhat divided purpose. There is full realization that stabilization will automatically react against those numerous industries that have profited by inflation; or whose books seem to indicate they have been; that there are still large readjustments of prices and wages to be made; but there is certainly in this report, on every page and permeating every paragraph, the fixed idea that the chief medicine for the malady will be lots of currency - currency of stable value, the new issue to be heavily covered by gold or foreign exchange, but still available in abundance. As commerce requires funds to tide it over the difficult time, the Caisse de Gestion is prepared to put 4 billion of currency into the circulation; although the advances to the State are nominally to be arrested at the present figure, the Treasury is actually authorized to borrow 4 billion above the figure of the end of June, itself the highest in history, direct from the Bank, in addition to 5 billion from the money market. Further special inducements are to be offered to attract French capital from abroad into the coffers of the Bank of France, and against these sums, whether sold to the Bank or deposited with it, currency is to be issued. In short, the most precise part of the program is the recommendation that no obstacle be put in the way of expanding the currency, so long as the new issues are covered by gold or foreign bills, while of course the usual discounting privileges will remain open. In short, while there is reference to the fact that the French money rate must be high enough to attract funds from abroad, and the rate on Treasury paper as high as the market rate (which under the circumstances would mean that the rate on this paper would still be in the close vicinity of the Bank rate), there is not a line in the report that suggests a policy of deflation.

This is, I think, the most important fact about the report. It is clearly foreseen that the ending of inflation will itself cause an industrial and commercial crisis, and it is intended, in my opinion, to moderate this crisis by a very large expansion of currency and credit, not issued against the command of the State, but at the demand of industry, and amply covered by gold or its equivalent. In the meantime, the exchanges are to be kept in order

(1) By foreign credits, etc.

(2) By an assumed favorable balance of payments, once the flight of capital is arrested

(3) By the return of French capital.

Now is there not a very grave danger that this would pile a gold inflation on top of a paper inflation? I am not sure that it would; but I raise the question. It is true that the United States has been able to absorb in the last few years an inflow of reserve gold far in excess of any imaginable inflow of gold (or devisen) into France; and it has done so without inflation. But it must be remembered that this inflow with us came after a period of severe deflation, and was met by a central bank enjoying powers of handling its money market with a high degree of flexibility, not to say ingenuity. But a similar flow of gold (or its equivalent) into France would find industry highly inflated, and a bank of limited powers and very inflexible methods, unless the Caisse de Gestion develops extraordinary facility in substituting for a central bank. In short, would it not be a parallel case to imagine what would have happened in and after November 1919, if the advance in the New York Bank rate had been immediately followed by an inflow of gold such as occurred in 1922 and 1923, and perhaps on a scale proportionately larger? I do not know what would have happened; and, anyway, to some extent the parallel is vitiated by the changed conditions in the world in general.

It is not my wish to be too captious about this report. They cannot do better than to follow it, and meet the problems which it may cause as they arise. But some of its provisions raise questions, like those of any other program; and the biggest question of all is this one of stabilization without deflation. It is of course easier for France to face this crisis, armed as she is with her own expatriated capital and with almost a whole world willing and able to help, and with the experience of other countries to help and guide, than it would have been for her two or three years ago, and than it has been for Germany or Poland. But I must say that I should feel easier at the prospect, if the Central Bank had the machinery to moderate and regulate the process. But it has little except its discount rate to retard the market with, while it is forced by the present law and by the proposals of the Committee to grant credit to the market in great quantities. A discount rate is a useful engine; a steam shovel is a useful engine, but it is not suitable for the daily chores about the garden.

As I have said, the proposed Caisse de Gestion exercises or can exercise some of the open market policies of a central bank - that is, it can put money into the market at will; granted the will and the skill, it could reverse and take a certain amount out of the market. But nothing in the report indicates that this latter policy is intended. The whole report is oriented in the direction of putting more currency into the market, if this should be desired, and absolutely nothing is provided for taking money out of the market. And with so many facilities for pumping money into the market, I fail to see how the discount rate can be trusted, should circumstances indicate that strong-arm methods were needed. Of course, they may not be.

It is a little absurd to wonder what the public thinks of the report. Only four Parisian papers published it: "L'Information Financiere", "La Journee Industrielle"

"Le Temps" and the "Journal des Debats". The abstract officially issued is very incomplete, and that is all most people have seen, let alone read.

As I telegraphed, not one of the dailies has come out flatly for the program. The warmest endorsement (about 42° Fahrenheit) was that of "L'Information", which commended it for the earnest consideration of the Chamber; and tonight its financial page came out with a savage slur to the effect that the Committee had stupidly outlined a program which at best could only plunge the country into years of misery, by seeking stabilization through depression instead of following the example of Roumania and seeking it through prosperity. As I am not familiar with the Roumanian program, I am unable to appreciate this remark. The "Temps", on the other hand, is horrified at the idea of the franc being devalued, instead of carried gradually and easily back to par; this is repudiation, bankruptcy, etc. Other papers are opposed to the tax program, others to the abolition of the 8-hour day, others merely point out inconsistencies of detail or style. "L'Information" attacks it because it is deflationary and the "Temps" because it is inflationary. I have not read one newspaper comment which sounded as if the writer had read the whole report through carefully from start to finish. In fact, it is pretty fairly dull reading compared to the usual provender of the Parisian press.

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<u>MEMORANDUM</u> BY R.B. WARREN Paris, July 4, 1926.

The evening papers published the text of the Report of the Committee, but evidently it was received too late for comment. In fact, I think most of the evening papers had only a brief summary. I have been going through it hurriedly this evening, noting some of the interesting points, and possibly putting a wrong interpretation on some of the features.

