CONFIDENTIAL

Hotel Trianon Palace,
Versailles, July 29, 1926.

Dear Mr. Harrison:

I have a big batch of mail from the Bank, received yesterday, but am unable to deal with it for a few days.

This is to confirm a cable which I am sending out as per enclosed copy, on the subject of Dr. Miller's testimony. It is of course most confidential.

I took opportunity to make some particular inquiries of Mr. Gilbert in regard to the position of the Reichsbank, its status and the question of the disclosure of foreign balances, etc. It seems that not only are the foreign balances most carefully safeguarded in the statement, as I wrote you, but the law actually prohibits full disclosures on this subject, even to the Directors. The object, as you will appreciate, is to give the Bank the fullest freedom in dealing with valuta accounts and with their reserves so as to afford the utmost protection to the exchange value of the mark. What Mr. Gilbert told me merely emphasized the serious character of the disclosure, so I explained the situation to the Secretary, who expressed the view that it was a rather serious matter. I told him I was going to try and have it eliminated from the record. My cable therefore is sent in the hope that in some way it can be arranged. I will have to leave the method entirely to you, and apologize for bothering you once more.

Best regards.

Sincerely yours,

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

Hotel Trianon Palace,
Versailles, July 30, 1926.

Dear Mr. Mellon:

You will recall that the Poincaré Government had not made its declaration to the Chamber until just before we left Tours, and since then we have been able to form some opinion of the prospects as a result of the change of Government.

Further talks with Governor Moreau and Vice-Governor Rist of the Bank of France and with M. Monnet seem to justify my sending a cable to New York of which the enclosed is a copy. It will give you a succinct picture of the situation as I see it. Gilbert went over it this morning and agrees that it tells the story.

The fact seems to be that there is much disappointment that the Ministerial statement was not more comprehensive, for in fact it leaves the country in doubt as to what is to be done in regard to debt ratification, stabilization, foreign credits and the policy as to the floating debt.

Aside from a few very general statements, the entire Ministerial declaration was confined to matters of taxation and proposes increases in taxes estimated to amount to 11 billion francs, without any proposal whatever as to taxes upon real estate or agricultural profits.

The only qualification which I feel justified in suggesting as to a comprehensive program results from a conversation which I have just had with M. Francqui, who had just left the Prime Minister. He urged upon him a course somewhat similar to that being pursued in Belgium, the development of a full dress program, reducing the value of the franc and stabilizing it promptly. He tells me that at first Poincaré appeared rather opposed to so comprehensive a program, but finally admitted the need for cooperation between France, Belgium and Italy and asked Francqui to return later today. The latter, as you know, is both energetic and enthusiastic, and he may have overstressed M. Poincaré's reaction to his suggestion. Of that I shall be unable to judge until I see Messrs. Moreau and Rist again tomorrow. It would

not justify my changing the terms of my cable.

Further evidence reaches me through Governor Norman, who was here yesterday and today, that the new officers of the Bank of France are determined to use every means at their command to force a thoroughgoing reform. His impressions of M. Moreau are identical with my own - that he is a quiet man, somewhat lacking in experience, but with ample determination.

Word also reaches me that the Government has taken vigorous measures to stop all annoyances to travelers, and so far as I can learn, they are successful in public places, although causes of irritation still seem to arise in the restaurants and shops.

While I may be a week in Holland, where my address will be care of the Nederlandsche Bank, Amsterdam, my mail and telegraph address on the Continent will be care of Messrs. Morgan, Harjes & Company, 14 Place Vendome, Paris, who will be kept advised. If you feel able to send me any comments in regard to the contents of the cable enclosed, I will greatly appreciate it indeed, and if you feel that the proposals it contains are inadvisable under present conditions, I hope you will not hesitate to send me a few words by telegraph to that effect.

Mr. Gilbert and I arrived in Paris in good time after a very comfortable ride, but I am sorry to say that he found Mrs. Gilbert suffering some little pain and discomfort. The doctors assure him that it is nothing important and that she is progressing satisfactorily. He left for London with Governor Norman this afternoon, but desired to join me in expressing the pleasure we had in our meeting and in sending you good wishes.

Very sincerely yours,

Hon. Andrew W. Mellon,
c/o American Embassy,
ROME, Italy.

BS:M

MEMORANDUM BY R. B. WARREN

CONVERSATION OF JULY 31, 1926

at Hotel Chatham, Paris

Present: Governor Moreau
Governor Strong
Dr. Rist
M. Cagnier [secretary in copy]
Mr. Warren

The conversation opened with the inquiry of Governor Strong as to whether he was aware of the existence or familiar with the contents of a letter which had been sent in the middle of June by Mr. Mellon to the French Treasury.

While Mr. Strong had never seen this letter, he understood that it was an attempt on the part of Mr. Mellon to explain certain of the objections raised in France against the ratification of the Mellon-Berenger agreement, particularly regarding the commercialization of the debt. Everyone present remembered having seen references to some such letter in the newspaper, but at the time no one had taken them very seriously, as the accounts seemed to be no more authentic than an infinite number of other alleged transactions which the papers were reporting at that time. Mr. Strong, however, said that he understood such a letter signed by Mr. Mellon had been presented to M. Lacour-Gayet and that it contained 3 points:

(1) The commercialization of the debt was practically extremely difficult if not impossible, because of the Liberty Loan Act's provision that such obligations could not be sold for less than par.

(2) That owing to the existence of the possible 3-year moratorium and of the schedule of payments, it was entirely out of the question to imagine these points being put into any form acceptable to investors.

(3) That the Government had no intention of commercializing the debt anyway.

M. Moreau said that he was aware of the existence of some such let-

ter, but did not know what use had been made of it during the present Ministry, although he felt sure that M. Poincaré also knew of it.

Mr. Strong said that he hoped they would appreciate that he had no authority to speak about debts, but that it was of concern to the New York bank, because they could not proceed with any negotiations until the debt was settled.

Mr. Rist remarked that, at the moment, it seemed to him that the question of the ratification of the American debt was a very delicate one and that a very little influence on one side or the other might secure action from the Chamber before it rose. If it were possible to secure some sort of an explanation regarding the commercialization of the debt, it might in his opinion be possible to induce the Chamber to ratify the agreement within the next few days. Whether or not the letter referred to would be of a type sufficient to produce this result, he did not know.

Governor Strong then suggested the possibility of getting in touch with Mr. Mellon entirely privately and unofficially for the purpose of ascertaining whether, in view of the possibility of securing favorable action upon the debt settlement before the Chamber rose, Mr. Mellon might now wish to make some sort of a statement calculated to further the matter. He suggested that, as far as any approach to Mr. Mellon was concerned, the matter be left in his (Gov. Strong's) hands, and that if he thought of a scheme he would get in touch with them; otherwise, of course, he would not, because they would appreciate that he was entirely without any authority or right to intervene in a purely political question. The most he could do was to use his personal good offices entirely detached from any official interference.

Governor Strong then remarked that he knew they had had some conversations with Mr. Norman, that he also had had some conversations with Mr. Norman, but had not mentioned the subject discussed in his (Gov. Strong's)

conversations with the Bank of France and would not do so without their opinions. He would not ask what Mr. Norman had talked with them about, but he was willing to wager that Mr. Norman had discussed at great length the question of the independence of the Bank of France, as he knew that this was a subject on which he felt very deeply.

Referring to the question of the introduction of a dual currency which had been raised by Mr. Rist in a previous discussion, Governor Strong remarked that while the scheme might have certain advantages, he wasconvinced that its principal effect would be completely to discredit the existing unstable currency and accelerate its depreciation, because the very reason for which it was proposed, namely, that it would remove certain difficulties of transacting business under an unstable currency, would at the same time remove a certain amount of resistance to the continuance of such an unstable currency in circulation. He could accept the idea of such a dual currency system only with one reservation, and that was that it was intended ultimately to get rid entirely of the franc, as he was convinced that the effect would be rapidly to destroy whatever value there was left of the franc.

Mr. Rist questioned this position and said that he believed that it would have a tendency to discourage the flight of capital because it had worked to some extent in the Saar.

Governor Strong, however, remarked that while he was not completely familiar with this phase of monetary economics, he was of the opinion that the example of the Saar, a small community attached to one much larger, was by no means a precedent for such a country as France. He cited at some length then the example of Germany during the period when the old Reichsmark circulated side by side with the Rentenmark, and explained with what difficulty the two currencies were maintained in circulation. It would, in fact, have been quite impossible in Germany if it had not been that at the time the Rentenmark was introduced, the entire value of all the Reichsmarks in circulation was grossly inadequate to the needs of the country. At the same time prices were rising very rapidly, so that between the

time when the Rentenmark was first introduced and the printing of Reichsmarks stopped, and the time when Governor Schacht took charge of the situation, the volume of Reichsmarks in circulation was entirely inadequate to meet the needs of commerce in completing the contracts which had been undertaken. In other words, everybody in Germany, whether concerned in domestic or foreign trade, whether industrial establishment or bank, was short of Reichsmarks. Governor Schacht had cornered the entire available supply of Reichsmarks and consequently was able to make his discount and rationing policy entirely effective. This, however, would hardly apply in France at the moment, since the currency situation was by no means comparable to what it had been in Germany at the time of the stabilization. In fact, given proper administration, it should be substantially easier for France to stabilize its currency and return to normal monetary conditions than it had been for Germany.

Referring again to the letter which it was desired that M. Moreau should write, M. Moreau asked if it would be agreeable that this letter, which after all would be a sort of formal affair, should be dated at about the time of the first verbal invitation to undertake these discussions, that is, about the day before Governor Strong returned to Paris. This was acceptable to Governor Strong, who also agreed to supply the Bank of France with a reply. In this way, the purpose and scope of these conversations would be made a matter of record, so that if at any time either bank should be called into question, a satisfactory record would be available.

Referring to the subject of the possibility of entering into some sort of tangible negotiations at some time, Governor Strong remarked that, while it was entirely outside his field or his interest to discuss the debt negotiations, it nevertheless was a fact that the ratification of the American debt settlement was an absolute antecedent to any practical considerations of inter-bank cooperation. It was understood that the Chamber would adjourn Saturday, August 8th. If this were the case, since it seemed hardly probable that the debt negotiations could be ratified before that time, it would postpone for many weeks any possibility of cooper-

ative action.

It was explained, however, that the Chamber was not to adjourn; it was merely to be given a leave of absence, the difference being that with the Chamber on leave, it could be reconvened at the call of the Ministry, while if adjourned, it could only be recalled upon the formal convocation of the President. In other words, provided the Ministry wished to consider the debts, the suspension of sittings next Saturday would not imply that all possibility of ratification was indefinitely postponed. There was indeed some possibility that the Ministry itself might wish to hasten ratification, providing certain difficulties regarding the terms of the settlement could be arranged. It was understood that there had been within the last very few days a perceptible change of attitude upon the part of the press, and even upon the part of the Ministry. All present agreed that the change in tone on the part of the press had been quite distinct.

Referring again to the matter of stabilization, Mr. Strong remarked that very likely there would be a period in the early days of the stabilization when it might be necessary for the Bank to give up some of its gold reserve, possibly in the form of Ricardo bars.

M. Moreau remarked that while he was perfectly willing to give up gold, it must be remembered that the French public had very distinct prejudices in regard to the gold of the Bank of France, and he apprehended that any diminution of the Bank's gold stock during the early days of the stabilization would have a very serious effect in weakening public confidence.

Governor Strong then remarked that if confidence would be weakened by seeing the Bank's gold reserve decline, it might be strengthened by seeing its reserve rise and asked whether or not it would not have a distinctly favorable effect upon public opinion provided in some way some 50 million dollars, say, of gold should be added to the Bank's reserve soon after the stabilization program started. He remarked that for many weeks after the Reichsbank got under way, almost every ship that left New York carried a few million dollars worth of gold for the Reichsbank, the total

shipments amounting to 95 million dollars. Such gold might be provided in various ways, possibly even through some sort of cooperative arrangement with the Bank of England concerning the gold which was carried in the statement of the Bank of France as held abroad, or if no feasible means were discovered for purchasing such gold, it is possible that a gold credit might be arranged in New York which would permit the statement of the Bank of France to carry a certain figure as being on demand deposit abroad. This would assume, of course, that the present form of statement of the gold held abroad by the Bank of France took on a more realistic form. The question then arose as to how, once the franc was stabilized and the Bank of France received a certain supply of foreign bills, such foreign bills could be carried in the statement, or indeed purchased by the Bank, owing to the limit arbitrarily established by law upon their circulation. This at the present time had only a very small margin, and if, as was expected, it was necessary to expand the circulation, they would presently find themselves in serious difficulties, as after every foreign bill purchased it would be necessary to expand the liabilities by an equal sum. For this there were two proposals:

(1) One offered by Governor Strong, that while it might be necessary at first to expand the circulation, before long the Bank would find itself in the necessity of contracting credit in order to prevent a disastrous inflation of prices. Under such circumstances, the holdings of domestic bills would decline, and their places would be taken to some extent at least by holdings of foreign bills. The exact difficulties of this operation, of course, depended to some extent upon the status of the Bank, as it did not seem to be entirely clear from the conversation whether or not foreign bills could legally be entered under the item of the portfolio in the statement or whether they could only be carried under the miscellaneous assets. At any rate, it was clear, according to M. Rist, that presently the Bank would find itself seriously troubled by the fact that circulation had reached its legal limit. He wished to inquire whether or not public opinion in the United States would be disturbed at this time by a request on the part of the Bank of France to remove the

legal limit on circulation.

Governor Strong replied positively that if such a proposal were made as an isolated instance, it would undoubtedly have an unfavorable effect abroad, but that if it were part of a comprehensive program, it probably would have no such influence.

It was also remarked at this point that, as far as the Chamber of Deputies was concerned, a request on the part of the Bank for the removal of the legal limit on circulation would hardly be disturbing if it was coupled with the simultaneous request on the part of the Bank to be given absolute and full responsibility for the maintaining of the exchange at par and the currency at a stable value.

Referring to the effect on public opinion, Governor Strong remarked that it was quite true that foreign opinion had very largely lost confidence in the Bank of France, because abroad it was regarded simply as an agency of the French Treasury, and that unless this impression could be dispelled, any action taken regarding the circulation would be simply regarded as being a demand by the French Treasury for a right to more inflation. Until the Bank of France was more independent of the Treasury, there is no doubt that foreign opinion would be somewhat skeptical of all currency measures.

M. Moreau then said that they intended to ask the Ministry for a convention which would guarantee that during the period of stabilization the Governor and Vice-Governor of the Bank should be free from arbitrary removal by the Ministry, that is, that they should not be removed without the advice and consent of the Board of Regents.

Mr. Warren remarked that he saw no reason to limit this provision to the period of stabilization.

M. Moreau said that that was complimentary, but that they did not feel inclined to ask so much of the present Ministry, whereupon Governor Strong added that in these matters affecting the prestige of the Bank, it was not necessary that the Governor should be personally too modest.

Once again at this point the question of the problem of controlling the market came up, and Governor Strong remarked how greatly this would be simplified if a part of the State's debt to the Bank should be converted into 30-day, 60-day or 90-day Treasury bills of a sort readily negotiable in the market.

Dr. Rist remarked that there had been formerly an active market in such bills, but that it had been destroyed.

Mr. Strong said that it would greatly facilitate the entire operation of stabilization if there were developed in Paris a satisfactory, smooth-working money market, for which these Treasury bills offer a very natural, available medium.

M. Moreau remarked that, for the present, while he recognized the inherent advantages of this idea, it was quite out of the question, because the Government was using these Bons de la Defense as a means for raising money for current expenses, and it was not until the Government had satisfactorily put its budget in order that it would be possible for the Central Bank to employ such operations primarily in the interests of controlling the money market.

Mr. Strong recognized the strength of this, and remarked that the existence of a free market in this kind of paper would possibly facilitate the position of the Government during certain of the difficult days of the stabilization period. (Although this question of converting part of the advances to the State into negotiable Treasury bills, and the employment of these Treasury bills in open market operations of the type familiar in New York and London, has been introduced in every conversation between Governor Strong and MM. Moreau and Rist, this is the first time that it has clearly appeared that both of them understood both the character and object of the operation and recognized its feasibility and applicability to the Paris market. It was quite clear today that both of them had accepted the idea, at least in theory, and were prepared to consider its practical application).

In conclusion, Mr. Strong remarked that in going over the proposals of M. Poincaré, it seemed to him that while the object, namely, the equilibrium of the budget, was commendable, the real problem of an equitable redistribution of taxa-

tion was not even touched. Would it be possible, he asked, to secure modifications or amendments of those tax proposals before they have become incorporated in law.

Both M. Moreau and Dr. Rist agreed that this was quite out of the question at the present time, and that the tax program as presented was necessary to be accepted because of its political expediency.

Recognizing this, Governor Strong then remarked that at least, if it was not possible to exercise any influence on the part of the Ministry in regard to its tax program, it was certainly possible for the Bank to bring some pressure to bear on the Government in its process of adjusting the relations between the State and the Bank, in the process for example of revaluing their gold.

[From Blessing Jr.] 4

Start.

Hotel de l'Europe,
Amsterdam, August 1, 1926.

Dear Mr. Mellon:

I have never seen a situation change with the lightning speed that has been the case in France. When I despatched my letter to you through the Embassy, it seemed to have been determined by M. Poincare that he would proceed with his tax program, secure certain additional authorizations from the Chamber of Deputies, defer consideration of debt ratification and the general program of stabilization until the Fall, and then let the Parliament adjourn on Saturday, the 7th. During Saturday, the whole situation seems to have changed, as I learned from conversations with the officers of the Bank of France, with M. Francqui and with my friend, M. Jean Monnet. The Prime Minister seems now to have become convinced that the ratification of the American and British debt settlements must be brought about immediately, if possible, and that steps looking towards stabilization must be attempted immediately thereafter.

Without recounting the detail of the long talks that I have had with these gentlemen, I believe that the following considerations have moved him to change his policy.

(1) The accumulating evidence of dissatisfaction in political circles and of the public with the incompleteness of his proposals to the Chamber, manifested partly in the press, but mainly in the course of the rate of exchange.

(2) Very positive statements which have been made to him by some of his associates and by officers of the Bank of France that something further must be done than embraced in his original proposals, if the Treasury is to be protected.

(3) Some communication from the Bank of France and possibly from his own officials in the Treasury indicating that the Treasury is not in position to

[Forwarded copy in Corres Files C 261.1 French debt Term]

meet the State obligations beyond a period of say four to six weeks, unless further measures are adopted.

(4) Vigorous representations which have been made to him by M. Francqui as to the perils of the present situation, coupled with the rather spectacular success which he seems to have achieved in the enforced consolidation of a large portion of the Belgian floating debt and its immediate conversion next Monday into preferred stock of the newly incorporated Belgian State Railway lines.

Of course all of this information reaches me in the greatest confidence, but, as I have indicated, from most reliable sources. One of the most significant developments is his decision, already announced, to have the Parliament recess but not to adjourn, and the further information I have that it is quite likely that the recess will not occur for another fortnight. A recess of the Parliament leaves the Ministry in position to recall it at any time, and adjournment would postpone the reassembling of Parliament until next October.

I am writing you this because it is now my belief that the success or failure of this Ministry and of such program as they may adopt will be determined by the success or failure of efforts to secure ratification of the debt agreements by the Chamber. I am informed that the letter which you addressed to M. Lacour-Gayet on the 14th or 15th of June is in the hands of the Finance Minister, but either because its terms may not exactly meet the existing situation or possibly even because it was addressed to an official and not to a Minister, it may not appear to be serviceable even in allaying the fears which undoubtedly exist and are widespread and, I believe, conscientious as to the commercialization clause, being Paragraph 7 of the debt agreement.

The proposal now being discussed is to endeavor to secure from the American Government some statement which will be reassuring on the subject of the sale

of bonds to the public. The actual phraseology of such a letter would, I gather, need to be devised with great skill in order, on the one hand, to give satisfaction in France, and on the other hand, to avoid its being understood by the people at home as more than an interpretation of the meaning of the agreement. I gather that, while it would be most helpful if something could be stated in the nature of a security clause, it is realized that this would be most difficult to bring about, and that the point might be covered to the satisfaction of the French Government and the French people by a preamble to the act of ratification, the substance of which would be to state that the agreement had been entered into in consequence of the action of the Funding Commission in applying a rule of capacity to the negotiations, and that while no assurances are asked on the score of capacity if circumstances change and the capacity to pay is materially impaired, the French Government would then rely upon the fairness of the American Government to consider proposals for a review or reconsideration of the debt in the light of existing capacity. Here again the question of language is of course of the utmost importance. Such a clause might be framed in a dignified way without any unfavorable reaction either in France or at home. On the other hand, it might be construed as a reservation and prove unacceptable.

I have again taken the position and reiterated that the subject of the debts is one with which I can have no concern, and that if this matter is approached it must be done through the usual channels or in some way which will not in any manner involve me in the discussion, indicating that the only relations which are possible by me are with the officers of the Bank of France. Quite privately, I have suggested to Mr. Monnet that it might be wise for him to have a further talk with Mr. Gilbert upon the latter's return from London on Tuesday, and that he cannot look to me to act as an intermediary. I have also advised Mr. Gilbert of the

substance of what I have learned in Paris, so I apprehend that you may hear from him shortly after his return.

After most careful consideration of everything that has been disclosed during my stay in Paris, I now rather hold the opinion that if arrangements could be made for an exchange of letters satisfactory in terms to you and the President, which would meet the pressing needs of the Prime Minister to secure ratification of the debt agreement in the Chamber, the whole course of affairs in France might instantly change for the better and the most serious crisis, which is now likely to arise within the next two or three months, be thereby avoided.

I have been sounded unofficially on the subject of credits and have taken the position that certain things are prerequisite to anything in the nature of negotiations, the principal ones being:

(1) Ratification of the debt agreements.

(2) The adoption of a comprehensive program which would be acceptable to us, to the bankers of the French Government in America, and to the other banks of issue and private bankers who might become engaged in other gold standard countries.

(3) That even the adoption of such program by the Government and its approval by Parliament would not be sufficient unless provision was made for continuity in the execution of the plan over a term of years, and covering that point it is stated to me by the officers of the Bank of France that they propose to insist and believe the Government will agree to give the Bank unhampered authority to execute a plan over a period of three or four years without governmental interference.

Of course nothing in the nature of commitments or even by way of encouragement that credits can be arranged has been offered to these gentlemen, beyond the bare statement that, the conditions being favorable, we will listen at a later

date, when these matters have been dealt with, most sympathetically to any proposals that are made.

There are a few matters bearing upon the situation in France which seem to be important.

One is as to the attitude of the French people towards foreigners, resulting in the annoyances that have been so much advertised. I have made rather careful inquiry and am now convinced that, while the feeling had its origin in the campaign conducted by the London "Daily Mail" and in the rather hostile speeches reported from England, which were widely advertised in France, nevertheless the fundamental feeling among the French people which gave rise to these occurences is not specifically hostility to Americans on account of the debt, but rather a general hostility to foreigners, who are making large purchases in the Paris stores. These purchases the French people, or at least many of them, feel are being made at only one-seventh or one-eighth of the price which the French themselves have to pay! It is a curious reaction from the statement one hears on every hand that the pound has advanced or the dollar has advanced, rather than that the franc has declined.

Another important development is the undoubted control which M. Poincare seems to have obtained in the Chamber. He has about 350 votes which seem committed to his policies, and the minority seems to have almost entirely lost its influence. I was told on Saturday that the Chamber is now voting in support of his measures with enthusiasm, rather than reluctance, and those who are supporting his program are intolerant of the obstructionist tactics of the minority.

Another development of undoubted importance is the Prime Minister's recognition of the fact that a program of reconstruction cannot be carried out without assistance from abroad, especially America.

You will gather from the above that I feel that, if some kind of a bridge

even though one of rather slender and indefinite character, could be furnished at a later date to enable those who have made definite commitments against ratification to retreat from their position, it might be possible to secure ratification and thereupon develop a really constructive and complete program of reorganization.

I am sorry to trouble you with this long letter during your holiday. If you feel that it is worth-while to send me any communication, it would reach me through the Legation at the Hague in the Italian Embassy code, as I am arranging with the Minister here to take care of telegrams for me.

With kindest regards, believe me

Sincerely yours,

Hon. Andrew W. Mellon,
c/o American Consulate,
ROME, Italy.

BS:M

PERSONAL AND CONFIDENTIAL

Hotel de l'Europe,
Amsterdam, August 1, 1926.

Dear Mr. Harrison:

It seems a shame to inflict you with these long letters all arriving at once, but the situation over here is so extremely critical and of such grave importance that I am rather inclined to write the letters for the sake of a record and, of course, in order that you also may be kept posted. But I beg of you to handle my letters with the utmost caution.

While Mr. Gilbert and I were with Mr. Mellon, M. Poincaré submitted his proposals to the French Chamber; 85% or 90% of them had to do with the taxes and the proposed raising of 11 billion francs. On the whole, the program is doubtless a wise one, although inequitable in that the distribution of the tax burden is still unfair. The last budget showed only 76 million francs from agricultural sources and something over 300 million francs from direct land taxes. Both should be greatly increased, but politically it seems impossible, and that is the weak spot in the French fiscal system. The debates gave him a vote of confidence on his general statement, and yesterday by a large majority of over a hundred approved the legislation. Nevertheless, the statement was a disappointment to the country, because it was regarded as incomplete. It failed to deal with debt ratification, stabilization, foreign loans and the floating debt.

When we reached Paris, after visiting Mr. Mellon, the franc was declining sharply, people were again becoming discouraged and it looked as though there was a rocky road ahead. I had almost lost confidence that the Government could pull through. A long talk which I had at Dr. Rist's house, with him and with M. Moreau of the Bank, added greatly to my discouragement and resulted in the despatch of my

cable No. 46. As bearing upon that, I enclose a copy of a letter which I wrote to Mr. Mellon accompanying a copy of the cable sent to him. On Saturday, however, a kaleidoscopic change took place, and it is of such great importance that I am writing Mr. Mellon giving a description of the situation as per enclosed copy. This will save a repetition of the story, except for a little embroidery.

While these gentlemen have been very cautious in their statements to me, I have concluded without their saying so that they have made some very stern representations to the Prime Minister and have probably point/ed out that he is headed for disaster unless he produces a complete program. M. Francqui has also informed me that he has made some very definite statements to the Prime Minister, which shock him a good deal. These were all the more effective because Francqui has just accomplished what is really a great achievement in Belgium. He has succeeded in converting the entire floating debt maturing within the next six months, including January I believe, into preferred stock of the Railway Company, thus removing the immediate menace of something like 7 billion francs of Treasury bills and giving him a pretty clear field as to domestic finance for six months. He still has some 42 billion dollars of foreign obligations maturing right along to deal with. This is an enforced conversion, and by a little skillful management of the press, by securing the cooperation of interested parties in advance and by giving the banks some special treatment so that they avoid a frozen portfolio, he has apparently carried out his plan with a really enthusiastic public support. His description of the way he was working was exceedingly amusing, as Mr. Young will appreciate. He said that just now he was the "little God" in Belgium. He did the work and the King signed the decrees, and everybody thought he was the biggest man in Belgium, but he said: "They likely will be shooting at me at the end of 2 or 3 months, so I want to get everything done that I can before they begin shooting."

I promised to see Francqui again, and in passing, let me say that the story that is now going about is that he will remove Hautain from the Governorship of the Bank and that Theunis will take it. This may or may not be true.

To get back to Paris, the change in the situation has become so significant and important that my cable No. 46 may be misleading, so I am sending you a brief cable as per enclosed confirmation to bring you up to date before our Directors get too far in discussing my No. 46.

This is about all there is to say at the moment. I shall be here for a week or even ten days, and as Schacht is at Noordwyk, I shall probably see him while here. This letter, finally, I think I shall mail, to finish up the reports on the French situation for the moment.

Sincerely yours,

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

BS:M

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CONFIDENTIAL

Hotel de l'Europe,
Amsterdam, August 3, 1926.

Dear Mr. Harrison:

I have just read yours of the 16th and the one from Jan Ciechanowski, the Polish Minister. He need have no anxiety in regard to the suggestion discussed with the Polish Minister in London, which was most tentative indeed and, as you have surmised, more for the purpose of trying Norman as to his true position. While he is wedded to the League of Nations idea, I told him quite frankly that I did not think we would be interested in any project along lines similar to those employed in Austria and Hungary. The political atmosphere is too intense, and there is too much play for position through the League, to justify our taking part. While he said that he would not necessarily stand out from some plan composed by a commission with international representatives on it, he was not especially interested in any plan produced under the auspices of the Kemmerer Commission and fathered by Dillon Read & Co. Later, at Antibes, he rather withdrew from what he had said in regard to a plan produced by an international commission. I think what lies behind the whole difficulty with Norman is his mistrust of Dillon Read & Co., basing that a good deal upon Logan's performances.

Logan has undoubtedly muddied the water a bit and created a good bit of ill feeling over here. I find Gilbert just as bitter and mistrustful as Norman is, and while Logan does not realize it, I think the same is true of the people in the French Government and the Bank of France. He is doing his firm no good, and in the long run they will lose out by a policy of intrigue. I hate to feel this way, because Logan has been a friend of mine for years. His best friends and old associates are gradually dropping him.

If you think well of it, you might forward the enclosed letter to the Minister. If not, hold it and write him yourself that you have heard from me and that I will defer an answer until I get home.

Sincerely yours,

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

BS:M

(7

Hotel de l'Europe,
Amsterdam, August 3, 1926.

PERSONAL AND CONFIDENTIAL

Dear Mr. Harrison:

This will reply to your personal and confidential letter of July 8th, which covers pretty wide ground. Much of it is answered by separate letters already mailed.

Generally, about the present attitude. One cannot expect them to grasp so complicated a picture as this, assimilate it and take action when they really know nothing of the subject, have none of the atmosphere and know none of the people. I am not disappointed in that, but I think if they wish to take a constructive attitude they must realize that, unless they are willing to tackle the job themselves, they have got to trust someone else to do so. It is just that failure in giving confidence that causes all the trouble.

I have not been able to learn much of Dr. Miller's visits. He has seen Dr. Vissering, who did not seem to be enough interested to report much of the conversation, nor have I questioned him particularly. The only significant statement was that Dr. Miller seemed to be strongly in favor of the Federal Reserve System aiding with credits for stabilization purposes, which surprised Vissering, as he was under the impression that Miller had been rather opposed. I suppose this came through Norman.

My talk with Francqui was altogether too brief to really get at his mind or to bring the conversation around to a point where I could talk about antagonism to America and the American bankers. All that I was able to say on that score was that it had astonished me to hear the reports from Belgium in regard to the previous effort and to tell him a little of the story. He laughed

and indicated, although not in words, that he knew the story well enough already. From Vissering I learn that he is not on speaking terms with Hautain. They have not seen each other since Francqui took office, nor for some time before, and the National Bank apparently is entirely out of touch with what is being done. This is most unfortunate, for indeed the National Bank is the instrument through which much of it should be done. I have again been asked whether I had learned that a change was contemplated in the National Bank, and it may be, as suggested in Paris, that Theunis is slated for Hautain's job.

You will gather from my cable what I failed to state in my letters, that Mr. Mellon feels just as strongly as Winston does about the need for doing something, but agrees that our aid should be preceded by debt ratification, the formulation of a comprehensive plan, and some sort of an assurance as to continuity. I was delighted to find Mr. Mellon as sympathetic as he appeared to be.

The French situation seems to be clarifying rapidly. Warren telegraphs me today indicating that Poincare intends to submit ratification proposals shortly. I hope he does, without attempting some impossible interpretation of the agreement, although I feel that Mr. Mellon might even attempt that if he were approached in the right way. As I dictate this letter, things in Paris are undoubtedly "looking up". The exchange has advanced rapidly and there seems evidence that Poincare is going ahead with thoroughgoing proposals. Probably he is gaining courage as the solidity of his political backing becomes more apparent.

Please tell Young that I shall have his advice in mind every minute of the time that I am talking with Francqui. It is likely that he will slip up here for a short visit, and we may meet at Dr. Vissering's house at Bloemendaal and so escape publicity. If not, we will arrange some other place.

I am terribly sorry to hear about Mrs. Shurtleff being ill. When she

returns, won't you please give her my sympathy and best wishes for a prompt recovery.

Sincerely yours,

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

BS:M

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PERSONAL AND CONFIDENTIAL

Hotel de l'Europe,
Amsterdam, August 3, 1926.

Dear Mr. Harrison:

The Whaley-Eaton Service of July 10th contains a very definite statement of what Governor Norman and I are proposing to do. It is not the first time that such statements have been published. Gilbert reads this service now and then, and he has been struck by the character of these articles in regard to the Federal Reserve Bank and finally has suggested to me that the time has come for us to do something about it. Now, this letter is most confidential and will need to be handled with the utmost discretion.

The first criticism is that the Whaley-Eaton Service has just opened an office in Paris and established a foreign service there. They sent out a circular inviting subscriptions, and for references they gave the names of American subscribers, the first 7 names on the list being 7 of the Federal Reserve Banks, and our name was first. I think we should discontinue our subscriptions in our own names and subscribe in the names of some individuals.

The next matter has to do with the method of collecting their information. I think I have already told you that this was carefully investigated by Moran. Of course we will not be authorized to disclose the source of our information as to this investigation, or even the fact of its having been made. Indeed, Mr. Winston should be consulted before doing anything, but I am informed by Mr. Gilbert that a large number of the Washington correspondents of the newspapers and press services receive regular salaries or some form of emolument from the Whaley-Eaton Service. This is not a guess, as Moran's investigation enabled him to make an examination of bank accounts, checks and vouchers, and he has the names

of the Washington correspondents who are receiving pay from the Whaley-Eaton Service. Among others, the Associated Press man who covers the Treasury is on the list. The understanding is that these men are paid for giving Whaley information which they get in the confidential talks in the various Departments and which they are not permitted themselves to publish. This is pretty low-down journalism, and Gilbert's suggestion was that this be taken up very privately with Kent Cooper of the Associated Press, that he be given enough information to justify his taking it up with other responsible newspapers, and then that they themselves as a body should undertake an investigation of the relations between their men and the Whaley-Eaton Service. Of course our name must never appear in the matter, and how it should be brought about would need most careful consideration.

Finally, I am sorry to say that Whaley seems to have pretty intimate access to some of our own friends, or to at least one of our friends in Washington. Anything that might come through that channel would be an indiscretion and nothing else, but I am not sure how discreetly he always discusses matters.

All of this is submitted for your consideration, and it may be that you will decide to await my return so that I can talk myself with Kent Cooper, whom I know very well. You realize that men of his stamp would not tolerate any such proceeding on the part of his representative, nor would other newspapers of standing submit to it.

I am cleaning up a lot of mail today, and am sorry that I have been so late in answering some of your letters. It is because I have been so busy.

Best regards.

Sincerely yours,

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

Hotel de l'Europe,
Amsterdam, August 3, 1926.

Dear Mr. Harrison:

Replying to another of yours of the 16th, I hope you keep in touch with Morgan's office in regard to the situation in France. Something is liable to develop any moment.

This letter is especially to refer to your comment about our rate. This year I don't think we can hesitate long about an increase, in case speculation shows its vicious teeth again. It may make it a little difficult for Governor Norman, but I warned him, and I think he is reasonably complacent about it. The important thing is to give them notice in advance and, if possible, sufficient notice so that they will have time for consultation and to communicate with him in case he is away.

While I think of it, I want to congratulate you upon the outcome of your negotiations with the Clearing House. It is surely an embarrassment to the other Clearing House Associations, especially Chicago, to have New York put the whole country on the discretionary list, and my guess is that they may "wiggle and squirm" a bit, but in the end they will find that they are losing business to New York and will be obliged to abolish their charges as well. I hope they all do. Certainly Atlanta should, and there the charges, as I recall, are highest.