As far as I have gone, I am unable to make any conclusion on the Budget and tax parts, as they are based on annexes to the report which have not yet appeared. I would particularly invite your attention to the paragraphs dealing with the "Caisse de Gestion" of the Bons de la Defense Nationale, as this introduces a new element of first importance into the Paris money market. The character of this element, it seems to me will be even more political than the present organization of the Banque de France, and the Caisse <u>may</u> become an even more powerful influence in the market than the Bank. I do not, of course, wish to imply that this power would be used improperly; but merely to remark that here is a new engine, and one which, it appears, could be the dominant factor in the market. I would further invite attention to the provision for expanding the State's borrowing power at the Bank, and to the fact that the first $200,000,000 of foreign money is to be given to the Bank of France for the purpose of permitting a <u>potential</u> increase of 8 billion in the circulation, tobe covered up to about 7/8 by gold or foreign exchange. At the same time, it should be noted that the interest rates on the present Bons de la Defense Nationale and on the proposed new issue of 5 billion new type Treasury Bill are to be flexible and free to follow the market.

As for an opinion on the report as a whole, I shall reserve judgment until I have had time to go through it more thoroughly. Some of the rather obscure proposals may be clarified by the comments in the press tomorrow morning.

After all, they came out flatly for the ratification of the debts. But now that our Senate has gone home, and with a good part of the Chamber committed to ratification only with amendments or reservations, I wonder what would happen if the Ministry should try to buy support for the program at the price of some reservations.

And now that the program is out, the keystone and corner stone and cap stone of the whole structure is the simple advice to pay the market price for money.

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MEMORANDUM BY R. B. WARREN Paris, July 5, 1926.

RECEPTION OF EXPERTS' PLAN
BY PARIS PRESS

I have taken all the important Paris dailies except the Communist "Humanite" and the Left Socialist "Oeuvre". Only one, "Le Temps", published the report verbatim; most of the others published the official abstract, of which I am sending the clipping. This abstract, as you will note, is sketchy, and omits all technical details. No paper has yet published any editorial comment, except the "Quotidien", which naturally limited itself to an attack on the proposals to reduce direct taxation.

Reduced to its simplest terms, the Report presents the following salient features

(1) Abandonment of idea of Franc's return to parity. Gradual stabilization at an unindicated figure somewhat above the present level.

(2) Debt settlement

(3) Foreign loans of $200,000,000 of which

 (a) $100,000,000 is evidently to meet the deficits of the current budget through issue of more currency

 (b) $100,000,000 to be applied if necessary to the redemption of the floating debt in currency

(4) Domestic borrowing authorized through issue of new type of Treasury Bill up to 5 billion francs

(5) Provision that Treasury shall pay market rate on short-time loans

(6) Creation of a new agency, the "Caisse de Gestion" which in its operations will assume some of the powers usually exercized by a central bank in its open market operations - this agency to be under the joint control of the Treasury and the Bank

(7) A shift in the incidence of taxation from direct to indirect taxation, with chief reliance upon additional taxes to be derived from the railroads, following a small increase in rates .

Of all these provisions, the most significant is of course No. 5; and in view of the source of this provision, it was most appropriate that the report should be issued on July 4th. But the effective use of the money market depends upon the will of the Treasury, just as it has during the past 12 years. If the Treasury had wished to use interest rates as an engine of stabilization it could have done so long ago. If it wishes to now, it can do so without the slightest necessity of foreign credits. So far as I can see the proposed use to be made of foreign credits is to permit an elastic expansion of the currency, against cover, which will serve as a cushion against the shock of stabilization. In the meantime, the indefiniteness of the program, particularly upon the time and level of stabilization, will open the door to lengthy debates. The vague suggestion that the level of stabilization ought to be rather higher than the present rate of exchange is perhaps designed to facilitate the scheme by encouraging bullish speculation in francs, but in view of the uncertainties to which this will give rise, it can hardly make the situation easier for business concerns which are under the necessity of making long-time contracts and who have no desire to speculate in the exchange. On the other hand, it must be admitted that as neither wages nor the cost of living have advanced to the level of the exchange, a higher rate than the present one of 180 is certainly academically defensible. Whether or not it is economically desirable would be a matter requiring elaborate study, and this the Committee has not ventured to make.

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Paris, July 5, 1926.

Dear Mr. Governor:

Your telegram was received late this afternoon. As Mr. Jay has been in close contact with M. Rist, who, through him, had already asked for an appointment with you, Mr. Jay went with me.

Dr. Rist was greatly pleased to be brought into contact, and inquired if you could come to Paris. I said that was out of the question, both for reasons of health and of publicity. I suggested that either he or M. Moreau should come South, perhaps to Monte Carlo or anywhere they might choose. To my surprise, M. Rist said that much as they should like to, such a meeting was out of the question until the status here was more clearly defined. Not only is the attitude of the Chamber to the program uncertain, but even that of the Regents of the Bank. Mr. Jay explained your reasons for avoiding publicity, especially emphasizing the possibility of unfavorable political agitation at home. M. Rist fully appreciates this position, and he cited the maneuvre of M. Tardieu as an example of the same sort of habit of political suspicion. When the air is cleared, and when the Bank is able to feel sure that it can move forward on firm ground, then they will be glad to undertake conversations; until then, there is no basis of discussion.

This conversation brought out three impressions:

(1) The new administration in the Bank takes the program very seriously and is evidently prepared to stand on it or fall with it. They mean business.

(2) The new administration of the Bank is quite uncertain of the political fate of the Ministry and of the program; and also, as yet, of the attitude of the Regents toward the new regime.

(3) M. Moreau and Rist are fully conscious of the dangers of publicity.

In conclusion I asked him to present your compliments to M. Moreau. By the way, I approached M. Rist instead of M. Moreau for three reasons: (1) he had personally asked to meet you through Mr. Jay; (2) he has represented the Bank in a recent conversation with Mr. Jay concerning a subject mentioned in your memorandum to the latter; (3) because, as I had met him in Washington, it made the first contact a little less formal.

Very respectfully,

(sgd) Robert Warren.

Hotel du Cap d'Antibes,
Antibes, July 8, 1926.

Dear Garrard:

I am just sending to George Harrison a letter, the enclosed copy of which explains itself. It is inspired by the receipt yesterday of yours of June 22nd.