And while I am on the subject of the work of the Bank, I must not overlook writing that I hear Case did a grand job in working out the June 15th operations. I think Mr. Mellon and the Treasury officials were all mighty pleased, and of course I was more than anybody.

Sincerely yours,

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

Hotel de l'Europe,
Amsterdam, August 3, 1926.

Dear Mr. Harrison:

Replying to another of yours of the 16th, principally about publicity, I have escaped it all since returning to Paris last time, but am on the edge of it again here in Holland. The newspaper people are watching Schacht, who has been at Noordwyk and returns there today. I have about decided not to go to Noordwyk, but as distances are short here, we can stop with Dr. Vissering at Bloemendaal and Schacht can come up there. Governor Norman arrives Friday morning, and between us we can arrange some plan to avoid publicity. I hate all of this dodging, but it cannot be avoided, and I am particularly anxious to do nothing which will arouse mistrust in French minds. But if we get afraid of our shadows in these matters, I will just have to come home and risk missing a chance to do something really constructive.

Sincerely yours,

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

BS:M

Hotel de l'Europe,
Amsterdam, August 3, 1926.

Dear Garrard:

I have your fine letter of July 16th, written, if I may say so, with a considerable spice of resentment, at which frankly I am not greatly surprised.

But after all, we must be charitable enough to realize that there are a lot of frayed nerves over here, and while Mr. Churchill's statement, which was unprovoked, is to my mind unforgivable, the attitude of the public may be regarded with more complacency. These feelings quiet down, and it is more important for us to aid in constructive work than it is to permit controversy. I really think our best policy is to keep our mouths shut and let the Winston Churchills do the talking.

Gilbert and I had a fine visit with Mr. Mellon. He arrived in France in the midst of a very panicky condition of affairs, and some of us were a little concerned lest he might meet with an unhappy reception and some unfortunate incident simply add to the bad blood. But everything went off beautifully. Rousseau was very clever in all the arrangements he made and it was never discovered that Gilbert and I had been to Dinard to see him. I think we gave him a pretty good picture of the situation, and he is apparently quite sympathetic with our views, that if it is made possible, a little friendly sympathy and cooperation just now will be most helpful.

I shall not send you details of affairs, as I am keeping Mr. Harrison fully posted and you will hear it all from him.

My best to you as always.

Sincerely yours,

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

BS:M

Hotel de l'Europe,
Amsterdam, August 3, 1926.

Dear Garrard:

Thank you for your letter of the 17th.

I think Mr. Mellon's letter to Governor Crissinger, expressed in your best language, was fine. They write me from the office that there was some demur about the size of the expense account by members of the Board, but they finally accepted the situation. Considering the amount of work which we had to do, which included weeks or preliminary preparation, and the fact that these two gentlemen who came with me both left their college work without any notice and only a few days in which to get substitutes for their lecture courses, the charges strike me as being moderate indeed.

As an echo from this incident, I am advised from the Bank that a resolution has been introduced in the Federal Reserve Board directing an inquiry to our Bank or to the Directors as to the object of my trip to Europe. It is all of a piece with previous affairs of that sort, and of course I am getting heartily sick of it.

About the subsidiary silver coinage, this of course is a rather complex matter just now. I am going to have a talk with Dr. Schacht about it, but anything that I might attempt to do would have to be regarded as most confidential just now, because it involves a lot of political questions over here the same as with us at home.

The Dutch are still coining silver, the British are coining it at a reduced percentage, that is, 500 fine; the Swiss are now coining silver, and in fact are putting a 5-franc piece into circulation, which I hear is not very popular. The Bank of France holds some 340 million francs of silver, principally, I imagine, Latin Union coins, and I had already had a talk with the officers of the Bank about

a suggestion which struck Warren and me one day as being worth considering. It surprised them, but they may at least give it a chance in connection with some big program of restoration. Our notion was to have the silver recoined whenever the new currency is undertaken, so that the Bank would realize a seigniorage profit of possibly 1½ or 2 billion francs, which is now possible through the depreciation of the franc. We thought they might issue a coin of say 500 fine like the British. Of course they fear that it will be hoarded, but the matter is under consideration and it may be taken up. If they do it, I think both Italy and Belgium might consider it. Of course the subsidiary and minor coin of all three countries will have to be reorganized when the currency is revalued, as it is out of line with the general price level. I have already recommended to M. Moreau that the Bank should discontinue issuing 5-franc notes, which today have the value of about a 6-pence, and later if possible discontinue the 10-franc notes. This would give a place for silver coin, and as the substitution of silver coins for 5-franc notes would more than absorb the entire stock of silver of the Bank of France, there might be a chance there to find a new customer for silver.

I cannot think of anything more that could be done at the moment, but this is just to let you know that the matter has been in mind and had already been discussed before receiving your letter. I really do not think it would be well to let any of our mining friends, like Mr. Robinson, at home know of these discussions. Those fellows are very active with propaganda and politically, and the impression must not be created abroad that I am engaged in promoting any such enterprise, for the main thing now is stabilization, restoration, and the question of a subsidiary coinage is distinctly one of detail.

Many thanks for writing me, and best regards.

Sincerely yours,

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

Hotel de l'Europe,
Amsterdam, August 6, 1926.

Dear Garrard:

Yours of July 21st just reaches me. I am indeed grateful to you for handling the matter of the silver inquiry with the Federal Reserve Board. It is as satisfactory as it can be, considering the difficulties we always encounter with the Board about any matter of expense. Considering the results and the great amount of work necessary to obtain them, I think the bill was moderate indeed.

We certainly have had a hornet's nest buzzing around in connection with the debts. Austin Chamberlain made a speech day before yesterday on the eve of the adjournment of Parliament which I did not like at all. I cannot for the life of me make out what they are driving at, but I agree with you that it is distressing, does no end of harm and may endanger much of what we are endeavoring to do. If the French debt settlement fails, I feel that it is largely to be charged to Winston Churchill.

About the Bank of England credit, I have no idea as to what their intentions may be, but I did have one discussion on the subject with Norman after this Churchill upset, in which I told him quite frankly that if we were asked to renew the credit at the present moment, the feeling as it was at home and this wholly unprovoked outburst from Churchill, I felt, would make it difficult and possibly impossible to recommend it. Norman, you realize, is an intimate friend of Stanley Baldwin's and visits him in the country frequently. I thought it just as well to say this to Norman, who will doubtless report it to the Prime Minister. By next Spring, when the matter will come up, much water will have flowed over the dam and we can consider the whole subject in a calmer spirit.

There is just one fly in the ointment. The statement about the post-armistice loans, I am afraid, will not hold water. The bulk of them were made for

the purpose of cleaning up existing contracts placed with American contractors, and had we been unwilling to continue our advances to the Allied governments, many American contractors would never have gotten the money or would have been obliged to wait a long time, and some of them would have "busted". The exchange could not have been had, and the disorder and difficulty occasioned to our own people would have been very serious indeed.

I am in close touch with the office by cable and am glad to gather that they are in close touch with you. Anything I write now will be so out of date when you get it that I will not duplicate what goes to the office. I wish you were over here to enjoy a most interesting experience with me.

My best regards as always.

Sincerely yours,

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

BS:M

Copy for F 261.1 Belgian Credit - 1926 - Page 3 is missing and presumably can be found in the original

FEDERAL RESERVE BANK

OF NEW YORK

Hotel de l'Europe,
Amsterdam, August 9, 1926.

PERSONAL AND CONFIDENTIAL

Dear Mr. Harrison:

It is literally impossible to send you a decent account of things here when they change so rapidly, but I will send you a little cross-section as of today, following various meetings.

I arrived here last Sunday, the 1st, from Paris, and saw Dr. Vissering on Monday. The only interesting developments were two:

(1) That Francqui had asked him to go to Brussels to consult him about his program. Apparently the discussion was super-theoretical, which is Vissering's hobby, and I surmise that Francqui got a bit tired of it, as he is too practical-minded to waste time on fine-spun theories about measures of value, etc.

(2) The other development was my conviction that Dr. Vissering is getting old. He certainly is weak, has not definite opinions himself, and seems more inclined to agree with the last man than I have ever known him before. He is also riding hobbies to death and it becomes difficult to hold him to a serious discussion.

In view of all of this, I was rather cautious in our talks, but I told him that I had promised Francqui to let him know my program, and Vissering thereupon wrote Francqui simply advising him of my arrival here, that I would be here about a week, stopping at Dr. Vissering's house in the country most of the time, and that he was expecting Governor Norman on Friday; also that Dr. Schacht was stopping at Noordwyk, which is right near Bloemendaal, where Dr. Vissering lives.

We spent the time before Norman's arrival in some trips in the country, and then Norman and I went down to the country with Dr. Vissering, where Schacht joined us. Meantime, Francqui telegraphed that he would be over for a "discreet"

conference on Sunday and wished to see all four of us. He arrived with Delacroix, and we spent all day Sunday and Sunday evening together. This simply describes the stage.

Most of the time was spent in spelling out the Belgian situation. It is certainly intensely interesting. The figures are roughly (relying entirely upon Francqui's memory) as follows: the interior floating debt in the hands of small holders is 3 billion 200 million francs, and of larger holders 1 billion francs. The December maturity, 2 billion francs, makes the total domestic floating debt 6 billion 200 million francs held by the public. The entire amount of this is converted by the forced conversion into either preferred shares of the Railway Company, bearing 6% interest, at par, or into a 5% bond of long maturity to be repaid by the operation of the sinking fund, which will be applied by lot. This leaves about a billion francs held by banks which are to be converted into notes, payable one-eighth each every three months, to be paid out of surplus revenues. (See Postscript #1)

If Francqui's memory is correct, this accounts for the entire floating debt of 6 billion 200 million francs. My impression is that his memory is wrong, and that there are 750 million francs more than this, which is the amount held by the banks, and that the amount converted is 6 billion 200 million and the amount repaid by the installment notes to be held by the banks of Belgium is 750 million. This accounts for a total floating debt of about 7 billion francs, which is the correct figure. There are maturities aggregating, in round figures, about a billion francs in the years 1929 and 1932, which he says he can take care of without difficulty.

The result of this rather bold transaction, which appears to have been received without a murmur by the Belgian public, is to entirely eliminate the domestic floating debt, except for some 6 billion 700 million francs owing to the

National Bank. In addition, there is owing to the banks of issue, (foreign) in round figures, $15,000,000, and there are short Treasury bills held abroad aggregating $37,000,000, making an external floating debt of $52,000,000. Of this external debt, about 17 millions is held in Holland, 8 millions in London, 15 millions by the banks of issue of Europe, and 10 millions in Germany. Other small amounts bring it up to 52 million.

This operation absorbed about 6 billions of the 6% preferred stock of the Railway Company, of which 10 billions are available. Francqui claims to have a sale of 500 million francs practically concluded with Dutch and Swiss bankers, leaving 3½ billions still in the Treasury. He also states that, during the course of advance of the franc, he has been able to purchase $18,000,000 of foreign exchange to build up his foreign balances, and I gather that the bank consortium loan of $10,000,000 which had been discussed with Morgans has been abandoned as not needed.

In a word, therefore, the Belgian problem resolves itself to this:

(1) How to deal with some 52 million dollars of foreign floating debt;

(2) How to deal with some 6 billion 700 million francs owing by the Treasury to the National Bank; $200 million

(3) At what rate to stabilize the franc;

(4) How to get money abroad and how much.

As to the floating debt abroad, he wants to cover it by a long-time loan. As to the debt to the Bank, I think he has in mind also using a portion of the long-time loan, and in addition bank credits, say with the banks of issue. I figure roughly that he would need to repay about 64 million dollars of the State's debt to the National Bank in order to bring its reserve up to 60% of its note liabilities. To borrow 64 million dollars abroad for this purpose, plus 52 million dollars to fund the floating debt, is, in my opinion, an impossible and exceedingly expensive

operation. As to 64 million dollars, the State would be paying interest on what is the equivalent of a purchase of a like amount of gold, which will produce nothing. Francqui seems to have been emboldened by the success of his projects to date and may not be counting the cost as carefully as he should, although he has the reputation of never missing that aspect of any situation.

So much time was devoted to the discussion of technique that we really did not get down to a nice discussion with the figures, but I think he was jolted rather hard by Norman, Schacht and myself when we pointed out to him that, with no floating debt at home, he could either refund a part of the debt of the State to the Bank by a domestic operation, or could permit the Bank itself to convert the State debt into a salable security and liquidate it at home, the effect of which would be to reduce the note issue, which on the other hand would be correspondingly increased by the Bank's continuing to buy foreign exchange, in other words gold. His proposal would saddle the State with the service of a very large foreign loan. Our proposal would convert the State's debt to the Bank into a domestic loan and enable the Bank to buy its gold in the open market. There is no question as to which course is the wisest.

Unfortunately Francqui does not always make a good impression. In the first place, in discussing the liabilities of the National Bank, there were figures which he had apparently omitted such as a deposit of a million sterling which the Reichsbank has with them, which is in fact a gold liability for that amount, being the Belgian share of the sale of the German Dawes bonds, which were left in Belgium; either he is not informed of the situation in the Bank in detail, or else he is unwilling to disclose it.

Another unfortunate impression arose through the fact that he did not disclose with whom he was dealing in negotiating for the sale of the railway stock, and it transpired after he left that he has probably been dealing with some bankers

other than those who have stood by Belgium through these trying times. If he should abandon the bankers who have done the financing heretofore and go to some firm like Dillon Read, or Mendelsohn in Berlin or some other Dutch banks than Hope & Company, he would certainly make a very bad impression. (See Postscript #2).

A third situation which became perfectly clear was the fact that he was practically not on speaking terms with Hautain and that the Bank is being ignored by Francqui for the moment, as to any matters where he has the power to give directions. On this last point, I do not think he is much to be blamed. Hautain has antagonized everyone and they have all lost confidence in him. There is a good deal of discussion of his successor, and I would not be surprised to see a change made any day.

Another development, which is most confidential, and which has the germ of some trouble in it, is the fact that Francqui and Schacht have concluded negotiations of a rather complicated character, which I will briefly describe as follows. Germany is to make a declaration of regret about the invasion of Belgium or something of that sort, then to enter into a compact of friendship by which Belgium will return Eupen and Malmedy to Germany, against which the Rhine Provinces to which Eupen and Malmedy formerly belonged will pay to Belgium $30,000,000, this being reimbursement of the amount spent by Belgium on the railway and other state properties there, such as public utilities, postoffices, telegraphs, telephones, etc. It is then proposed that the Reichsbank will loan to Belgium, or to the National Bank, or arrange a loan in some form of 30 millions additional, which is to be repaid in ten installments of 3 millions each out of the Belgian share of the German Dawes Plan annuity. This 60 million dollars is in fact, however, the settlement by Germany for the so-called mark note debt to the National Bank of Belgium, which now amounts to 5 billion 200 million francs and is a part of the 6 billion 700 millions above referred to.

I surmise, and Schacht has been told, that the difficulties will be as follows:

(1) The rectification of the Belgian-German frontier may likely require the assent of all the signatories to the Treaty of Versailles;

(2) These payments may possibly be considered as a transfer and require the assent of the Transfer Committee;

(3) They will almost certainly require approval by the Reparations Commission;

(4) How can Germany effect such a settlement with Belgium, of a sort of extra-legal character vis-a-vis the Dawes Plan and the Treaty of Versailles, without inviting France, Italy, Great Britain and others to inquire what they get out of it? At least as to 30 million dollars, it would appear to me to be an anticipation of Dawes payments, something which the French would be very loath to agree to unless in like proportion their annuities were anticipated.

This project has all been discussed, apparently, with the French officials, as well as in Great Britain, and the next step seems to be to consult Gilbert and see how he stands. I think they will find him rather lukewarm, although he may approve in principle, subject to all interested parties approving; but I feel certain that he would not recognize a pledge or anticipation of the annuities and may question the legality of a transfer of such amount. I think Schacht expects to use the million pounds sterling owing by the National Bank and the 10 million dollars or even more of Belgian Treasury bills held in Germany as a part of the payment, and I believe he has other funds available which have already been exported, so the transfer would not be very large as to the first 30 millions in reimbursement for public buildings, etc.

This is a matter of purely academic interest to us, as I explained that we were not concerned with the matter at all and could not discuss it. Of course, if such a program should be carried out with everybody assenting, it would make it

immensely easier to reorganize the whole Belgian situation.

I also gather from Francqui that he has about fixed his mind on stabilization at the ratio of 7 to 1, which is about 175 francs to the pound, and roughly 36 francs to the dollar.

We ended our discussions without any proposals for credits, but Francqui is intending to keep us posted as the development of his project proceeds and it may well be that some credit plan may come forward in due course.

But Francqui is a good bit of an old fox. He said to me just before leaving, aside from the others, that he thought it was most important that the Bank of France should get some material and moral support, and asked me why I could not arrange with Norman to have a meeting in London of representatives of the principal banks of issue, to which Moreau would be invited, which would have a splendid public effect. I told him there were difficulties in the way, but I would mention the matter, and said no more than that. Before I had a chance to mention it, Schacht the next morning asked Norman and me whether such a meeting could not be arranged. (Inferred: F.) You will see that the idea in Francqui's mind was to get a lot of public notice of support of the Bank of France in contradistinction to the French Government, which will immensely assist him in avoiding the difficulty of the sympathetic action of the Belgian franc when the French franc gyrates. I told Norman and Schacht that such a meeting was out of the question. There were two things that would certainly be necessary: the first one was ratification of the debt settlements by France, and the other was some definite understanding about the management and independence of the Bank of France and of the Belgian National Bank as well, and even then such a meeting would be of no value unless there was a wholesome, thoroughgoing, definite project to discuss and I was not at all in favor of those townhall meetings with all of the advertising and public discussion that went with them. So the project was abandoned.

It was a curious coincidence that this morning, when we had finished breakfast in the country, Vissering received a call from his bank saying that Mannheimer, the Amsterdam partner of Mendelsohn's, wished to bring Colonel Logan to see him this afternoon. It looks suspiciously as though Mendelsohn and Dillon Read & Company are working together with the ones who were negotiating with Francqui for the sale of the railway preferred stock. We have not yet discovered certainly whether that is so or not, but of course if it is, it is rather improper that Francqui should negotiate without first notifying Morgan, Hope, Baring and the banks such as the Westminster who have acted as the financial agents of the Belgian Government heretofore.

My general impression of Francqui is that he is smart as chain lightning and just as quick on the trigger, but very foxy; never tells all that he knows, but does respond when questioned intelligently and particularly about any particular matter. I also gained the impression that he is liable to be successful in Belgium if he does not attempt some fancy work such as would alienate the people who are best able to help him. We are waiting to see. Schacht, Norman, Vissering and I were all a bit disheartened that he was somewhat lacking in frankness.

This is about all that transpired of any consequence, although we had endless talks about every possible feature of the situation in Belgium. It is likely that they will organize a special bank to operate on a gold basis pending complete stabilization, but we have all urged Francqui that, if he attempts this, it should be considered as a most temporary plan for the period of transition only, as otherwise the operation of such a bank will tend to drive the entire price level, with wages etc. following promptly, to gold values and cause a much sharper crisis than would be necessary by a considered program of stabilization.

I am hoping to write you in a day or two, and possibly cable, some def-

inite word about the situation in Paris, which is complicated beyond description just now, because of the debt situation.

My best to all the folks at the Bank.

Sincerely yours,

Benj. Strong

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

Postscripts:

(1) I should add that interest on this preferred stock is payable in the equivalent of pounds sterling at the rate of 175 francs to the pound, so that if the franc declines, the interest payable in francs correspondingly increases, but it will not decrease, as I understand it, if the franc advances above 175. This operation, therefore, really fixes the rate of stabilization of the franc at 175 to the pound.

(2) Since dictating the above, we have come to the conclusion that Francqui has been dealing with Du Bois in Switzerland, which is all right, as his bank is the financial agent of the Belgian Government, but we do not know with whom he is dealing in Holland, and it has been said that Termeulen of Hope & Co., Belgium's bankers here, has stated that his firm will not be interested in the railway shares.

(3) I am sending you some Belgian newspapers containing evidence of the public attitude in Belgium towards Francqui's program.

[From B. Strong] 1/5/27 (14)

X 435

Photostatic copy on 790

Hotel de l'Europe,
Amsterdam, August 10, 1926.

My dear Mr. Mellon:

Since our talk in regard to the agitation about the difficulties of the American farmer, I have had a further talk with Gilbert and we both felt that it might be well to put the substance of what we discussed into more concrete form, which I shall now attempt to do.

As you know, this subject has had our attention at the Bank, principally as a credit problem, ever since the agricultural inquiry of 1921. The following thoughts are the result of a good deal of study, in connection with which I have read most of the literature of the last few years and almost all of the bills offered to Congress on this subject.

The agricultural problem divides itself naturally into four parts, as follows:

(1) Agricultural credit;

(2) Marketing facilities and methods;

(3) The cost of making the crops;

(4) The market and market prices for the crops.

As to (1) - Credit. Beyond the gradual development of the present system of Intermediate Credit Banks (especially for the benefit of the cattle industry), I do not think any good will result from enlarging agricultural credit facilities, which may indeed have a tendency simply to extend and perpetuate an unsound situation. If the farmers are deluded into thinking that their industry will become more profitable by growing more crops, which they may be encouraged to do by supplies of cheap money, they will add to their difficulties rather than solve them.

(2) As to market facilities. Much has already been accomplished, and doubtless still other methods for facilitating cooperative effort in marketing and

cheaper and more efficient means of delivering and distributing farm produce can and will be developed, but this is a slow growth and many of the measures attempted have demonstrated their futility through failure or have exhibited the incapacity of the farmers' organizations to manage them, as in the case of the recent unsuccessful efforts to purchase the Armour grain elevators and market grain by farmers' cooperation. The development of better and more economical marketing methods cannot be accomplished by legislation anyway, but will depend more upon intelligent cooperative effort among the farmers themselves.

(3) The cost of making the crop. It is undoubtedly true that the causes of the farmers' high cost of production are our high standards of living, the high prices prevalent in the United States, the high cost of his land - which, in many cases, is heavily mortgaged - and high labor costs. The Immigration Law will likely retard or prevent any decline in labor costs on the farm. The price of the farmer's land, the interest on his mortgage and his taxes are fixed and cannot be altered. The only costs which can be reduced are of those things which he has to purchase for working his farm (outside of seed), which might be reduced by a reduction of the tariff. The most apparent are: all chemical fertilizers which are still on the tariff list, farming machinery and farm implements, hardware, fence wire, lumber, tools and doubtless other things of like character. It has struck me that if concessions were possible on a very limited list of articles which enter considerably into farm use, it might reduce a widespread demand for general alteration of tariff rates, a project which would certainly prove to be disorganizing to the business of the whole country. It happens that most of those things which the farmers use, like special kinds of wire and lumber and of course fertilizer, and probably many of his tools and much of his hardware, are produced by industries which have a large and varied production and which would not be seriously affected either by tariff reduction or even by putting these few articles

on the free list. And there is much justice in the claim of the farmer that, because his prices are fixed by world price levels and his costs are fixed by domestic price levels, he is at a great disadvantage in contrast with other industry, which can regulate its production more accurately and scientifically with regard to world prices. The farmer is subject to the vicissitudes of weather which he cannot control, not only in his own country, but the crop weather of all other parts of the world.

(4) But the farmer's chief difficulty is the low price which he gets for his production, both at home and abroad. Roughly, between 15% and 20% of our farm production is exported. In a general way, one-half of our exports are agricultural in their origin, and of our agricultural exports about one-half consists of cotton and cottonseed oil and cake. An exportable surplus of 17%, or even less than that, if it cannot be marketed, makes a sufficient surplus to disorganize domestic market prices. What the farmer needs is a larger world market for all exportable agricultural production, and that larger market we cannot expect to develop except by the gradual elevation of world standards of living. There is no one thing which is so disturbing to the world's commerce and so dangerously lowers living standards as such conditions of financial and monetary disorder, with wide unemployment and consequent economy and poverty, as now exist in some parts of Europe. The consequences are felt directly by the farmer, because those farm products which we export are to a certain extent luxuries in countries of lower living standards. Wheat flour, that is, white bread, meat, lard and even cotton are all capable of greatly reduced consumption when people are obliged to economize. Belgium is now imposing limitations upon the amount of white flour in bread. The need for raising the price of bread, as has recently been done in France, has a tendency to reduce the consumption of wheat flour. In Italy prizes are being

offered for increased wheat production. The consumption of veal, chickens and other less nourishing meats in Europe can readily take the place of American beef and bacon and the higher priced meat products which we export.

The pressure of economy in Europe is exhibited by 2,500,000 unemployed in Great Britain, 2,000,000 in Germany, 350,000 in Poland and many in middle Europe; possibly a total, with their families, of 30,000,000 who cannot afford the expensive foods we partly furnish. The same is true of the enforced economy of large classes who are impoverished in France, Italy and Belgium, and in other countries as well, because of the reduced domestic purchasing power of the currency.

It seems to me that there is every argument for the development of a constructive policy towards European restoration, and that this may apply not only to cooperation by the extension of credit, as at present, but may even extend to our policy in regard to the political debts.

We are now engaged in making calculations at the Bank as to the burden of the payments which must be made to the United States, both on private loans and on the funded Government loans. So far as we have already gone, it appears that the service of all of these loans will next year call for payments very close to a billion dollars, if not quite that. While there are offsetting items, the principal one is of an uncertain character, namely, the possible return to European countries of the fugitive capital which has taken refuge in America. It may well be that this burden of payments, which has now become so heavy, represents such a sudden and formidable change of balance, because of the war, from the days when we were a debtor nation, that the world is in fact today experiencing a real difficulty in paying for what it would otherwise buy from us, because at the same time it is unable to pay interest and principal of the magnitude required to meet what they already owe. This development is difficult to detect or appraise, but it can safely be assumed that the many

dollars required to pay loans reduce the amount available to buy our farm products.

While I realize the difficulties of such a course, the question may be asked whether our policy as to the political debts cannot now or soon be modified in the interest of our own commerce, especially of the exports of the farmers.

The possibilities of modification may be divided into:

(a) Some scheme of cancellation. This would be so unpopular politically as to be out of the question.

(b) Some plan for readjustment of individual settlements. Probably the only one which might be justified is the British agreement. To modify one without opening the door to changing others would seem to be impossible. Besides that, the feelings aroused by recent developments would appear to make any change in the British agreement very difficult.

(c) A general plan. From time to time it is suggested that, within a few years, it may be possible to effect some general settlement of German reparations. Such a settlement could not be effected by a down payment of cash, as the financial operation involved would be too large. It would necessarily involve employing some form of security, such as the railroad and industrial bonds created under the Dawes Plan, which would be a continuance of a part of the annuities on a capitalized basis. Such a settlement would of course greatly add to the difficulties of the Allied Governments in meeting their funded obligations to the United States Government. Their income from Germany would be reduced by the fact that the annuities were capitalized, and to the extent that the railroad or industrial bonds were sold in the markets, the income would entirely cease.

At the present moment, an attempt to settle the indebtedness to our Government by the use of the securities delivered by Germany would be unpopular in America, but might be possible after a lapse of years. The only suggestion which seems at all feasible now, is for the American Government, late this year or early next year, on its own initiative to propose a moratorium (excluding Germany; also Austria,

the latter being already postponed) for a short period, say for three or at the outside not over five years, during which no interest would be required nor even accumulated, so that at the end of the period, payments on all the Government debts would commence upon exactly the bases which are provided under existing agreements, unless a readjustment had been made. This would relieve Europe of an immense burden, greatly facilitate financial and monetary restoration and, I believe, do more to protect the farmer's market than any other thing that we could do. At the end of five years, the present bitter feelings would have subsided, and much more would then be known of the capacity of Germany to carry out the terms of the Dawes Plan than is now possible. At the end of two or three years, it might be possible to work out a general readjustment of the debts which would eliminate them as a source of irritation. It would relieve us of the unfortunate position which we now occupy of exacting payment from our debtors upon a fixed basis, when Germany's payments are so controlled under the Dawes Plan that they may be suspended if capacity to pay is shown to be unequal to the burden. We now are in the unfortunate position of extending greater leniency to the defeated enemy than we show to our victorious associates in the war.

While it is not possible for me to comment upon the political effect of such a program, there are evidences that it would be popular with so many people at home that it would moderate the demands of those who are now so vehement in insisting upon full payment. Such a modification, applying to all agreements, after all had been ratified, might satisfy needs on both sides and overcome much of the present bad feeling.

Sincerely yours,

Hon. Andrew W. Mellon,
c/o Hotel Royal,
EVIAN-LES-BAINS.

BS:M

Hotel de l'Europe,
Amsterdam, August 11, 1926.

Dear Mr. Harrison:

Both Dr. Schacht and Dr. Vissering have approached me in regard to the matter of taxes on income earned from bills purchased for the account of their Banks. I understand that they are in correspondence also with Dr. Bachmann of the National Bank of Switzerland. This subject is getting more active and apparently is causing a good deal of difficulty with these gentlemen, who are now so largely dependent upon the earnings from their foreign portfolio as to feel the need for close economy.

I also had a little general talk about their balances with us. We shall probably experience no difficulty with the Reichsbank, but as to both Holland and Switzerland, I think the pressure for earnings makes them keep a similar balance as low as possible. The question to consider is whether the law does actually impose the taxes they are now paying, or whether there is a possibility of some interpretation giving any relief; or on the other hand, whether there is a chance of Congress being willing to modify the tax law in the interest of the promotion of our foreign banking relations.

Won't you put this on the calendar to be considered and taken up at the proper time.

Sincerely yours,

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

BS-M

Hotel Grand & Euler,
Basle, August 13, 1926.

Dear Mr. Harrison:

I have been intensely interested by the printing of the enclosed article day before yesterday in one of the Dutch papers, which led me to cable you as per draft on the back. The whole situation is fully described in my long letter of the 11th. There seems to be no occasion to make any denial, as these matters are of interest for a few days and they are then forgotten, but still it is annoying and disturbing because of its effect on other people.

My best regards as always.

Sincerely yours,

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

BS:M

Hotel Grand & Euler,
Basle, August 17, 1926.

CONFIDENTIAL

Dear Mr. Harrison:

Replying to yours of the 5th about the participation of foreign accounts in our purchases of Government securities, I think that matter is ended and am sorry to have given you so much bother as I did. The fact is that Norman and the others have got to take their chances in the market, just as we do ourselves, and I don't think we should strain our procedure in their behalf, no matter how urgently they press us. Dr. Schacht never mentioned the matter, which confirms my feeling that Norman is trading, or endeavoring to.

Sincerely yours,

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

BS:M

(18)

MEMORANDUM BY R. B. WARREN. IRBW

CONVERSATION OF AUGUST 23, 1926

Place: Princess-Hotel, Paris

Present: Governor Strong
Governor Moreau
Mr. Rist
Mr. Quesnay
Mr. Warren

Time: About 3 hours.

The conversation was opened by Governor Moreau, who referred to some points brought up in the discussion which occurred on the train from Evian between Governor Strong and Mr. Rist. He mentioned the fact that on some of the points of that discussion, he was unable to agree fully with the position taken by Governor Strong. For example, he did not agree that the system of indirect taxation for France presented the disadvantages which had been remarked by Mr. Strong. Second, in view of the efforts toward consolidating the floating debt, he did not agree with the proposals that the Bank should undertake at the present time the practice of buying and selling State securities. He was afraid that such a practice would lead to increased borrowings by the Treasury from the Bank.

Mr. Strong ~~quite~~ agreed ~~to~~ with this last position, but made it clear that, for the present, he had contemplated only the sale of Government securities held by the Bank and did not contemplate their free purchase as well as sale until after the relations of the Bank to the Treasury had been clearly determined and until an organized money market was functioning smoothly.

Governor Strong then remarked that since his last meeting with them, he had been in Holland, where he had met Governor Norman, Governor Schacht and Governor Vissering, as well as Francqui and Delacroix. In the course of these conversations the general problems of stabilization and, to a certain extent, the specific problems of France, had been discussed in general terms by all present, but that no reference had been made to his conversations with Governor Moreau. During these

meetings in Holland, the question of Eupen and Malmedy had come up, in which he, Governor Strong, had said that this was ~~entirely~~ a political question in which he had no interest, but that he was forced to remark that he doubted if such an agreement could be concluded between Germany and Belgium without appropriate compensation being given to all the other ~~signatories of the Treaty of Versailles~~ German Creditors. As for its relations to any contemplated American participation in the stabilization program of Belgium, it is clear that there would be no relation, the entire disposal of that question being outside of American interests.

From Amsterdam he had gone to Basle, where he had met Governor Bachmann of the Swiss National Bank for a few hours conversation; then he had gone to Evian where he had met Mr. Mellon. Mr. Mellon was considering the advisability of meeting M. Poincare if he passed through Paris, and as he had asked Governor Strong to take ~~certain~~ soundings, Governor Strong asked Governor Moreau whether he believed that it would be more or less desirable for Mr. Mellon to meet M. Poincare. The reasons arguing for such a meeting were, principally, that Mr. Mellon had already conferred with representatives of the Italian Government, there was good reason to expect that he would meet the British Prime Minister and also the Chancellor of the Exchequer, and that for that reason it might be that M. Poincare would consider it a ~~distinct~~ slight to be omitted from such a list of calls. On the other hand, there was ~~always~~ the danger that such a meeting would be given a false interpretation by the press, in which case the relations between the French Government and its Parliament, and that of the Administration at Washington towards its Congress, might be complicated. It was, however, the opinion of Governor Moreau, which was ~~fully~~ shared by Professor Rist, that, recognizing the difficulties of either of these alternatives, it was ~~very decidedly~~ preferable that Mr. Mellon and M. Poincare should meet. In order to find out if a meeting was desired, it was suggested that the approach be made through Mr. Whitehouse of the Embassy with the Ministry

of Foreign Affairs.

Governor Strong then asked whether there was any special topic of conversation which Governor Moreau would like to raise at this time, as it might be that, owing to pressure of other duties, Governor Moreau would not be able to be present at all of the conversations.

M. Moreau said that the subject in which he was most ~~vitally~~ interested was the possibility of securing adequate foreign credits.

Referring then to a program of stabilization a copy of which had been given him by the Bank of France, and specifically to that part which dealt with foreign credits, Governor Strong remarked that the sums proposed in the program seemed to be very large. In his own mind, he had outlined three sources of foreign credits: (1) A State loan; (2) Credit arrangements between the banks of issue; (3) Private arrangements between borrowers in France and abroad. These were the methods which also were discussed at some length in the program.

In order to clarify the position of the Federal Reserve Bank of New York, Governor Strong gave an extensive outline of the negotiation and terms of the similar credit to the Bank of England:

(1) The reasons which induced the Bank to undertake this operation were the desire to facilitate the restoration of sound monetary conditions in Europe and specifically to hasten the return of the world to the gold standard. The operation, which had been to some extent criticized in the United States, was, however, ~~entirely legal and~~ contemplated by the Federal Reserve Act itself. It involved the right of the Bank to open accounts with foreign correspondents, to purchase satisfactory paper in foreign markets, to buy and sell gold, and to make contracts. In one way and another, every one of these rights was involved in the transaction. The Bank contracted to sell to the Bank of England during a period of two years gold to the value of 200 million dollars. The Federal Reserve Bank of New York would receive payment in the form of a deposit in the Bank of England, which would be invested for its account in satisfactory commercial paper in the

London market. When this transaction was questioned, it was pointed out that, while the Act ~~specifically~~ authorized the Bank to buy and sell gold, the objection centered on the period of time involved in the contract. It was, however, demonstrated that the only feasible way by which the Federal Reserve Bank could sell gold to a foreign bank of issue would be over an extended period of time, as under any other form of contract which involved either no time or a shorter period, the ~~entire~~ value of the transaction would be lost. This precedent, therefore, had become firmly established as far as the Federal Reserve Bank of New York was concerned, and there was no doubt as to their capacity to make other agreements of the same kind. Nevertheless, before engaging in this undertaking, the Federal Reserve Bank of New York had insisted upon three safeguards:

(1) That during the period of the contract, no fundamental change in the character of the Bank of England itself should be made;

(2) That during that time, the British Treasury should not alter the status of the currency notes in the direction of an inflation of that type of circulation;

(3) That the British Government should bind itself during the duration of the contract to raise no barrier to the exportation of gold in case such an exportation should be necessary to meet the terms of the contract.