Your comments about the Bank are of course justified. The indications seem to be that an important change is taking place, but that it will not be productive until the status of the Bank with the Treasury is better established and especially until the relations between the new Management and the Regents have become more settled. I feared dissent there, as we both realized when we were in Paris.

Since your letter was written, our friend Peabody has come out with another blast, which has been widely quoted over here, and as you say, that never helps. I agree with you that we would be inviting trouble to arrange a credit with the Bank of France until they ratify the debt agreement. It would have the appearance of buying ratification, which in fact it might be, and it certainly would be interpreted by our Senate as in some ways tying their hands. If, however, the French ratify the debt agreement, adopt a sound and complete program, and proceed with stabilization, I should hardly think the argument would hold good. Our Senate would still be free to accept or reject the agreement and the risk, if it was a risk, would all be assumed by the French and by the American bankers. But the outlook at the moment is not particularly hopeful anyway.

I am very glad that you and Harrison had the meeting with the Board. Harrison wrote me all about it, and I since hear that the Indian matter has been cleaned up with your good aid. Norman has just heard from London that the

Commission has submitted a report in India, but the terms of it are not known. You certainly handled it in fine shape.

It may not be a bad idea to let some of those Senators from the West get an inkling of what we have been doing in regard to the Indian silver proposal, but they should not use it publicly. I am sure it would still cause trouble. I recognize the touch of irony in what you write.

Bill Phillips has just arrived and tells me that Miller spent a couple of days with him in Berlin and announced that he was proposing to say to Francqui that he was in Brussels for the purpose of studying the monetary situation and the question of stabilization, etc. Phillips pointed out that that was about the worst possible statement he could make in explanation of his presence, as they would then have him on the job in a day or two with applications for credits and have him advertised as visiting Brussels for purposes of stabilization, etc. It apparently scared him a bit, and he was approaching a dinner that Francqui was giving for him to meet all the bankers with a good deal of uneasiness. I shall hear pretty soon what happened. He is expecting to go from Brussels to Amsterdam to see Vissering, who is away just now, and then to Berlin to see Schacht, who is away and will not return until the end of July; then I believe he is going to Hamburg, probably to visit Max Warburg.

This is all the news at the moment. I will write you again if anything new develops.

Sincerely yours,

Hon. Garrard B. Winston,
Under Secretary of the Treasury,
Washington, D. C.

BS:M

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Paris, July 7, 1926.

Dear Mr. Governor:

In view of its importance, I wish to translate that part of M. Caillaux's speech of July 6th relating to the debts.

After a statement of amounts due, he said:

"There is the situation. It is clear. I said we could not extract ourselves from this mass of charges except on the condition of obtaining credit, which hitherto has been granted to us from abroad, but which today depends in large measure, if not entirely, upon the settlement of our political debts.

"The Government, gentlemen, intends to present this problem as a whole to your sovereign judgment.

"At the moment, I have resumed negotiations with England. They are going forward. Although, as you understand, the fact that I am in the course of negotiations obliges me to observe special caution in my speech, it would not be candid to hide from you that the ratification of the agreements (des accords) - with the ameliorations which we shall hope to secure for them or with the assurances of which certain have already been obtained by us - appears to us indispensible."

Then followed certain remarks on debts in general and the British debt in particular, concluding:

"Such, gentlemen, are the general observations on the subject, to which I wish to limit myself, the Committees having in hand one project and the Government having stated that it intended to ask the Chamber to approach the discussion of the settlements only in their entirety.

"Having said this much, without pledging myself to anything, for there are now negotiations in progress, I do not push the subject further."

As you will note, there is no direct reference to the American debt apart from the British. As you will see, the references to the amendments run gramatically only back to the "negotiations" of the British debt, but the implication certainly extends to the American debt. The phrasing, I am sure, is intentionally vague, but I am afraid of it. On the other hand, it is, I think, absolutely essential here, as I have repeatedly written, to the continuance of the Ministry.

(sgd) R. B. Warren.

Paris, July 7, 1926.

Dear Mr. Governor:

The accompanying comment of the London "Times" correspondent received this evening confirms my letter and telegram sent this morning, but it hardly does justice to the shrewd and tactful approach of M. Caillaux to the Chamber. I assure you that if M. Briand and Caillaux had come out flatly for the Experts' program, the Cabinet would have fallen yesterday. There was not the slightest evidence that the Experts' program had aroused any real popular support - I almost said "interest", but there was interested opposition. As I have repeatedly remarked in these communications, too many people are enjoying the drunk, and while they are willing to pay lip service to "stabilization", they and their representatives shudder at the consequences.

My letter of this afternoon translated the equivocal paragraph about the "reservations" on the debts. It was the best he could do - he had to mention them, and he had to imply that he could or might or had secured modifications. Grammatically, his statement is or may be literally correct; but if the U. S. Senate were in session, the fat would be in the fire. Still, as I wrote the other day, the majority - almost the whole Chamber - is hostile to the debt settlement, and it is at least doubtful if M. Caillaux can get a majority even by receiving or suggesting that he has received or will receive more favorable terms. But it was becuase I fear that these and other necessary ambiguous remarks about reservations, uttered in a desperate attempt to obtain a working majority, will have the unfavorable effects in America, that I strongly urge that no further conversations with the Bank of France be held until the situation here and the position of the Administration on the debts is clearer.

Because I feared something like this, my first reaction upon receiving your instructions to visit the Bank was to delay over Tuesday, to see how M. Caillaux would fare. However, nothing was said in that conversation which would not bear repetition before the most antagonistic Congressional Committee that could be called. My first remark to M. Rist was to express my pleasure at being able to renew in Paris an acquaintance begun in Washington, etc. Of course, this remark of M. Caillaux's may pass entirely unnoticed at home. But I am sure that in the course of the debates there is at least an even possibility that M. Caillaux may be forced to take the alternative of coming out flatly for acceptance of the agreements with reservations or of facing an adverse vote. The only possibility of his being able to secure a vote for the acceptance of the agreements as they now stand, would be by frightening the Chamber at the possibilities that lie in refusal - and the Chamber does not see it that way.