This last provision, of course, required an Act of Parliament, and it had been ~~specifically~~ written into what was now called the "Gold Standard Act of April 28, 1925."

The other proposal had been for the British Treasury to agree to give the Bank, in return for any sums drawn upon by the Bank of England, dollar Treasury bills, and while they might have been legal, it was ~~infinitely~~ less desirable, as far as the Federal Reserve Bank of New York was concerned, than the type of provisions actually made. However, as far as the Morgan credit which supplemented the credit of the Federal Reserve Bank of New York is concerned, the security upon

which that was based was the promise to give in return British Treasury bills expressed in dollars. While such security was no doubt good, it was ~~a character~~ more nearly a ~~of~~ a collateral loan and as such ~~was~~ might be open to some question of legality.

The terms given to the Bank of England were ~~extremely~~ light, but could be justified for three reasons:

(1) The ~~strong~~ desire of the Federal Reserve Bank of New York to facilitate the reintroduction of the gold standard in England;

(2) The fact that the debt arrangements just concluded between England and the United States had been ~~extremely~~ burdensome to the British balance of payments;

(3) The fact that the character of the loan itself was ~~unusually~~ high, since it was supported (a) by the credit of our Government, (b) by the credit of the Bank of England, and (c) by the individual credit of the three names appearing upon all the paper in which the funds created under the issue of this credit would be invested in the London market.

Protection against loss by exchange lay in the fact that, if the credit was used, the account would be adjusted from day to day in accordance with the fluctuation of the cable rate on New York.

These exceptional conditions had justified granting this credit without any commission, but this leniency had been ~~severely~~ criticized in the U nited States, even by persons who were friendly to the credit itself. In Governor Strong's opinion, there was much merit in this objection, and he believed that if the British credit were renewed it ~~would~~ might be necessary to charge a commission. He was also of the opinion that if any further similar credits were offered to any central bank, some commission would be charged. Finally, ~~he was doubtful if~~ this generosity on the part of the Federal Reserve Bank ~~had really spared~~ had been misconstrued as intended to save the British people ~~much money~~ a commission which the private bankers received, ~~as he was of the opinion that the amounts saved from the possible~~ ~~to the~~ ~~commission charge~~ ~~of the Federal Reserve Bank of New York had been added to the charges imposed by the private bankers which accorded a~~ on the credit ~~at the~~ this (which) ~~same time, was, the, claimed,~~ This was not the case, but the criticism did much harm.

(II) It was necessary to state candidly that a credit to the Bank of France would encounter a certain amount of special opposition in the United States. While the Federal Reserve Bank of New York was authorized to act for the entire System, it was ~~of course~~ necessary for Governor Strong to refer a matter of such importance to the Federal Reserve Board and to the Secretary of the Treasury. While these people ~~would have no actual~~ exercised only supervisory authority ~~either to grant or refuse~~ as to such credits, their ~~good will~~ cooperation was ~~certainly~~ essential. Further, the Federal Reserve Bank of New York in such a transaction would be acting as the representative and agent of the other 11 Banks of the System, and it would be necessary, ~~of course~~, to have their endorsement of a program. Finally, the Directors of the Federal Reserve Bank of New York themselves would have to endorse the proposal, and this fact necessitated a ~~candid~~ statement of a previous transaction with the Bank of France.

In 1916, on the occasion of Governor Strong's visit to Europe, at a time when the prospects of the Allies seemed none too bright, and having in mind the necessity of ~~close~~ cooperation between central banks after the war, the Federal Reserve Bank of New York made certain proposals to the Bank of England. A copy of this letter was at the same time transmitted to the Bank of France. Further, in order to express a certain degree of interest, the Federal Reserve Bank of New York bought £ 100,000 which it placed upon deposit in the Bank of England, and 1 million francs which it placed upon deposit at the Bank of France. Both of these deposits had been maintained continuously. The one at the Bank of England had ~~of course~~ fallen in value during the period of the decline of the pound to the neighborhood of $3.~~00~~50, but it had ~~completely~~ recovered and now ~~of course~~ showed no loss. As for the deposit at the Bank of France, which was subject to drafts, it had steadily declined in value, but on one occasion, in the absence of Governor Strong from New York, it had been doubled, apparently with the object of averaging on the loss. At the present time, of course, this deposit of 2 million francs with the Bank of France represented practically the sole loss which the Federal Reserve Bank of New York had ever sustained in any of its operations.

They had, in fact, had no loss on any other type of loan or credit, and the total loss to the Bank on all accounts, whether petty thefts or unaccepted vouchers of the Government or clerical errors, amounted to only $46,000. over a period of 12 years.

As a result of this transaction and its ~~speculative~~ resulting loss, there was a certain amount of feeling among the Directors of the Federal Reserve Bank of New York that any further transactions with the Bank of France should be hedged about with ~~a very considerable~~ a degree of caution. Furthermore, while up to the present time the Federal Reserve Bank of New York had undertaken such a credit only in the case of the Bank of England, there was reason to expect that in the ~~not distant~~ future they would receive requests similar to that now being made from the Bank of France, from Italy, Belgium, Poland and possibly Japan. If all of these requests were granted, it was clear that the ~~entire~~ sums engaged would be ultimately very large. The risk would fall entirely upon the Federal Reserve System; in fact, in the case of the two deposits with the Bank of France and the Bank of England, the entire burden had been assumed ~~solely~~ by the Federal Reserve Bank of New York, which had not felt warranted in distributing it even among the other Banks of the System.

(III) Passing then to the third type of foreign credits, Governor Strong suggested the advisability of engaging the commercial banks of Paris in some such form that they would be in a position to lose money if the franc declined. He suggested that the Bank of France refuse credit to the commercial banks except upon the stipulation that ~~they~~ it should be repaid at a gold value equal to the value of the loan at the time it was made.

Governor Moreau expressed the opinion that this was ~~quite~~ out of the question; that first there would be legal difficulties, and second, many of the commercial banks were so strong that they ~~had simply~~ would refuse to have any transactions with the Bank of France on such a basis. As an alternative, he suggested that already they had given some consideration to a plan for obliging the commercial banks to assume a certain proportion of the Government debt, with the understanding that they would not

liquidate it until the stabilization program was completely assured.

M. Quesnay further suggested that the proposal contained in the program, by which certain foreign credits were to be raised by the consortium of commercial banks in Paris and the proceeds sold to or deposited with the Bank of France, would give those banks some interest in the maintenance of the value of the currency.

Governor Strong said that one of his strongest impressions in regard to the difficulties which the French Treasury had faced during the last few years had been that they were due

(1) to the refusal of the commercial banks to carry the proportion of the floating debt which they had formerly supported, and

(2) to the fact that the budget had been left unbalanced year after year.

The combined effects of the necessity of maintaining the floating debt and the necessity of balancing the budget by the issue of currency, had thrown ~~entirely~~ upon the Bank of France the burden which should have been shared between the commercial banks and the taxpayers, and had forced the continuous increase in circulation. If the commercial banks were so strong that they could get along without the assistance of the Bank of France, ~~obviously~~ they were strong enough to give the Government and its Treasury ~~a great deal~~ more effective support than they had recently been giving.

Returning again to the subject of the magnitude of the credits suggested in the program, Governor Strong said that he would be unable off-hand to give any estimate of the amounts required. If the program of stabilization was a good one, ~~obviously~~ a ~~very~~ small sum would be needed. If it was a bad program, no sums that could be borrowed would be adequate to meet the situation. However, two factors which bore on the subject could be ascertained:

(1) The decomposition ~~depreciation~~ of the floating debt, and

(2) A comprehensive statement of the balance of ~~plans of~~ payments of France, with special reference to the sums which must be found by the French Treasury to meet its foreign obligations.

Further, as far as any credits extended by the Federal Reserve Bank of New York to the Bank of France were concerned, it would be ~~absolutely~~ necessary that those should be entered in the statement of the Bank of France in so clear a way that, in case they were drawn on or utilized, it would be obvious to the French public that the Bank of France was merely returning gold or credits which it had borrowed abroad. Owing to the prejudices existing in France regarding ~~the amount~~ a loss of gold from the reserves of the Bank of France, it was necessary to take ~~certain~~ precautions to avoid misunderstandings which would be superfluous in the case of a country which had a different popular attitude on gold movements.

These ~~various~~ objections which had been raised, such as the possibilities of commission charged, the difficulties arising from the previous transaction with the Bank of France, etc., Governor Strong said that he had advanced, not for the purpose of creating a discouraging atmosphere, but simply to give a ~~candid and~~ fair statement of all of the factors involved in the transaction.

Governor Moreau then asked whether, in considering plans for the securing of credits with other banks of issue, Governor Strong would recommend that an approach be made at the present time to the Reichsbank.

Governor Strong replied that he was convinced that for the present such an approach would be undesirable.

Governor Strong then mentioned the fact that one of the greatest problems which would arise out of the period of stabilization would not be the difficulty of securing adequate foreign credits, but rather the difficulty of handling such foreign credits as would be offered plus French capital which would be repatriated. From his conversation with American bankers, he was convinced that, just as had been the case with Germany, once the stabilization program was adopted in France, the Bank of France would find itself almost swamped with valuta. At the present time, even ~~a good deal of~~ foreign capital was coming into France, and as an example it was

curious to note that while French capital was being exported to Germany via Switzerland, ~~a great deal of~~ German capital was coming into France and being invested in equities in French industrial concerns and in banks. In other words, the very capital which was exported from France to Germany was coming back into France, with the exception that in the transit, the control represented by this capital passed into the hands of strangers. This was ~~a most~~ an undesirable situation, and in passing he made the remark that it was ~~quite~~ different from the attitude of the American investor in France. While American investors and bankers were interested in making profitable ~~and lucrative~~ investments, there was not the same incentive nor desire to secure control of French enterprises that existed among investors in certain other countries.

M. Moreau replied that he did not apprehend much trouble from the return of French capital, because he imagined that it would be ~~very~~ slow in coming back, even under a period of stabilization, and M. Quesnay advanced the ~~supplementary~~ remark that he doubted if it would come back except under some sort of compulsion.

M. Moreau then said that, while they were anxious to proceed with a program it was ~~obviously~~ impossible for them to guarantee that a program of elaborate details would be possible of institution. The attitude of the Government on some of these details, ~~of course,~~ was quite impossible to predict.

Mr. Strong replied that these details were not disconnected, but would naturally ~~fall~~ follow one after another, once a stabilization program was put into effect, ~~but~~ and that it was well to have the sequence in mind as early as possible. For example, the question of the reorganization of the currency would come up ~~very~~ promptly after stabilization. The present unit, the franc, was entirely too small for convenient use. Furthermore, the practice of issuing small banknotes was ~~entirely~~ unsuited for any bank of issue in a great country; therefore he anticipated that the inevitable step following stabilization would be the creation of new ~~anmitin~~ multiples

of the present franc, that business would naturally fall into the habit of using such units, but that ~~it~~ the transition could be facilitated if ~~they~~ it were planned for from the start. For instance, if the franc is stabilized in the neighborhood of 2½¢, the next logical unit would be a metallic piece of 10 francs, worth about a quarter, and the smallest convenient gold unit would be a piece worth about 200 francs, or somewhere in the neighborhood of $5 or $6. This natural sequence would involve or should involve the abandonment by the Bank as soon as possible of banknotes or a smaller denomination, say, than 50 francs, and their substitution by a metallic unit, probably silver.

This immediately, ~~of course~~, raised the question of the position of silver in the Bank's vaults. This would have a value of something like 3 or 4 milliards of francs, at the present worth. The utilization of this silver, ~~of course,~~ would immediately bring into question the revaluation not merely of the silver, but of the gold in the Bank's vaults, and this ~~of course~~ would involve a ~~distinct~~ change in the present account of the State with the Bank.

M. Rist remarked that once again Governor Strong was on his favorite subject of the profits of revaluation; that it would be ~~very~~ difficult to persuade the State to forego such profits.

Governor Strong remarked, however, that the Bank of France was a civil and legal unit, exactly like an individual or corporation; that it would be ~~quite~~ absurd for a man who possessed 10,000 francs in gold and ~~7,000~~ 70,000 francs in Bons de la Defense to be told by the State that the State would cancel its indebtedness to him on the Bons which he possessed by ~~taking~~ recovering his gold and merely leaving him 10,000 francs ~~in paper~~ of 1/8 the the Sres value. The question was more or less the same in the case of the silver.

M. Rist, however, remarked that historically the profits of seigniorage had always been assumed by the State.

Mr. Warren remarked that in the case of a revalorization of gold, there was no question of seigniorage ~~whatever~~ involved, and in the case of the silver, only

part of the change in the value could be called seigniorage, and the rest was revaluation; that the question of the bookkeeping profits derived from revaluation was ~~entirely~~ distinct from that of the profits of seigniorage, and the two should not be confused.

However, Governor Strong said, as a matter of policy it might be ~~quite all~~ right for the Bank to accord to the State as much as it pleased of the benefits arising out of this bookkeeping rearrangement, but the Bank should make its position ~~entirely~~ clear, that any benefit given to the State this way could not be claimed as a right of the State; that the assumptions underlying the Experts' report in this matter and underlying much of the popular comment on it were ~~absolutely~~ false; that the Government should be made to understand that if the Bank gave them this favor, it was doing so ~~entirely~~ as a gift ~~of~~ good will.

M. Rist remarked that, at this point, the Government might say that if the Bank of France refused this benefit, they would oblige them to restore immediate convertibility of the note issue into gold at the face value of the notes.

Mr. Strong said that the answer of the Bank to this was that the Bank of France would be ~~perfectly~~ willing to restore gold redemption for the notes which it had issued of its own volition against commercial paper, but that it could not be expected to grant the same convertibility to notes which it had been obliged to issue against ~~merely~~ the promise of the State; however, that it would be ~~perfectly~~ willing to assume gold convertibility of the note issue provided at the same time the State would repay its debt to ~~accept liability in gold at par of its obligations toward~~ the Bank. However, in view of all the circumstances, the least that the Bank could insist on would be that some of the benefits of this operation should go to the extinguishment of ~~some of~~ the dubious elements among the assets, such as the loans to the Russian Treasury, and so on. Further, there was the position of the shareholders of the Bank of France to be considered. They were still receiving virtually the

same dividend in paper as they received before the war in gold. This could be justified only on the assumption that at some time the paper francs which they were receiving would be convertible into gold. With the reorganization of the currency, ~~of course~~, this hope would disappear. At the same time, if the shareholders were asked to give up a very large part of the value which appeared in the assets under the form of gold, they could not properly be expected to give up all of that value; yet if in the process of reorganizing the statement of the Bank some sort of stock dividend were issued, it would ~~of course~~ be necessary to take into account the Bank's capacity to earn a dividend upon the increased capitalization.

RBW

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MEMORANDUM BY R. B. WARREN

CONVERSATION OF AUGUST 24, 1926

Place: Hotel Princess, Paris

Present: Governor Strong
Dr. Rist
Mr. Quesnay
Mr. Warren

Time: Two hours.

This conversation was ~~entirely~~ devoted to a discussion of ~~various~~ topics mentioned in the program prepared by Mr. Quesnay.

The first subject discussed was raised by Prof. Rist, who stated his belief that it would be ~~very~~ dangerous to announce at the outset the details of a program of stabilization, and especially to accompany such a program by the statement that it was ~~absolutely final and~~ complete.

Governor Strong opposed to this suggestion the idea that the more complete and definite the program announced, the more it would be likely to inspire the confidence of foreign investors.

Mr. Quesnay, ~~however~~, remarked that already, at the mere prospect of stabilization, there was developing a ~~very considerable~~ demand that the holders of the public debt should receive some compensation which would recognize the fact that the francs which they had loaned to the Government were of ~~substantially~~ higher value than ~~a franc~~ that at which it was proposed to stabilize. ~~It was clear that~~ Such public opinion would have to be taken into account, as, if it were antagonized at an early stage of the proceedings, it might develop sufficient opposition to retard the operation.

Referring to the demand in the program that the Bank should be given complete charge of the monetary stabilization, and especially that it should be released from all obligations to lend money to the State, it was suggested that perhaps the most satisfactory form to present such a request to the political authority would be to represent it as a return to the prewar status, rather than as a demand for some-

thing ~~entirely~~ new. Before the war, the Bank of France did not lend money to the State beyond a ~~very~~ small fixed sum, which was provided for in the charter.

However, Prof. Rist was ~~quite~~ insistent that political opposition was likely to develop at the prospect of releasing the Bank entirely from its subserviance to the State, and that the subject would have to be approached with ~~a great deal of~~ caution. The principal danger, it was agreed, came from the uncertainty as to whether or not the budget would be balanced. If the budget were not balanced, ~~it was obvious that~~ the deficit could be met only by borrowing, either from the Bank of France or from the money market.

Governor Strong emphasized the necessity of creating the circumstances which would oblige the money market to take over the obligations which would be issued to meet any deficit in the budget, provided such a deficit should arise during the ~~uncertain~~ period of stabilization. He recognized, ~~of course~~, that provided the budget were ~~really~~ balanced, temporary advances to the State from the Bank of France ~~merely~~ in anticipation of repayments which were certain to be made out of current revenue, would ~~actually~~ do no harm. Nevertheless, in view of the fact that such easy borrowing ~~would~~ might be ~~possibly~~ ~~taken advantage of~~ exploited by the Treasury, it would be better if such temporary borrowings were made ~~entirely~~ in the money market, rather than from the Bank of France.

Under the topic "B 3" of M. Quesnay's program, which related to an understanding between the Bank and the Treasury relative to the discount rate and the rate on Treasury bills, Governor Strong gave a brief account of the relations which prevailed in the United States. There, whenever the Treasury proposes an issue, the Secretary of the Treasury ~~invariably~~ consults the Federal Reserve Bank of New York. Also, when the Federal Reserve Bank proposes to raise or lower its discount rate, it ~~invariably~~ discusses such action with the Secretary of the Treasury. This arrangement does not suppose that either will be subservient to the other. The Federal Reserve Bank of New York does not pretend to dictate to the Treasury the

terms of its borrowing, nor does the Treasury presume to dictate to the Federal Reserve Bank the terms upon which it will supply funds to the market, but because of the intimate relation, it is desirable and it has been found ~~entirely~~ feasible to maintain ~~a full~~ an exchange of views and the closest cooperation.

At this point in the discussion, Governor Strong inquired as to whether the recent change in the rate of the Bank of France had been suggested by the Treasury or had been initiated by the Bank, inasmuch as the result of the increase in the Bank rate from 6% to 7½% had been accompanied by an increase in the Treasury bill rate merely from 5% to 6%, leaving the differential between the discount rate and the Treasury bill rate rather wider than it had been before.

Prof. Rist stated that the initiative in this instance had come from the Bank, but he also affirmed that the differential had not been changed, because the Bank rate had been raised ~~merely~~ from 6% to 7%. In this position, he was supported by M. Quesnay, but a statement of the Bank was produced which showed that neither of them was correct, ~~either upon the present discount rate of the Bank of France nor upon the rate which had prevailed before the change~~, and as a matter of fact the situation was as Governor Strong stated, namely: that the differential between the discount rate and the Treasury rate had been widened as the result of the recent change.

Under the topic "B 4" of M. Quesnay's program, which covered the operations of the Bank of France in the exchange market, Governor Strong emphasized the need of securing an ~~extremely~~ able man to head such a department.

Professor Rist said that they were intending to secure as good a man as they could, and that they had already received suggestions from a number of the largest banks in Paris, who offered them the services of their own operator for this position.

Passing down to the topic "C (a)", the question was raised as to the amount of the long-time Government loan. Governor Strong leaned to the opinion that such a loan should be as small as possible, because the foreign debt charge

of the French Government was already ~~very~~ onerous. In his opinion, $100,000. 000 might be enough, and $150,000 000 in all probability would be the outside limit.

Professor Rist expressed the opinion that it would be necessary to have sufficient funds available at the outset to insure confidence, but Governor Strong remarked that if the borrowing was excessive~~ly large~~, as for instance over 200 million, it would be in itself an expression of want of confidence by the French Government and would in that way defeat the ~~very~~ purpose for which it was raised.

M. Quesnay's prospectus had raised the question as to whether or not this loan should be raised through the French Government's regular bankers, namely, J. P. Morgan & Company. In this respect, Governor Strong remarked that, while of course the French Government would be ~~entirely~~ free to select as its fiscal agent any firm which it chose, they should remember that there was a ~~very considerable~~ difference in both the capacity and the reliability of various New York banking houses, and that if the Ministry of Finance changed its bankers, they should take care not to trust too heavily in the promises of any firm before they had ~~carefully~~ ascertained the capacity of that firm to carry out its promises. In case they received ~~bids or~~ offers from any New York firm other than their regular fiscal agents, he suggested that the Minister of Finance immediately do two things:

(1) That he should refer the offer to the Government's regular fiscal agents for an opinion, and

(2) That no offer be considered which was not signed by a responsible member of the firm, and the terms thereof ~~studied~~ stated in complete detail.

Only in this way could the French Treasury insure itself against ~~possibly~~ embarrassing disappointment.

The next topic raised in M. Quesnay's prospectus was the relation of the German railway bonds to the scheme. It appears that these railway bonds have been considered as offering either of two possibilities. Either they might be used to repay the long-time Government loan, which is provided for in the prospectus, or they could be used

~~simply~~ for distribution in France to afford a means of consolidating the floating debt.

It was ~~immediately~~ pointed out that these bonds were probably unavailable, and ~~almost~~ certainly unsuitable, for either of these purposes. First of all, for the mobilization of these bonds it would be necessary to consider their legal status. As a creditor, the rights of France, although proportionally large, were in no way superior in law ~~before~~ to those of any other of Germany's creditors. Consequently, no mobilization of these bonds could take place in the interests of France unless with the ~~full~~ consent of every other creditor of the Reparations program. It was ~~entirely~~ doubtful ~~whether~~ if such consent would be forthcoming. Second, the mobilization of these bonds would introduce a new feature into the Reparations program. ~~It was obvious that~~ They could not be marketed unless the interest thereon could be given priority over other ~~order~~ Reparation payments. There was nothing in the bond itself or in the Dawes Plan which assured these securities of ~~any~~ priority, and consequently the only way that they could be used in the manner proposed would be as an ~~a distinct concession and~~ act of grace by the German Government. There was no reason to believe that the German Government would wish to accord such a favor to France, even if it could be imagined that the French Government was prepared to ask such a favor of the German Government. There is a certain parallelism between the proposal to commercialize these German railway bonds and the proposal to commercialize the French debt to the United States. It was ~~absolutely~~ out of the question to commercialize any debt of France to the United States, following the terms of the Mellon-Berenger agreement. In somewhat the same way, it would be extremely difficult to commercialize the German railway bonds under the terms of the Dawes Plan without German Government assistance. Furthermore, a loan floated, for example in New York, first on the credit of the French Government and second with the proviso that at some time it was expected to exchange it for railroad bonds, would in the opinion of Governor Strong be ~~much more~~ probably more difficult to sell than the straight unsecured bond of the French Government. There was by no means an enthusiastic market for German securi-

ties in New York, in spite of the fact that a very considerable number of small issues had been taken by that market. There was a general wish on the part of the American financial community and of the American investors to be entirely free from any direct association with the Reparations program or responsible for financing it, and consequently the announcement that the loan of the French Government was intended to be converted into or secured by such railroad bonds would render the issue more difficult rather than less difficult to sell.

As for the proposal that they should be used to consolidate the floating debt, it was pointed out that it was ~~quite~~ uncertain whether holders of the floating debt would voluntarily accept such securities in exchange, especially if, as was proposed by Professor Rist, an element of force was introduced into the conversion. Further, assuming that these bonds were put on the market in the interests of France, ~~it was evident that~~ they would have to be placed at the same time on the market in the interests of the other creditors of Germany. At the present rate of money, a 5% bond of this character could not be sold in the world market at issue price above perhaps 70. It was ~~by no means~~ not certain that the other creditors of Germany would ~~put~~ accept a proposal to sell such securities at 3/4 of their face value, and even if they did, it would ~~certainly~~ be ~~extremely~~ difficult to market them at their face value in France, while at the same time they were being offered at perhaps 3/4 of that value in the markets of the world.

Governor Strong further pointed out that Germans were ~~of all persons in the world~~ most likely to be attracted to ~~purchase~~ ~~such~~ these securities, ~~the Germans would undoubtedly prove the best clients,~~ and that if these securities were placed upon the market, it was ~~more or less certain~~ probable that they would immediately be bought in large quantities by German investors. The transfer of funds necessary to effect this purchase would involve such a strain upon the transfer of capital from Germany that it was hardly conceivable that the Transfer Committee could permit it to occur.

For all of these reasons, it was the Governor's opinion that the question of

using the railroad bonds in a large way in connection with either the refunding of the proposed stabilization loan or the consolidation of the floating debt was at the present time ~~entirely~~ Lekés out of the question.

(It was quite obvious that this presentation of the status of the railroad bonds was entirely unexpected to Professor Rist and was in fact a ~~very serious~~ disappointment. While he did not say so, it seemed to be apparent from his general demeanor that he had been counting ~~very heavily~~ upon these securities to support the proposed program of stabilization.)

The next question that arose under the program of M. Quesnay referred to the proposed issue of Bank of France notes to meet the requirements of the Caisse de Gestion. It was explained, however, that it was not contemplated that the Caisse de Gestion should in any way transfer the internal floating debt to an external funded debt, and that nothing more was contemplated by this proposal than that, if the Caisse de Gestion found itself in the necessity of reimbursing Bons de la Defense at a rate faster than could be managed under its regular receipts, it was to draw upon the proceeds of the external loan, which in turn would be given to the Bank of France to purchase the francs necessary to meet the requirements of the Caisse.

Taking up the general question of foreign loans and credits under "C", Governor Strong remarked that there were some four kinds of credit operations proposed under that heading, and that it would be probably poor market policy to attempt to utilize all four at the same time. For instance, it would probably be inadvisable to attempt to secure a Government long-time loan and a Government credit from the commercial banks of the United States at the same moment, for to a very considerable extent this would involve making two applications simultaneously to the same lenders. ~~It was obvious that~~ The circumstances of the moment would dictate what particular kind of borrowing would be most suited to the needs of the situation, but it was well to remember that it would ~~probably~~ not be advisable to try every possible form at a single time.

Referring then to the question of the recently signed contract for a loan of

60 million francs in Switzerland, M. Quesnay remarked that this loan had not been discussed with the Bank of France but had been contracted without their knowledge or accord. However, he remarked that it was not part of the stabilization program and that this might be advanced as an explanation for the fact that the Government had contracted this loan without reference to the wishes of the Bank.

Governor Strong then remarked upon the ~~extremely great~~ prejudice which any sort of secured loan would ~~offer~~ cause to the market for the existing French securities or for any French securities to be offered in the future. The exact terms of this railroad loan had ~~of course~~ not yet been officially announced, but certain reports had been circulated in the press which seemed to imply that this loan was secured by a pledge upon ~~certain~~ State property. If this were the case, ~~it was clear that~~ it would prejudice the status of all of the existing French loans, none of which are secured, and would make it ~~extremely~~ difficult in the future to issue any unsecured French loan. ~~Obviously,~~ It would be necessary to provide security for all French loans if security were provided for any, and the aggregate of these had reached such a figure that it would involve pledging in one form or another to foreigners a ~~very~~ great part of the domain of the French Government and of their specific revenues.

[It was learned positively later that the loan in question of 60 million francs from Switzerland did not involve a specific pledge of State property, but it was ~~certainly~~ well that the disadvantages of introducing ~~a~~ pledges into the borrowing practice of the French Government ~~were very important to~~ should be emphasized to the authorities of the Bank of France.]

Concluding, the conversation, Governor Strong remarked that the United States had a ~~very~~ real interest in stabilization - stabilization of France and general monetary stabilization throughout the Continent of Europe. This interest was partly selfish, but it was not the kind of selfish interest which had been represented in the newspapers. So long as monetary unsoundness prevailed in Europe, so long as conditions in Europe represented a succession of inflationary booms and deflationary slumps, Europe would

remain a poor market for American products, most particularly for American farm products, because the purchasing power of the average European consumer ~~was~~ had to come too ~~small~~ reduced to provide a market for our all exportable foodstuffs and cotton. There was, ~~it was true,~~ an idea rather prevalent in the world that a nation got rich out of exports. This was ~~absolutely~~ false. Prosperity comes from the total exchange of goods, exports and imports, and the United States could have a prosperous foreign trade only if the markets of the world were good places to buy in and good places to sell in at the same time. For this reason, the Federal Reserve Bank of New York was ~~extremely~~ interested in the question of stabilization, because it viewed stabilization as the only sure way of returning European markets to the normal purchasing power of prosperity, and because in the absence of such prosperous conditions in Europe, ~~it was certain that~~ the American farmer would have a ~~relatively~~ poor market for his production and would consequently suffer from a relatively poor price for the goods which he produced, in comparison with the goods which he purchased.

Professor Rist then raised the question as to why the American price index had, over a period of several months, been showing a steady tendency to decline. He asked whether, in the opinion of Governor Strong, this was merely a seasonal and brief tendency or whether it was to be taken as an indication that prices in the United States were showing a definite tendency to proceed to a lower level.

delete

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Mr. Strong said that the American general price index was rather deceptive as to the trend of prices in America and required careful analysis in order to ascertain the causes of the trend. Something like 53% of the Department of Labor index, by present weighting, was made up of agricultural and food products, and ~~xxxx~~ the decline in the prices of agricultural commodities and the decline in the price of cotton combined had offset a fairly steady or even advance in the price level for manufactured goods; the declining tendency shown by American indices of prices which were comprehensive enough to include most agricultural production really was reflecting special declines that were taking place. This decline in the value of agricultural production appeared to him to reflect somewhat the reduced power of consumption by Europe, especially of the more expensive foods produced in America. The suggestion that a very active trade in America was resulting in domestic consumption of these commodities, and consequently the export was declining from natural domestic causes, could not be sustained, because domestic consumption of that character, which absorbed the surplus of American production at a time when there was any demand at all from Europe for these same goods, would result in advancing prices rather than declining prices.

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MEMORANDUM BY R. B. WARREN RBW

CONVERSATION OF AUGUST 25, 1926

Place: Princess Hotel, Paris

Present: Governor Strong
Professor Rist
M. Quesnay
M. Warren

Time: about 2 hours.

The conversation opened with the remark by Prof. Rist that it was extraordinary how many people still believed that the franc could go back to par, and how many more who no longer expected it to go back to par were hopeful that it could be ~~very~~ considerably appreciated in value.

Governor Strong remarked that the only possibility for such a maneuver would be through an extremely drastic deflation or a capital levy, and this again was possible only in theory, ~~because it was absolutely~~ and impossible ~~to~~ in practice.

Prof. Rist then remarked that Prof. Jeze was one of the few eminent persons in France who had throughout believed in both the theoretical and practical possibilities of a capital levy.

Governor Strong expressed a desire to meet Prof. Jeze.

Turning again to the program, the question was approached of the possibility of negotiating accords with other banks of issue. Governor Strong of course declined to speak for such other banks, although he believed that contact should be opened with them. Even in regard to ~~the assurance of~~ support by the United States, it must be remembered that it was impossible to give assurances until the circumstances were clearer, and above all, it was ~~certainly~~ impossible to negotiate (the word used in the program) any agreement prior to the ratification of the debts. ~~At the same time~~, Governor Strong said that he would be the last person to seem to put himself in a position of bargaining to secure ratification with anything resembling a promise of credits. However, he expressed the opinion that without rati-

fication, ~~other~~ European banks of issue would hesitate to give their support to the stabilization scheme, because of the ~~very natural~~ doubt as to the ~~extent~~ amount of the foreign liabilities of the French Government.

The next question was, ~~the proposal that~~ in the event credits could be opened, whether they could be issued on the general solvency of the Bank of France. Governor Strong referred again to the precedent of the Bank of England, and said that it was proposed that any credits employed should be used for the purchase of bills in the London market. This was ~~obviously~~ difficult of application in the case of the Bank of France, because there were no bills to be purchased in the market, and the volume of domestic bills, ~~even~~ in the portfolio of the Bank of France, was very small. It was ~~quite~~ uncertain, therefore, just how such a transaction could be carried out if it ran to any great size. It was also clear that, since it would be impossible for the Federal Reserve Bank to assume any exchange risk, the ultimate liquidation of the credit might involve the ~~sale~~ export of gold. This offered particular disadvantages in the case of France, because of ~~the~~ popular feeling in regard to gold. ~~It was clear, therefore, that~~ Such a transaction with the Bank of France would offer particular difficulties not found in the transaction with the Bank of England. The question would have to be explored ~~very~~ thoroughly.

The question then arose as to the utilization of the proposed current account in foreign exchange. Governor Strong inquired as to the use which it was expected to make of such an account. ~~It was clear that~~ If the Bank issued francs or loaned francs against the valuta deposited, it could either invest this valuta and receive ~~an~~ interest thereon ~~purely~~ as an agent, or it might under certain circumstances sell it as part of the reserve. This latter course would ~~of course~~ be ~~extremely~~ dangerous, for the Bank ~~it~~ would then have an uncovered position toward the depositor. This objection made it impossible, for instance~~s~~, to use these current accounts and valuta as a collateral pledge against a credit.

M. Quesnay proposed the purchase of gold, buying spot and selling future, but

this ~~of course~~ would be a costly transaction. There remained, however, the proposal which had been suggested in the case of the Bank of England, that is, the use of dollar Treasury bills.

Governor Strong, however, explained that these were open to two ~~distinct~~ disadvantages:

(1) ~~They were~~ Their nature would be in the character of a collateral loan, and

(2) ~~They~~ The transaction would be assimilated to a loan to a foreign Government;

and with both objections, it ~~was questionable~~ raises questions as to whether the Federal Reserve Act covered ~~such~~ transactions, in such form.

Passing on to the question of the duration of the credit, Prof. Rist remarked that the most ~~serious~~ difficul~~ties~~ periods in the stabilization program would probably ~~occur in~~ be the first few months, and then again some time during the second year. This he believed had been the case in a number of other countries, notably Czechoslovakia and England.

Governor Strong questioned whether the second year in England had been particularly difficult on that account. As a matter of fact, the gold holdings of the Bank were practically as large as they were at the time that stabilization was announced. They had in the meantime been able to resume foreign lending on a large scale, they had not been obliged to make use of their American credit - on the contrary, they had accumulated certain hidden assets - and yet, their case was in some ways not so ~~simple~~ easy as that of France, because there was not that ~~some~~ same volume of exported capital to be drawn back home. On the whole, he was inclined to believe that, if it had not been for the strike, the situation in England would have been comparatively satisfactory this year.

Passing then to the question of the relative desirability of a sudden stabilization, against a protracted period ~~of waiting~~ during which the Bank would limit its activity to checking wide fluctuations in the exchange, Prof. Rist expanded upon the desirability of giving certain speculative advantages in a rising franc, whether to French people

who were considering repatriating their capital, or to foreigners who might think of buying francs.

Governor Strong, however, took the view that there was no ~~particular reason~~ justification for to offer my such a speculative profit, and that on the contrary, the advantages of ~~a complete and~~ thoroughgoing stabilization, once the moment had come to stabilize, ~~completely~~ out ~~weighed~~ any arguments that might be made in favor of a delayed process.