For that reason, in view of the eventualities that may turn up in this debate, please permit me to suggest that no further steps be taken toward conversations, until the attitude of the Ministry and the Chamber on the debts is clearer; and until/unless it is also clear that the French attitude, whatever it may prove to be, is acceptable to the American government. So far, nothing has been done which can cause the slightest embarrassment, no matter what the outcome of the debt negotiations.

You will recall that I wrote at the formation of the Committee that its weakness lay not in its capacity nor courage, but in its salesmanship. It has failed absolutely in "selling" its program to the country. M. Caillaux's first paragraph prudently jettisoned the report except "in principle", but he is engaged in trying to sell the principles of the report, which are the principles of sound money, to a Chamber heavily charged with what the correspondence schools call "sales resistance" In doing so, he may find it necessary to resort to some extraordinary "selling talk" of one kind or another.

(sgd) R. B. Warren.

Hotel du Cap d'Antibes,
Antibes, July 8, 1926.

Dear Mr. Harrison:

The situation in Paris is just now one of great uncertainty. Following the receipt of your cable from Washington, I telegraphed Warren as per copy enclosed, to which I received replies as per copies of his telegram and letter enclosed. I am sending them as it will give you the best information I have at the moment.

Judging from Warren's reports, from the newspaper accounts, and from what I have heard from a Baron La Grange who is here and seems to be pretty well posted, the fate of the Experts' report, of Caillaux's plans and indeed of the present Government is today hanging by an eye-lash. The opposition seems to center about three main points: as to the Socialists, indirect taxes rather than direct taxes; or a capital levy; as to various elements in the Chamber, ratification of the Washington debt agreement; and also as to a mixed group, as to further foreign loans.

There are some obvious defects in the program which I shall not elaborate in a letter just now, because within another 48 hours or so the whole program may be scrapped anyway. If the present Government falls and the present opportunity for stabilization is lost, the outlook will be dark indeed for a time. Various hints appear that one of the difficulties is the suggestion whispered about the Chamber that Caillaux contemplates a "coup d'Etat" and that the appointment of his old friend and intimate, Gen. Guillaumat, as Minister of War was no less than preparation for just such a step. The abandonment of constitutional forms in France, following their suspension in Italy, would be a singularly significant development these days, and I think a good many people are commenting on the fact that our

Ambassador at Berlin in his Fourth of July speech seemed to go out of his way to reconcile dictatorships with modern theories of government.

In view of all the circumstances, I shall wait here in the hope of getting word that Mr. Mellon will be in Paris around the 21st, and then go from here to Paris, probably on my way to Berlin. But I shall not start until I feel certain that I am not going to get knocked out again.

Whitmarsh drove up from Monte Carlo yesterday and I had a pleasant hour with him, but his news from home was of course over a month old.

My best to all at the Bank.

Sincerely yours,

Mr. G. L. Harrison,
c/o Federal Reserve Bank of New York,
New York.

BS;M

Paris, July 8, 1926.

Dear Mr. Governor:

Let me make, first, one general remark on the Experts' report. You will remember that in my other comments I said that its outstanding feature was that it provided every facility for expanding the circulation, and no facilities for contracting it at any point of the process, should need for contraction arise. This remark was qualified by the belief which I expressed that, given the will and the skill, the Caisse de Gestion could devise means of moderate contraction, although such means were not suggested nor even implied in the report. The reasons, of course, as I see them for the position of the Experts was (a) that such currency expansion was indicated as interior prices and wages advanced to meet the level of the exchange and (b) that this would act as a cushion during the period of readjustment and previous stabilization from becoming deflation.

It has just occurred to me that this part of the report has a familiar ring. It is in fact the very program which J. M. Keynes formulated for France about a year ago and published, I think, in the "Nation" and "Atheneum". He expressed it then, as I recall it, about as follows: that the exchange should be pegged at the market rate of a given test day. That as internal prices were below the world level (that is, that the rate of exchange was below the purchasing power parity) the stabilization of the exchange would be followed by a rise in prices and a demand for currency which could be used by the State to pay off part of the floating debt, and to ease the process. That is, since the exchange would be stabilized at or near the market rate, and since this level would be below the purchasing power parity, the operation would of necessity require a further depreciation of the internal value of the currency (its external value being fixed) measured by the extent of the rise in prices which would reduce the purchasing power parity to the level of the exchange; and that the Government could turn this depreciation to its account.

Without giving any credit to the author of the scheme, the Experts appropriated it with some modification of detail.

Mr. Keynes proposed, of course, to peg the exchange by the use of the Bank's gold; the Experts proposed to do it by foreign credits. Mr. Keynes proposed to employ the increase in currency in reducing the floating debt; the Experts proposed to employ about half in reducing the floating debt and about half in meeting deficits# in the current expenditures of this year. Under the Keynes scheme, the gold reserve would diminish as the circulation increased, with a consequent drop in the reserve ratio. Under the Experts' plan the gold reserve would increase as the currency expanded - but it (the reserve) would be increased by foreign credits. Personally, I consider Mr. Keynes' proposal as honest and frank, and perilous in the extreme; the Experts' variant was designed to prevent a shock to public confidence, as the public would see the reserve rising and forget what made it rise. But with all that, there were valid objections to the program's proposal to increase the circulation by borrowing abroad, instead of coming out flatly for a hard-boiled interest policy which would have moderated rather than facilitated the inevitable expansion of the currency, and have obliged the market to repatriate (or to borrow abroad) the devisen which, sold to the Bank, would have permitted the necessary and gradual expansion of the circulation to the required level.

But, essentially, the theory underlying the Experts' program was Mr. Keynes', and once again, as I have so often said, it represents the search for the magic formula, the philosopher's stone, which would enable France to achieve the benefits

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(#) It is unfortunately true and what is worse is even becoming obvious, that the Experts' presentation of the Treasury position for the current year was grossly uncandid. At the very beginning of his speech Tuesday, M. Caillaux was obliged to give a clear statement of the Treasury position, and it came as an honest to goodness shock to the Chamber.

of a return to sound money without paying such a price as every other country has had to pay in proportion, so to speak, to the bill which it had run up during its period of inflation.

Yesterday the Government was asked for a flat "Yes" or "No", whether it wished to go on record as sponsoring the program. The answer was equivocal and evasive, and the question, I think, will be pressed again. But whatever the answer, the fact remains that the program as a program is dead as a door-nail; although M. Caillaux is trying desperately to save its essential, basic principles.

Since Monday morning, it has b een evident that the Experts' report had few friends, and those luke-warm; that it had many enemies and those violent. M. Caillaux probably realized it Tuesday, but perhaps he could not estimate the position completely. At any rate, he did the best he could with it - endorsed it in spots, tried to interpret others to make them more acceptable to the Chamber. But it is no use trying to make that report palatable. I honestly think the position of the Ministry with the Chamber would have been stronger if M. Caillaux had mounted the Tribune Tuesday afternoon with the report in his hand and, before he said a word of his speech, had torn the report in two and flung the pieces in the waste basket.

You remember the sign they used to hang up over the piano in California dance halls in '49: "Don't shoot the professor; he is doing his best."

(sgd) R. B. Warren.

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MEMORANDUM BY R. B. WARREN Paris, July 9, 1926.

DEVELOPMENTS OF JULY 7 AND 8

The violent decline of the franc to 194 yesterday does not seem attributable so much to political developments in France as to the combined influences of weakness in Belgian and Italian rates and a bad Bank statement.

The Bank Return

The combined note and deposit liabilities increased by almost an even 1 billion over the previous week, which brings the total increase since June 17 to just under 2,500,000,000. Of this, about 400,000,000 only is due to increased discounts, about 1,300,000,000 to advances to the State. The remainder, 800 million, is found chiefly through "adjustments" of the divers, possibly through the inclusion of the proceeds of the Morgan loan. I am convinced that it is the recent rapid inflation of the currency on Government account that has enabled the market to avoid heavy discounting at the Bank, such as might have otherwise been anticipated from the strong price rise now obviously in progress.

The Stock Market

The boom in stocks, which up to about a week ago was almost strictly confined to sterling values, now has taken in domestic securities as well, and since Monday these have been climbing in a manner astonishing to one habituated to the modest fluctuations of our stock exchange. The principal reason is undoubtedly the proposals of tax reduction, which is one of the few parts of the Experts' report specifically endorsed by the Government. A second reason is that under current systems of bookkeeping, industrial companies are undoubtedly showing fabulous profits for the first half of the year, and in all probability tax reduction would be followed by a wave of extra dividends. Financial papers, of course, have not failed to comment upon the anomoly of a stock market boom accelerating in the teeth of the precise and unmistakable warnings of the report. This is not so surprising after all: few people have read the report, and almost everyone is sure, as I have repeatedly stated, that a way will be found - a magic formula - to avoid such dire consequences. The third reason, of course, is the recent inflation, which has increased the means of payment far beyond the immediate needs of commerce and industry, and which is now finding its outlet in security speculation.

I dare say that there is also some tendency to commodity speculation. If the franc declines further, commodity prices will rise further; on the other hand, the Experts' report also indicated that even if the franc is stabilized, a further substantial rise in commodity prices is to be expected, and the program specifically devises means by which this price rise is to be facilitated "to accommodate commerce and industry", so to speak. So altogether it is not surprising that the prices of industrial securities are soaring.

Politics

After M. Caillaux's masterly and conciliating speech of Tuesday, the attack developed in two columns, one from the Right flank and one from the Left.

The attack from the right was commanded by Louis Marin and Franklin-Bouillon, both of whom concentrated on the Washington settlement. It was most significant that it was not against debt settlement itself, but was confined to insistence on certain reservations. It was met by the Government exactly as the German army met the threatened British offensive on the Somme in April, 1917 - by a strategic retreat. The Government holds out vague assurances of "amelioration" secured or expected and has more or less cut the ground from under both Marin and Franklin-Bouillon. This has enormously strengthened its hold upon the right of the Chamber.

The attack from the left, developed by Leon Blum, was met by a vigorous counter-offensive. M. Blum concentrated upon the Experts' plan of stabilization at a level which would involve a rise in domestic prices. The program, he said, "oozes inflation at every page"; he advocated deflation by means of a capital levy. M. Caillaux met him precisely on his own ground. In the first place, M. Caillaux has not committed himself to this part of the report, so he was able to hold out prospects of a rise in the exchange which would prevent a rise in prices; second, he demonstrated pretty clearly that a capital levy of the type advocated by M. Blum would itself involve inflation. This part was very well done, and certainly won much support on the right. He replied to M. Blum's charge that the Experts' program "oozed inflation" by the rejoinder that M. Blum's plan "reeked with inflation". And he proved it, I think. But this part of the debate was of the utmost significance, for both the Government and the Socialists were most outspoken in their condemnation of inflation.

Tuesday, the battle was very much of a draw. Caillaux' speech provoked no enthusiasm whatever, and the best thing that could be said was that he had survived. This in itself was a victory on points; for one false move Tuesday and the Ministry might have gone by the board.

Wednesday, if anything, started the other way. The attacks on the debt settlements were almost unanimously applauded, while the vague references to "ameliorations" were not received with much conviction. On the other hand, M. Blum's speech on the capital levy drove again the wedge between the right and left of the Chamber; and I think tended to counteract the unanimity developed around the debt settlements So at the end of the day, the position of the Government was better than it had been 24 hours earlier.