Referring again to the question of the duration of the credit, the relative advantages of a 1-year credit with a privilege of renewal as contrasted with a 2-year credit were discussed. Governor Strong was of the opinion that a 2-year credit at the outset might be too long, and that the advantage favored a 1-year credit, with a privilege of renewal. At the same time, he repeated the probability that it would be necessary to charge a commission in the case of any further Federal Reserve Bank credits.

M. Quesnay raised the question then of the relative cheapness of employing the funds secured from the Federal Reserve Bank as against those borrowed in a credit from the commercial banks.

Governor Strong explained that the question of which credit was used in the United States must be at the option of the Federal Reserve Bank, owing to the necessity of maintaining control of the money market. As to the size of the total credit required, he was of the opinion that $400,000,000. would be excessive, and that $300,000,000 or somewhat more would be ample, including all credits raised for the specific purpose of stabilization.

Under the topic of "Other Relations than Those of Borrowing with Central Banks of Issue", he remarked that the Federal Reserve Bank would of course be glad to exchange information, and if such credits were opened in New York, they could undoubtedly have a very fair idea of the character of the exchange market in francs. As far as other European banks of issue were concerned, he strongly recommended that the Bank of France make every effort to extend its personal acquaintance among such institutions by the

exchange of visits.

As for the question of the possibility of securing gold in the event that it was desired to translate some of these credits into gold, there would of course be no difficulties in the United States. Any claim upon any American bank could be instantly withdrawn in gold.

Under the topic of the proposed publication of a reserve ratio by the Bank of France, Governor Strong ~~strongly~~ recommended that this be done as soon as possible. The public should be accustomed to look for fluctuations in the reserve. At the outset, it probably would have a desirable influence upon public sentiment to see gold coming into the Bank, whether from abroad or from the purchase of domestic gold.

As for the question of an accord with the Bank of England, Governor Strong ~~of course~~ was not willing to speak for that institution, but he suggested that the Bank of France establish contacts with the central banks of other European countries as rapidly as possible, and that when the time came for international credits, they might consider approaching the Bank's of England, Sweden, Switzerland and Holland. He would not recommend that they should at this time endeavor to secure credits in Germany, and he doubted the capacity of Czechoslovakia and Austria to give anything more than moral support. It was also important to establish contact with Italy and Belgium for the specific purpose of insuring that these banks did not operate at cross-purposes. ~~It was also desirable~~ In his opinion ~~that~~, in the stabilization process, France should take the lead, and he suggested that probably in the event of these three countries stabilizing, the total amount of credit required for the operation would be less if France was the first to stabilize and was followed by the others, rather than for instance if Belgium ~~started~~ tried again, followed by Italy and last of all by France.

Concluding this question of relations with central banks, Governor Strong emphasized the idea that, for the present time, more beneficial results could be expected from individual contacts rather than from having a single great international banking conference such as had been proposed at Genoa in 1922. The reasoning back of the

Genoa proposal of an international conference was wrong. At Genoa, it had been expected that ~~there~~ would result as part of the stabilization process a scramble for gold. This had not materialized and there was no reason to believe that it would.

Prof. Rist then remarked that world prices in gold had for the past year or 18 months shown a steady tendency to decline. He was inclined to attribute this to the gold situation and gave the impression that he believed that world deflation was in prospect owing to an insufficient supply of gold.

Governor Strong remarked that he saw no prospect of a gold shortage of size sufficient to cause general deflation; that the only part of the world whose gold demand seemed to be large enough to be a disturbing factor might be India. As for the gold reserve of the United States, while it was true that the ratio of the total gold stock against the total volume of currency and deposit liabilities was ~~no~~ not much larger than before the war, it must be remembered that it was very much more efficiently used; with 2 billion 800 million dollars worth of gold in the vaults and nearly a billion more available in the form of certificates it was clear that the United States could readily afford to send ~~very~~ a considerable quantities of gold to Europe, replacing the same either ~~through the~~ by purchases of securities by the Reserve Banks or by taking in ~~some of the~~ gold from circulation.

Prof. Rist pointed out that he expected prices to decline all over the world, owing to the enormous increase in production. of goods -

Governor Strong, however, was inclined to minimize the effect of ~~such~~ a price decline caused by such circumstances and looked forward ~~over~~ during the next few years to a decided and general rise in living standards over the Continent of Europe. During this period he anticipated that the cost of capital might steadily decline ~~a probably steady decline in the cost of capital~~, but that very likely short credit, or bank credit, would remain on the whole fairly high. He saw no reason, however, to anticipate any abrupt movement of prices in a downward direction.

Referring again to Paragraph (5), page (3) of the program, he emphasized the

importance of permitting the Bank of France to control foreign loans, whether contracted by French nationals abroad or loans of French capitalists to foreign countries; he was inclined to believe that there was a real danger of France's overborrowing. Already France was indebted for ~~very~~ large sums, and it was not desirable that these should be expanded more than was absolutely necessary.

Passing then to the rate of stabilization, Governor Strong remarked that the two principal things to determine the appropriateness of a given rate of stabilization were prices and wages.

Prof. Rist remarked that one of the biggest factors in the question of both prices and wages in France was rent control, as the ~~purely~~ nominal rent charges under the present laws had a very considerable influence on both.

Governor Strong suggested that this matter be given the ~~most~~ thorough study, in order that over the next few years there should be a gradual and just revalorization of existing leases.

MEMORANDUM BY R. B. WARREN

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CONVERSATION OF AUGUST 26, 1926

Place: Princess Hotel, Paris

Present: Governor Strong
Professor Rist
M. Quesnay
Mr. Warren

Time: about 2 hours.

The question was immediately raised as to whether, after the Bank of France had begun to purchase foreign exchange, the Federal Reserve Bank of New York would handle their dollar account. Governor Strong assured them ~~they~~ it would be glad to, the same as ~~they~~ it handled the account of numerous other European central banks, and explained something of the character of the investments, taxes, and the relative advantages of investing in commercial bills and in Treasury securities.

Prof. Rist then took up again the question of prices and remarked that the indexes both of wholesale and retail prices had recently shown some decline, which seemed to ~~suggest~~ indicate that the franc was very nearly at its proper level, so that prices were sensitive to movements of the exchange. After stabilization, he was inclined to believe, ~~of course~~, that retail prices would rise somewhat. This raised the question of the volume of circulation.

The margin of circulation available for issue against domestic securities was of ~~course~~ very small, but with the return of funds from abroad, the volume of circulation could be expected to increase.

M. Quesnay explained some of the estimates in the program, suggesting that the circulation of the country might expand under stabilization by something like 50%, as for instance from $50 per capita to $75 per capita, if the exchange remained at about its present level.

Governor Strong remarked that such an increase would be safe only if it were assumed that the Bank had control of the market, and in this connection, it was important

that such a market be established in Paris, particularly for trading in short-time Government securities.

Prof. Rist, ~~however~~, remarked that the banks were practically out of this kind of securities and that they did not seem at all anxious to invest in them.

Taking up the question of the floating debt, which was raised by this reference to the market in Treasury paper, Governor Strong remarked that there were three possible means of meeting it:

(1) To reduce it by operation of a sinking fund

(2) To convert it into a longer issue voluntarily

(3) A forced conversion.

The French Government had elected the first means, but this plan was defective in that, while it provided for the retirement of the Treasury securities, it did not make any provision for retiring the debt to the Bank. The Bank, of course, could be repaid in two ways: either out of the proceeds of a foreign loan, or out of the accumulation of francs by the Government in the form of budgetary surpluses. In any event, to secure control of the market, it was desirable to be able to mobilize part of the State's debt to the Bank.

Prof. Rist immediately raised the difficulties of inducing the State to mobilize this debt, inasmuch as it would be obliged to exchange a security on which it paid almost no interest for one on which it paid the market rate of interest.

Governor Strong showed that this was ~~exactly the~~ parallel to the case of the British Treasury and the Bank of England with regard to the currency notes in England.

Prof. Rist, however, remarked that the Government was not wholly averse to this idea, and it was suggested that it might be possible to proceed, to such mobilization ~~rather~~ gradually by limiting the demand of the Bank upon the State to amounts merely of a size ~~demanded~~ needed by the Bank for some particular operation. The time when such an operation was likely to be required would be one when money was easy and confidence strong. It was true that the Treasury could sell its securities at such a time as

well as the Bank, but if the sale were entrusted to the Bank, it would facilitate the Bank in getting the control of the market. At the present time, the Treasury itself conducted a kind of open market operation, in that whenever the public subscribed to Bons, the Government turned over the proceeds to the Bank and thereby reduced its debt to the Bank. However, under such a system, the Bank itself had no option~~, as to the effect upon the market.~~

Prof. Rist at this point remarked that there were certain people, particularly industrialists, who were desirous of a violent program of deflation without stabilization, their object being to provoke a crisis which would enable them to consolidate French industry into a few powerful groups, somewhat on the German model.

Governor Strong remarked that deflation without stabilization meant that higher Treasury charges would occur at precisely the time when revenues from taxation were being reduced, and that it ~~would result in~~ might lead to State bankruptcy.

Passing then to the question of the type of currency reform needed, Governor Strong said that there were three choices:

(1) Abolition of the old unit and introduction of an entirely new one. Such a plan disturbed confidence and was ~~extremely~~ difficult to put into effect, ~~at least~~ unless the value of the old unit had been practically destroyed.

(2) The second choice would be to make no change whatever, but to continue, even after stabilization, with the same denominations of currency that had been in use during inflation. This, however, had the disadvantage in that it made no definite break with the inflation period.

(3) The third was to retain the old unit, but gradually to introduce new units or denominations more calculated to serve the convenience of the public.

M. Quesnay suggested that in the choice of the new denominations or units and their value, there were three possibilities:

(1) The new unit could be stated in terms of a coefficient of the old, as for instance the value of the franc could be stated as being 1/7 of the pre-war value.

(2) The second choice was to make it a fraction of a foreign currency, as for instance to call the value of the franc ~~as being equal to~~ 1/160 of a pound sterling.

(3) The third was to give it from the first a gold value direct. This had the advantage of appealing to the national sentiment, but it was also desirable, if possible, that the new unit should have some simple fractional or multiple relation to the old, for facility in making comparisons. No advantage whatever would be gained in giving it a simple fractional relation to any foreign currency. The Latin Monetary Union of course had tried this and had been unsuccessful. There was no particular need or advantage in having such a simple relation with any foreign currency.

~~However~~, Governor Strong ~~remarked~~ added that as soon as stabilization was determined upon, they should have a conference with all the exchange dealers and determine the method of quoting, and lists should be published showing the new parities of the various currencies and their cross-rates.

Raising the question of the utility of index numbers, Governor Strong remarked that while the prices of wholesale commodities commonly traded in in international markets responded instantly to movements of the exchange, the price of common consumers' goods often showed very little relation to the rate of exchange; for example, while the price of wheat in India was sensitive to the fluctuation of the rupee, it by no means followed that the price of every article of consumption in a village in the interior of India was equally sensitive to the movement of exchange. As a matter of fact, the prices that played upon the exchange were solely those of goods which were actually exchanged between two markets, or which in certain circumstances would be actually traded in. For instance, the question of the purchasing power parity would not apply to the price of tooth-brushes unless a movement of the exchange actually gave rise to an international sale of tooth-brushes between two markets. Another example would be cotton and shoes. The price of cotton was

always at its international purchasing power parity, because it is freely traded in in all markets all over the world. On the other hand, shoes were relatively unsensitive to movements of the exchange. For that reason, the analysis of interior prices of consumers' goods in francs was less important from the point of view of determining the position of the exchange. Index numbers ~~are~~ were of comparatively little value in arriving at the purchasing power parity, because an index number composed of simple international commodities would always be at its purchasing power parity and would consequently be useless. The reference in the plan to the necessity of balancing the sacrifices which would be required of the various classes of people in France seemed just, and as far as he could determine from an analysis of the figures presented, Governor Strong was of the opinion that a rate between 160 and 170 would seem to be quite appropriate for the franc under the present conditions. As for the relative advantages of the two proposals in the program, namely, ~~the question of~~ that of having a preliminary period during which the exchange would not be stabilized but would be limited in fluctuations, and the plan under which stabilization once determined upon would be carried through suddenly, Governor Strong remarked that he would support the idea of such a preliminary period, provided it was limited to the time required to determine the level at which stabilization should occur, and during which a plan of stabilization was being matured. Once the rate had been determined upon and the plan formed, he believed that every advantage lay in putting the whole thing into effect at one time. Otherwise, the State would be likely to be drawn into a pegging operation, which was extremely costly and liable to failure. At this point, Governor Strong asked whether, (to illustrate his point only) in view of the fact that there were an unusual number of important international bankers present in Paris, and assuming for the moment that no question of inter-Allied debts was in existence, it would not ~~be worth-while~~ have been possible for Governor Moreau to meet these people informally for a thorough exchange of views and understanding of the technical details of a plan of stabilization. Such a meeting would develop probably the necessity of giving the

did not propose meeting delegate. Stat. to present summary of plan

Bank very full powers, and there were certain advantages in moving rapidly under the present circumstances, since if action were delayed too long, the present popular confidence would be allowed to become lost.

Prof. Rist, however, was of the opinion that such a meeting would be ~~absolutely~~ impossible without consulting the Government, although it was true that the Government might be willing to permit such discussions. Actually, ~~however~~, everything hinged upon the ratification of the debts, and Prof. Rist ~~remarked~~ added that it could not be denied that the prospects of debt ratification at the moment did not seem ~~very~~ bright. The public was extremely worried over the transfer and safeguard clause. ~~The public~~ And was also somewhat resentful over the American tariff, and suspicious of American penetration. They also resented what appeared to be the lenient attitude of the United States toward Germany in securing such transfer and safeguard clauses, while at the same time similar leniency did not seem to be extended to France.

Governor Strong remarked that the whole atmosphere in regard to the American debt had been clouded on both sides by misunderstandings, and to a certain extent by misrepresentation.

M. Quesnay then remarked upon the fear expressed in certain quarters that the world was entering upon a period of declining gold prices. He was somewhat afraid that France would be caught, as was Finland, with rising internal prices while gold prices elsewhere were falling, and that this would complicate the difficulties of stabilization, particularly if stabilization was effected at too high a level.

Governor Strong remarked that a general fall in prices would be due to only one of two causes: the first would be over-production, the second would be general monetary deflation. As for over-production, the only sort of over-production which seemed imminent was that of farm products, and it could not be denied that the longer stabilization was postponed over Europe, the greater the danger of a general decline in farm products, owing to the low purchasing power of European

populations. As for the prospects of general deflation, none were in sight anywhere except possibly in France, Italy and Belgium. As a matter of fact, if a decline in world prices was threatened from any quarter, it was threatened from these unstabilized countries and the reduced purchasing power of European populations, whose standard of living was threatened by a continuation of unsound monetary policies. The recent decline in world prices was due very largely to the low purchasing power and low consumption of the masses of Europe, resulting from inflation, and at present continued even under stabilization ~~by the enormous number of unemployed.~~ as a result of widespread unemployment.

Passing then to a discussion of the relation between the Bank and the Treasury, Governor Strong remarked that if a central bank had a very large portfolio, comparatively small changes in the rate at not very high levels ~~was~~ were ~~extremely~~ effective upon the market, while if the portfolio of the Bank was small, much wider changes and much higher levels of the discount rate were required in order to produce a similar effect. This was ~~a very~~ an important consideration, in view of the proposal to convert part of the State debt to the Bank into a form which would facilitate the increase of the commercial portfolio. In all probability, while such a maneuver would at first increase the cost of borrowing by the State, it would presently permit the Bank to gain effective control of the money market at relatively low levels, and thus ~~in a not very long time~~ eventually to reduce the debt charge of the Treasury by permitting reduced interest upon the short-time debt and facilitating conversion of the longer debt. This naturally led to a question of the consolidation of the short-time debt and a renewed discussion of the possibilities of using the railroad bonds for this purpose. Governor Strong was again ~~quite~~ insistent that this suggestion was ~~quite~~ impossible of application at the present time, as there was no reason to believe that it would meet ~~the slightest~~ support outside of France.

MEMORANDUM BY R. B. WARREN RBW

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CONVERSATION OF AUGUST 27, 1926

Place: Hotel Princess, Paris

Present: Governor Strong
Professor Rist
M. Quesnay
Mr. Warren

Time: About 2 hours.

At the opening, Prof. Rist referred to the hypothetical question raised by Governor Strong the day before, as to the possibilities of an informal meeting with American bankers for the purpose of discussing details of a plan. Prof. Rist stated that M. Moreau's opinion was that such a meeting was ~~rather~~ out of the question at the present time. Turning then to the program, he remarked that one of the first steps which the Bank desired to take was the purchase of gold in the domestic market. The Government was favorable to this idea and was anxious to have them start as soon as possible. The Regents, however, were still firm in their opposition.

Governor Strong then asked whether the commencement of purchase of gold would not automatically put the Bank in the position of being ~~somewhat~~ responsible for the exchange.

Prof. Rist was of the opinion this would not be the case, because at any time the Bank could suspend purchases. The gold so bought would be kept as a separate item. When Governor Strong opposed some objection to such a further complication of the balance sheet, it was explained that this idea of keeping new gold purchased under a separate item, whether purchased at home or abroad, was merely a temporary measure until final determination of the new rate, as until that time, it would be impossible to adjust the corresponding items in the liabilities if any attempt was made to combine the new gold with the old.

Governor Strong then raised the question as to how the Bank would be able to comply with the law, which requires 100% cover for notes issued against new gold and ex-

change and demands that, if gold or exchange is lost, an equivalent amount of notes must be retired. In the event of a rise in the franc, as for instance from 175 to 150, automatically a certain number of notes would be left uncovered.

M. Quesnay explained, however, that as the law provides the Bank should make neither a profit nor a loss on this transaction, the loss in such a case would be adjusted by assessing it ~~as a charge~~ against the Treasury.

This question of profit and loss had also arisen in connection with the possible interest to be earned by the Bank on its valuta deposit. It was interpreted, however, as not meaning that the Bank would not be authorized to earn interest on such accounts, although naturally the earnings on valuta turned over to it by the State would be still regarded as the property of the State, and the Bank would operate merely as an agent in such a transaction.