Thursday, as I have described, was very much Caillaux's round. He very largely took the wind out of the Marin-Bouillon group; and his rebuttal of M. Blum, while making perfectly clear his position on the capital levy, was so courteous and fair and able, that it convinced everyone except the doctrinaire Socialists. One of the most important points made by M. Caillaux on the debts was that he wished to disassociate debts and credits. He said: "This consideration leads me to declare that we do not intend to create any relation whatever between the opening of credits and the settlement of our debts; this attitude would be unworthy of our great country". If I am not mistaken, this is the first time that the question has been lifted to this plane in the course of the discussions in the Chamber.

So altogether, I think the sky is a little clearer. But if it does clear, and if a program is presented and accepted and inaugurated by the Government, it will, in my opinion, be a fundamental mistake to credit it to any great awakening of public sentiment or any particular change of heart in the public or in industry or the Chamber. There may have been - probably has been - a good deal. But mostly it will be due to the political adroitness of M. Caillaux himself. For the other view, it seems to me personally, there is little evidence.

Another thing. No program has yet been presented by the Government. When one is presented, it may follow the report or it may not. But the Government has specifically declared that it will not follow it "servilely".

MEMORANDUM BY R. B. WARREN   Paris, July 9, 1926.

In considering the exact status of affairs, it is necessary to consider that the American papers here give a very erroneous view of what is happening, and none of the papers a very clear or comprehensive view.

Specifically, the situation is as follows:

(1) Sunday night a Committee chosen by a defunct Ministry presented a report which had been virtually completed when the present Ministry took office. The Committee was composed of men of high qualifications, but without any popular following. The Committee left its offspring on the doorstep of the Ministry and vanished. It made not the slightest attempt to sell itself to the public. The Ministry which inherited this Committee itself includes a considerable number of men whose reputations in finance are equal to if not superior to those of most of the members of the Committee.

(2) Monday. The report or its summary was ready by the public and the Chamber. It was received with varying degrees of faint praise, qualified approbation, antagonism and apathy. It found support, if anywhere, only in a small, but of course important financial milieu.

(3) Tuesday. The new Ministry presented itself before the Chamber. In a very capable and comprehensive speech the Ministerial spokesman introduced the report with the remark that he was inclined to consider the plan with some favor because most of its elements had been frequently presented to the public by himself and his colleagues in speeches and articles, but that he had no intention of following it "servilely". In the course of a two-hour speech, he made numerous references to details of the report, some commendatory, others critical.

In this speech he outlined a fiscal program, part of which similar to elements of the report; but at no point in the elaboration of this program was any reference made directly to the report. It was presented as hiw own; and consisted of 4 points, to be elaborated later:

(a) Increase of wages in civil service

(b) Establishment of a correlation between revenues influenced by rising prices and expenditures subject to the same influence (indirect taxes)

(c) Reduction of certain direct taxes

(d) Simplification of the fiscal system.

There was an exposé (very guarded) of the debt situation, referring it to a later time, and warnings regarding inaction. He then referred to the dangers of foreign control of industry through credits, and disclosed the Treasury position as being much worse than in the report. The reference to the foreign credits was interpreted as a rebuke to the Committee in some quarters; the disclosure of the Treasury position certainly reflected on the candor of the Committee, or its penetration. He then, after some references to negotiations with England, said that the Government would ask for "delegation" of powers in a text of law to be presented.

From this time on the session was frequently interrupted and the reference to stabilization was not very precise nor coherent.

(4) Wednesday: Debate by opposition.

(5) Thursday: Rebuttal by M. Caillaux. These two days were outlined in my letter of this morning.

(6) Friday: The Government will present its bill for a delegation of powers and ask a vote.

The dope at noon (according to "L'Information") was that if Caillaux could have the support of the Marin group on the right and of the Radical Socialists, both of whom are committed to no ratification without safeguards, he would get about 280 votes. This is, of course, a minority, but it is regarded as safe because it is expected that many of the others will abstain from voting.

Now the situation leaves itself this way:

(1) If M. Caillaux remains in office, it will be at the price of an

understanding with certain of the Chamber groups regarding amendments to the debt settlements. The terms of the bargain may or may not be public.

(2) If he obtains his delegation of authority, it will be either by the vote of an actual minority of the Chamber, or of a slender majority.

(3) No general program has yet been enunciated by the Ministry. While its program, if permitted, is likely to have a relation to the plan of the Committee, it will be presented as the Ministry's program and may differ widely in essential details from the plan of the Committee.

My personal opinions on the Experts' report are mixed, but may be summarized as follows: As far as the relations between the Ministry and the Chamber are concerned, its existence has been a source of embarrassment rather than assistance. If the Ministry lives, in its relations with the public, the report is likely to be an educative factor of considerable help, as whatever program is adopted gets under way. You will recall that the first Cunliffe report was ignored by the "Economist" and excoriated by the "Statist", and neglected, it appeared to me, by the Government for nearly a full year. Yet it became almost a part of the Constitution.

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Hotel du Cap d'Antibes,
Antibes, July 16, 1926.

Dear Mr. Harrison:

I am so sorry that you had all the trouble of writing me out your longhand letter of July 6th, but I was equally glad to get it and would reciprocate in kind except that I am doing mighty few hand-picked letters.

Your letter covers the whole ground eminently satisfactorily, but it does justify my saying that Mr. Jay's letters to me were equally unsatisfactory. They really told me nothing, except what he and the Directors proposed not to do. I know that you and he sometimes think that I am too downright in my approach to a good many things, but after a good many years experience in human affairs, I have found that in the end, that is the best method.

I shall now have a nice talk with Mr. Mellon and will see where we get. Of course I will write you just what happens, but in any event, it will not be possible for me to show proper regard for my associates and for the Directors unless I withhold a final decision on my own program until I get home. This I think you should tell Mr. Jay, because it would certainly be an impropriety of the first order for me to do otherwise.

You will be interested to know that Bill Phillips yesterday showed me a letter he had received from Adolph Miller describing his dinner party in Brussels, which took place after Phillips had left. Francqui, who I hear is a very sick man, was in fact taken ill the day of the dinner, so was not there. Miller's talk, apparently, was principally with Cattier and with Houtard, the Finance Minister. They must have pumped him pretty full of information about a forthcoming program of stabilization, concerning which he seemed to be rather enthusiastic. I wonder if he recalls those opening lines of Caesar's "Commentary", or if you do, in which

Caesar described the Belgians as the "worst of the bunch". They are a very difficult people, and seem to live in the clouds.

Phillips was so indignant, following the reading of our cables, that he went right to the Prime Minister on his return to Brussels from his first visit here and secured from him a categorical denial that the American bankers had demanded a "gage" for the loan, hanging his statement upon what he described as statements appearing in the foreign press. This, of course, was to let Vandervelde out, because it was Vandervelde who made that statement in the Belgian Parliament. It was a good thing for Phillips to do. I only wish he could have gotten at some other things also.

This will fill up the budget for today. Again, a thousand thanks for your letter, and especially for the spirit that led you to write it.

Sincerely yours,

Mr. G. L. Harrison,
c/o Yale Club,
Vanderbilt Avenue,
New York.

BS:M

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RECEIVED
JUL 29 1926
G. L. H.

FEDERAL RESERVE BANK

OF NEW YORK

Hotel du Cap d'Antibes,
Antibes, July 16, 1926.

Dear Mr. Harrison:

I am enclosing a collection of newspaper clippings and some translations which may amuse you, but the one to which I ask your particular attention is the "Riviera Silhouettes". This was written by Mr. Hanscom of the Associated Press, who chased me up to St. Paul, as you recall. He seems to be a very decent fellow and what he wrote is really helpful.

Sincerely yours,

B.S.

Clippings in library

Mr. G. L. Harrison,
c/o Federal Reserve Bank of New York,
New York.

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Hotel du Cap d'Antibes,
Antibes, July 16, 1926.

Dear Mr. Harrison:

This will be about Hungary.

You will recall that when Jeremiah Smith went to Hungary to represent the nations which were contributing to reconstruction under the plan of the Finance Section of the League of Nations, the British also sent a Mr. Siepmann to become technical adviser to the Hungarian National Bank. Their work has now been completed, as you know. Smith has gone home, and Siepmann has been here with us for the last few days, at Norman's request, as he has arranged to become a member of the staff of the Bank of England, where he takes up his duties shortly.

He has impressed me favorably, as I expected, and I have made this the opportunity to get what information I could about the Bank and affairs in Hungary. This is to report to you the substance of what he says.

As to the Bank's personnel, Dr. Alexander de Popovics, the head of the Bank, is one of the leading men of Hungary, a man of strong character and of the type who has made the Bank a good deal of a one man institution. He gets his office by appointment of the Director. The Director, Admiral Horthy, you will recall, is not the constitutional President. He occupies the anomalous position called "Director", but really Regent, not under the powers of the constitution of Hungary, but really under the tradition of that curious country, where for the time being he has been a sort of extra-legal dictator pending the selection of a monarch. He is a man of no very great ability but a great deal of tact, and has maintained his position partly because of the fact that there are five separate families which have claims to the throne of Hungary, and the selection of a candidate from any one would develop opposition from the other four to such an extent that the selection would be impossible.

It is of course unfortunate that the head of the Bank should be a political appointee, but it seems to be a necessity which cannot be escaped in that part of the world. There is an understanding, quite informal and unofficial, that if a successor to de Popovics must be found, he will be appointed by Horthy after consultation with the Directors of the Bank (by "Directors" I mean the official staff) and with the general approval of those who have been concerned with Hungarian reconstruction.

The Bank is departmentalized functionally very much as ours is and has four Directors each supervising a function. De Popovics has two Vice-Presidents, who are figure-heads, and the four Directors, plus the General Manager, Dr. Schober Bela, are the people who really run the Bank. The departments are roughly:

(1) Banking, which includes foreign exchange;

(2) Administration, that is, personnel and all the interior management;

(3) Accounting, similar to ours;

(4) Discount, which covers all loaning operations except the purchase of bills in foreign markets.

Strange to say, the Bank has no audit, but the system of accounting has been examined by two English firms of public accountants, who pronounced it in every respect first-class.

The Board also has twelve elected Directors, making thirteen with de Popovics, and these twelve Directors are divided into groups, four representing the land class, four being bankers, and four being business men. The Board is ineffective because of the apparent inability of these groups to coalesce, and de Popovics seems to take advantage of this to extend his dictation over the Bank to include the activities of the Board. But Siepmann seems to think it works very well and much better than if the Directors were more of an influence. The Bank has nothing to do with the domestic exchanges, strange to say, which are handled by an association of the banks, like our Clearing House, which conducts two clearances, one for the city of Budapest and the other for the rest of Hungary. This body also has certain legal powers, as it is incorporated; among others, the right of examination, which they exercise rather effectively, and in the case of any bank troubles, they do the nursing.

Interior exchange payments are made through the banks and not by the National Bank. The National Bank, however, is a large dealer in exchange, and with the exception of some railroad and other special funds, it is the sole depositary of the Government. Its portfolio of domestic bills consists entirely of the usual trade bills bearing two names, which largely come from private customers and smaller banks and bankers, as the large banks do not discount with them. The Commercial Bank, being the biggest bank in deposits, takes pride in the fact that it never has and never will melt its bills. A large part of the portfolio consists of bills, especially Treasury bills which are in London and some in New York.

The Bank has no power to make loans to the Government, nor even to buy Government securities in the market, which they claim is a great handicap. They can, however, buy Treasury bills of foreign governments.

While its capital is only 1½ million sterling, its earnings have been very large, and Siepmann tells me that they have written off every conceivable thing that can be written down, including buildings, etc., so that their reserves are in excellent condition.

The Government owes the Bank an old debt from pre-reconstruction days of about 5 million sterling, which is being reduced out of certain profits, and they claim that this will be reduced to about 2 million sterling at the end of ten years. Under the statute, whenever the Government's debt is no larger than the Bank's capital, the Bank must then resume gold payment.

A considerable proportion, probably half, of all the domestic bills come to the Bank through their 18 branch offices.

The Bank's earnings after meeting all expenses are appropriated, first, 10% to the Bank pension fund, which is now a large amount and will shortly be fully established on an actuarial basis, so that it will need but moderate appropriations; second, 5% to reserves; third, payment of an 8% dividend. The surplus beyond that amount is divided, 1/3 to an additional dividend and 2/3 to the Government, until the dividend gets up to 10%, when the ratio again changes so that in practice they estimate that the stockholders can never get more than 10½%. Under an arrangement with the Government by which the interest on the Government debt is re-adjusted from time to time, it works out that the stockholders are virtually guaranteed an 8% dividend.

The Bank is undoubtedly a large factor in the foreign exchange market, and it has a regular commercial foreign exchange business, except that it issues no letters of credit. It today has a disclosed reserve of about 8 million sterling, which includes gold and foreign balances which are shown in the statement. It has an undisclosed reserve of foreign balances of about 4 million sterling, and it has possible reserves of foreign exchange beyond that, consisting of the balances really owned by the Government, being the unexpended proceeds of the reconstruction loan of roughly 5 million sterling. Of this 5 million sterling, about 2 millions are appropriated for certain construction work, leaving ultimate foreign balance resources of the Government at about 3 million sterling, which may be used in the event of a heavy drain on the Bank's reserve by the Bank requiring the balances from the Government in exchange for Hungarian crowns.

Unfortunately, the banks of Hungary do not maintain reserve balances with the National Bank. They are not required to do so by law and prefer to adjust their reserve position largely in their foreign balances. The net effect of this is that the banks are not dependent upon the National Bank, and not being dependent upon the National Bank, the Bank has no position in the money market. While there is some market for bills in Budapest which are traded in between banks, the National Bank has no position in that market. Under these circumstances, if Hungary should sustain two successive years of bad crops, the Bank might need to ask for outside assistance. It seems that in the Spring the exchanges always run against the Bank and it takes between 2 and 3 million sterling of the Bank's foreign reserves to meet the drain. Then in the Fall, when the crops are exported, the balance turns the other way and the reserve is built up again. The drain on the reserve has heretofore been within the limits of the undisclosed reserve, but they have not had two successive years of bad crops since reconstruction. Two years of bad crops would exhaust the undisclosed reserve, draw down the Government's balance of valuta, and might require the Bank to dip into its published reserve. People in Hungary are so timid that the appearance of any great depletion of the reserve would cause exchange difficulties of the first order.

Siepmann tells me that they carry a very large amount, for them of American currency in their vaults, partly because there is a constant demand for it in Hungary, where it is regarded as the most stable of all currencies, but also because it is a very good barometer by which to judge of the state of public feeling about the currency. If any distrust arises, it is immediately shown in a demand for American currency.

In connection with general conditions in Poland, Siepmann has given me a lot of most interesting information, which I shan't bother to recount. Today the most important item is the fact that, while the Hungarian plains were almost denuded of cattle during the war, largely by the Roumanians, the herds have been substantially built up to pre-war standards. This is an important fact in the economic life of Hungary, which is a large furnisher of meat in the form of sausages and other manufactured products to nearby countries. Hungary is on good terms with her neighbors, except the Roumanians and the Czechs, - the Roumanians because of the treatment accorded them during the war, and the Czechs because of their intimate relations with the French, who are not popular in Hungary.

Siepmann says that conditions there politically are most stable. He sees no possibility under ordinary circumstances of anything like a political or social upheaval. Those days, since the passing of Bela Kun, are over. They may have changes of government, but they will be orderly and within the law. He thinks on the whole the economic position of the country is good, that the Bank is thoroughly well established, and barring successive crop failures or unforeseen disasters of an unusual type, they have a very favorable outlook. Of course the country is described generally as being a country of children. While they are not exactly unstable, they are ingenuous and rather simple-minded. One of their outstanding faults is a willingness to make any sort of a statement or promise rather than appear to be impolite or harsh.

I was amused by Siepmann's bringing me a message from Jeremiah Smith, recalling an incident that I had completely forgotten. It seems that we had traveled together when he was on his way out to Hungary, and I told him then that a nation which has a favorable balance of payments could have any kind of a currency that it wanted, and one that had a persistent unfavorable balance of payments could not have any sort of a monetary system, so that if I were to take his job, I would concentrate upon building up exports and insist that the Bank should build up its foreign balances against the day of adverse trade. He sent word to me by Siepmann that this had been his Bible and text-book ever since taking up his job and he attributed their success in great part to that fundamental principle.

Undoubtedly those two fellows did a great job in Hungary. They gave them a most tremendous send-off when they left, and reading between the lines, I gather that Norman's policy with the Bank has been so generous and yet so firm that the Bank of England has a special place in their affections. On the whole, my impressions are extremely favorable, but I am confirmed in my opinion that it is a London attachment and whatever they do in New York is a side issue to what they do in London. I think probably about 95% of the Bank's reserves are carried in London, and the portion now held in New York is a fortuitous balance arising from the stabilization loan. On the other hand, if Siepmann's advice to the Bank is followed, they will be careful to maintain close relations with us against the day of bad crops, adverse trade balances, and the need for foreign assistance.

There is some doubt as to the wisdom of my going there. It is a gossipy place, and I learn that, despite caution which my friend Fletcher of Rome sent to our Minister, Mr. Brentano, he promptly spread word around that I was shortly to arrive in Budapest, and everybody there is expecting me. The comment on that is "Beware of Ambassadors"! They remind me of the famous statement made of someone whom you know in Washington, that there are three means of rapid communication in Washington: telegraph, telephone and tell a _____. If you put the word "Ambassador" in the blank space, you will get the paraphrase.

Yesterday I received your cable about Mr. Mellon's plans, and of course am looking forward to seeing him. There are many things about the situation over here which he should know and which he cannot get except by a meeting.

Best regards to all at the Bank.

Sincerely yours,

Mr. G. L. Harrison,
c/o Federal Reserve Bank of New York,
New York.

BS:M