Mr. Strong then raised the question of the need of securing an ~~extremely~~ able man to handle the exchange department of the Bank. Such men, he said, were ~~extremely~~ difficult to get, particularly at the scale of salary prevailing in the Bank of France. It was also ~~extremely~~ undesirable that their exchange expert should be a man with ~~strong~~ previous local attachments.

Dr. Rist said, however, that the Bank intended to offer a salary adequate to secure a competent man.

The question of valuta deposits again arose. With the margin of issue so ~~very~~ narrow, it was clear that the Bank had ~~very~~ little room for maneuver. Prof. Rist and M. Quesnay both remarked that the pressure for credit was becoming large and said that that ~~very~~ day the Director of the Societe Generale had said that they had been obliged to refuse requests for credit from a ~~great~~ number of their clients. At the same time, Prof. Rist remarked that while the demand for credit was growing, it did not appear to have reached an acute stage, as there was not the slightest evidence of unemployment. In the opinion of both M. Rist and M. Quesnay, this fact was partly to be explained by the release of hoards, ~~partly~~ perhaps under the pressure of higher money, and more

probably because under the revival of confidence a considerable amount of hoarded currency was being brought out, and thus the demand for credit was not finding its fullest expression as yet. Nevertheless, both were convinced that within a very short time the demand for credit would reach large proportions and would probably necessitate the introduction of rationing. In this connection, they suggested that, while there were several theories of rationing, the one which they were most inclined to was that employed by Governor Moreau in Algeria, namely, the allotment of certain lines of credit to each branch of the Bank and leaving it to the Manager's discretion to employ such a sum to the best advantage. This also was the method used in Germany.

Continuing the discussion of valuta deposits, Governor Strong raised the question of whether the Bank intended to lend francs against such deposits. This, it appeared, would put the Bank into the swap market on a large scale.

Prof. Rist said that such was not the intention of the Bank. The idea had been written into the Experts' report at the insistence of the representative of the Banque de Paris, but such a policy of putting the Bank with unlimited powers of issue into the swap market would run contrary to all the policy of the Bank and Government for many years. They had, however, thought that they might offer, not interest on such valuta deposits, but possibly a special lending rate against such items. The same might also be used in the case of gold brought to the Bank; in case the owners did not wish to sell it for currency or exchange it at the Bank for a security they might leave it on deposit with the Bank and secure a loan against it as collateral.

Governor Strong remarked that the opening of a valuta deposit account introduced into the Bank of France certain of the features of a gold discount bank. However, the real function of a gold discount bank was not so much to lend francs against the deposit of pounds or dollars, but to lend dollars or pounds ~~against francs~~ so deposited for making foreign payments.

Passing down to the subject of the Bank's earning assets, which had ~~been raised~~ come up

in connection with the interest charged or received upon these valuta deposits, Gover Strong raised the question of the facilities offered by the market for the employment of very short funds. It appeared that at the present moment practically the only available market for the employment of short liquid capital lay in the Treasury current account. This of course was recognized by Prof. Rist as being an unnatural state of affairs, as it was embarrassing to the Treasury, which became ~~and was of course~~ a ~~direct~~ competitor ~~with~~ of the Bank, which offered no interest on deposits.

Governor Strong then raised the question of the Caisse de Gestion. While it was true that this institution was provided with a very considerable amount of current income, it had no working capital. In the event of a sudden demand for reimbursement in excess of its income, was it contemplated that the Caisse should apply to the Bank for accommodation?

Prof. Rist said that under the circumstances it could do nothing else. The Experts' plan had intended to endow it from the outset with capital derived from a foreign loan. This was not now incorporated in the law of the Caisse de Gestion, and consequently they might at any time find themselves confronted with the old situation, in which, however, a direct loan to the State would be changed nominally into an indirect loan to the State through the Caisse. It was pointed out, however, that under the program submitted by M. Quesnay, it was contemplated that notes issued at the demand of the Caisse should be covered by valuta furnished by the State to the Bank out of the proceeds of its external loan.

M. Quesnay also suggested that in the event of such a demand for reimbursement, the State and the Bank could agree not to permit the Bank to issue notes to reimburse these maturing Bons, but insist that the money market absorb them.

A question arising as to the statutes of the Bank, Governor Strong asked that a complete set of such statutes be secured, if such were available.

Reverting to his previously stated objections about taxation, Governor Strong remarked that sooner or later it would be ~~absolutely~~ necessary that France should

reorganize its tax system on a more equitable basis. When this question came to be considered, would the Bank of France have any influence on the course of the discussion?

Prof. Rist said that the Bank could have no direct influence on taxation, inasmuch as this was regarded as a peculiarly political matter. However, they might exert a certain amount of influence through discussion, ~~conversation,~~ and articles ~~that appeared~~ in the press.

Under the question of the return on taxation, Governor Strong suggested that, just as it was expected that the tobacco monopoly would prove more lucrative in the future under its new management than it had in the past, so it might be possible to extract more income from the telephone and telegraph services, as in Italy, where rates were advanced on fast service, with the result that a large number of people paid the higher rate for the better service, and the ~~income, were~~ revenue was correspondingly increased.

Prof. Rist, however, was of the opinion that the telegraph service was not able to offer better service even at a higher rate, inasmuch as the equipment was too obsolete, and until the Ministry was in a position to improve its equipment, it had no interest in expanding a business which it could not handle. As for a ~~special rate on~~ proposal to develop the night service, there was some question as to whether or not this could be expanded.

Passing down to the question of the floating debt, Governor Strong remarked that he had six possible solutions: (1) forced conversion, (2) voluntary funding, (3) gradual amortization, (4) exchange for some security like securities of the tobacco monopoly, (5) repayment by the Bank of France, or (6) transfer to abroad through a foreign loan. None of these except the exchange for the tobacco securities seemed particularly attractive, and most of them were actually vicious. A funding operation was likely to occur in in one of two circumstances. In the event of a great crisis, forced consolidation or forced conversion would probably be necessary and accepted. On the other hand, if the stabilization plan were a conspicuous success, it would

probably be possible to do something on a voluntary basis, on reasonably good terms. Either way, it was important to have a plan in mind, as the present plan of gradual amortization was so slow that for years the situation would be threatened by the existence of this debt.

The question then arose as to whether, with the increase in tax payments which might be expected to occur within a few weeks now, there would not be some demand for reimbursement of these Bons to raise money to pay taxes. Governor Strong therefore asked whether it was Prof. Rist's opinion that an acute crisis over the floating debt was likely to arise within, say, two months.

Prof. Rist thought that it would not come within two months, but he would not be sure that it would not arise within, say, four months. However, Prof. Rist expressed himself as very hopeful. He had been pessimistic ~~optimistic~~ last Spring; he had been very doubtful as to whether or not the Treasury would be able to get through the month of August without a crisis. Both times he had been agreeably disappointed. He was therefore extremely hopeful that his gloomy forecast of the possibility of a crisis within four months would prove equally vain.

Governor Strong cautioned him against basing too firm hopes upon the optimistic features of the present moment, as some of these were undoubtedly temporary and it was entirely open to question whether they ~~would be permanent or continuous or~~ of sufficient magnitude to avoid the consequences of the ~~very grave~~ weaknesses ~~which were~~ inherent in the situation as it was today.

M. Quesnay supported this view ~~very strongly~~. He said that, while at the moment the franc was stable but not stabilized, public confidence in the stability of the exchange was not very firm; in fact, people were openly skeptical. The present confidence, to a certain extent, was based upon the quietness of the exchange, but ~~everyone knew - at least~~ everyone in financial circles knew that some time in September or October, seasonal demands upon the exchange would make themselves felt and many ~~most~~ people were ~~very~~ apprehensive as to what would happen at that time.

Governor Strong then raised the question of the possibility of doing something

with the tobacco securities, but Prof. Rist was of the opinion - and in this he was supported by M. Quesnay - that at the moment it would be ~~absolutely~~ impossible for the Government or the tobacco monopoly to issue any kind of a long-term security in France.

Prof. Rist, however, advanced the belief that if no crisis happened between now and perhaps March or April of next year, a funding operation of that sort might be ~~possible and probably would be.~~ feasible.

Governor Strong then inquired as to the character of the management of the floating debt in the Treasury - whether any flexibility or imagination was employed in its handling.

Prof. Rist said that the entire operation was mechanical and automatic, with the exception of the operation of the investments of the Caisse de Depots et de Consignations. Up to the present time, this Caisse had been ~~very~~ reluctant to buy short securities, because ~~for two reasons: (1)~~ the rate of return was substantially below the rate of interest available on other types of Government bonds, ~~and (2) of course, as~~ Governor Strong pointed out, theabsence of a market in these short securities made them an ~~a very~~ undesirable type of investment for an institution like the Caisse, which was subject to heavy demands for withdrawals from its depositors. Except for the flexibility offered by the purchases of the Caisse, there seemed to be no flexibility whatever provided in the handling of this mass of debt.

Governor Strong then made the remark that ~~a great~~ many people - and he was not sure that he should not be included in this list - were of the opinion that stabilization on a secure basis was ~~absolutely~~ out of the question until some more permanent disposition had been ~~was~~ made of the floating debt. ~~Until the situation was relieved of the menace presented from this quarter, confidence was very difficult to secure, as at any time the situation might be upset with very little warning.~~

Prof. Rist agreed fully with this position and said that indeed the floating debt was a kind of "sword of Damocles" hanging over their heads.

Turning then to the question of the flight of capital, Prof. Rist said that the

Government was extremely embarrassed by the entire problem and would be very glad to turn it over to the Bank to get rid of it.

Governor Strong said that there were three ways of bringing capital back:

(1) The first was to apply some measure of force to oblige people to repatriate their capital.

(2) The second was to propose some sort of inducement or attraction to lure it back.

(3) The third, which had been found sufficient in certain countries like England and Switzerland, where the value of the currency had not been greatly lost, - the natural and spontaneous revival of confidence - had been sufficient.

For France, it seemed very doubtful whether this capital could be brought back except by the use of some sort of pressure.

Prof. Rist, however, remarked that it was very difficult to apply pressure, for example by the restriction of credit, whether by rationing or by a high Bank rate, as holders of the floating debt could evade the consequences of it either by discounting their Treasury bills or by simply allowing them to mature.

M. Quesnay then expressed the opinion that something might be done under such circumstances by forcing the Banks to take over Treasury paper as fast as it was presented at maturity under such circumstances.

Governor Strong then raised the question as to what would happen if the debts were ratified and by the complete program of monetary reform was not regarded as satisfactory. Under such circumstances, obviously a certain amount of the foreign support on which they were counting would not or might not prove to be available. This had been the case with Belgium, where after the debt ratification the program of reform was not regarded as sufficient to justify foreign cooperation on the scale or terms required to stabilize the currency. Suppose this same situation should arise in France. Would the French Government and the French public consider that they had been "let down"? This idea had been very industrially circulated in Belgium. Without presum-

ing to speak for various Governors of other banks of issue, Governor Strong said that he could readily imagine the questions which would be raised, even after the debts were ratified, in connection with the program of stabilization. For instance, the first thing that Governor Norman would inquire would be as to the status of the Bank, whether its independence was fully assured. With Governor Vissering, the foremost question would be fixing of the measure of value. With Governor Bachmann, the question of the disposition of the floating debt and the availabilities of adequate foreign credit would be uppermost, while Dr. Schacht would also stress the dangers of the floating debt and probably advocate forced conversion. In his conversations with Dr. Schacht, he had learned that the latter was of the opinion that only forced conversion of the floating debt would provide the necessary assurance. Governor Strong had asked him whether he was not attempting to apply measure which might be successful in Germany to a people of radically different temperament, but he was sure that Dr. Schacht's reply to such a questions ~~was~~ would be that what had worked in Belgium ought to be applicable to France.

Speaking of this question of forced conversion, Governor Strong stated that he did not believe that forced consolidation would endanger the credit of France abroad.

M. Quesnay, however, was ~~strongly~~ of the opinion that forced conversion would have ~~a very serious~~ an undesirable effect upon French Government credit within France, and M. Rist quoted from the Experts' report the phrase that "the credit of France is indivisible."

Governor Strong remarked that of course they were better judges of the reaction of the French people to any measure than any outsider would be, but that as far as influence on French credit abroad was concerned, he doubted if there was ~~no~~ a particular risk for France. He was further inclined to believe that, while a certain amount of extraordinary demand for credit might arise or would arise, even as a consequence of forced consolidation of a previously liquid security, this would not reach a magnitude sufficient to be dangerous, provided the Bank of France was in a position to exercise a reasonable measure of control over the money market. The conversation concluded with a warning of the dangers of reposing too much confidence in the optimistic features of the moment, as these were to a considerable extent superficial.

MEMORANDUM BY R. B. WARREN RBW RBW

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CONVERSATION OF AUGUST 28, 1926

Place: Princess Hotel, Paris

Present: Governor Strong
Professor Rist
M. Quesnay
Mr. Warren.

Time: About 2 hours.

The conversation opened with a reference by Governor Strong to the fact that the forward rate on Italian exchange had been passing through some unusual fluctuations.

Neither Prof. Rist nor M. Quesnay had any information on this subject.

Prof. Rist then produced a series of figures showing the subscriptions to Bons de la Defense Nationale through the head office of the Bank of France. They indicated that subscriptions were coming in at a very rapid rate, but inasmuch as they did not show the rate of reimbursements, the figures were not conclusive. The proceeds arising from the excess of subscriptions over reimbursements were being used by the Government to retire its debt to the Bank.

Governor Strong asked whether, after the State had turned over the floating debt to the Caisse de Gestion, it would still retain the right to borrow up to the previous authorized limit.

Prof. Rist said that undoubtedly it would.

Returning to the program, Governor Strong read the passage in which it is proposed that, prior to official stabilization, a tentative revaluation of the "encaisse" should be made at the average rate of exchange for the preceding six months. He remarked that this would represent in the minds of the public a kind of anticipation of the future rate and that for that reason it would introduce certain undesirable complication ~~features~~ into the plan, especially if the final revalorization had to take place at a very different rate. ~~more than once.~~ There was every reason to desire that the first revalorization should be made as near the final rate as would be possible.

!

2 Period. If 6 months or 3 months subject by results shown.

Continuing in the discussion of the program, which provides that in the event of an excessive influx of valuta ~~it~~ the proceeds can be ~~brought in~~ transferred in the form of gold and this gold put into circulation, Governor Strong remarked that the ~~sole~~ value of such a process would be on the assumption that this gold would be hoarded and would thus pass out of active circulation. This was neither a good habit to cultivate nor a ~~very~~ dependable measure of monetary control. It would be ~~far~~ preferable to create a good market in which the Bank could sell Government securities when it was necessary to contract circulation.

M. Quesnay remarked that another method, provided the Bank found itself with an excess of valuta, would be to encourage foreign loans, that is, loans of French persons to foreign countries.

Governor Strong ~~agreed~~ did not with this point but it was not fully discussed.

Governor Strong then repeated the point he had made at the end of the previous conversation, namely, that the larger the portfolio, the greater the effect of relatively small fluctuations in the rate, while if the portfolio itself were ~~very~~ small, ~~very~~ wide fluctuations would be required to produce the same effect and in the event of a desire to contract, ~~extremely~~ high rates.

Prof. Rist remarked that this whole idea of money market control, whether through the discount rate or through market operations, was ~~very much of~~ a novelty in France. Before the war, French commercial banks had regularly maintained ~~extremely~~ large portfolios of London bills.

Governor Strong said that this had ~~undoubted~~ly meant that the French monetary position was regulated on London, ~~but~~ and it was ~~an outgrowth~~ result of the fact that the discount rate of the Bank of France was too low and too inflexible. ~~that~~ These ~~very~~ facts, leading to the regulation of the French monetary position through London and through Berlin, had ~~practically~~ largely destroyed the independence of the French money market and ~~that~~ the control of ~~this~~ the market had been abandoned even before the war by the Bank of France.

Passing then to a discussion of the recasting of the Bank of France statement, Governor Strong remarked that while the law provided that during the process of reaching stabilization, all loss or profit on the transaction should belong to the State, he supposed that once stabilization ~~were~~ was effective the Bank would retain the usual profits and losses on its exchange operations, ~~just as~~ like any other bank, ~~would expect to do.~~

Prof. Rist and M. Quesnay both agreed to this, and M. Quesnay added that after stabilization the Bank alone would be responsible for the regulation of the market, but that up to that time the State was responsible. ~~and that~~ It was consequently necessary that the State should bear the loss, and in that case of course also receive the profit. This would be an undesirable situation, ~~however~~, to perpetuate.

Governor Strong then took up the question of the circumstances which would follow stabilization with reference to the sale of the valuta holdings of the commercial banks to the Bank of France. As at this period the market would be presumably operating under a high discount rate, there would be every inducement for the commercial banks to ~~present~~ sell valuta rather than to discount. This would ~~of course~~ be a feature of a policy of forcing the return of valuta. At that time it would probably be necessary to sell securities to offset the easing tendency, but under such circumstances, namely of high interest and of some commercial depression, it would probably be safer to expand the note issue than it would under certain other circumstances.

Taking up the proposal in the program that after the revalorization of the gold the State's debt to the Bank would amount to a total of 25 milliards, Governor Strong questioned whether the program's proposal that a residue of 10 milliards be left as a permanent debt and merely 15 milliards be made mobilizable would be ~~an~~ adequate ~~distribution~~. The ground by which could be reduced Fifteen milliards was a very small sum with which to operate in the market.

However, M. Quesnay pointed out that this would not represent the total of se-

curities available for utilization in market operations, as there would be besides this 15 milliards, 50 milliards of the existing floating debt, plus 5 milliards of new Treasury bills to be added. This would give a total of some 70 milliards of floating debt in the market, with which the Bank in cooperation with the Caisse de Gestion could operate.

Governor Strong then raised the question as to whether, under this proposal, the right of the Bank to purchase prior to selling would be impaired, but M. Quesnay did not think that it should.

Governor Strong then raised the question as to what legal provisions authorized the State to erect embargoes on imports or exports.

Prof. Rist explained that there was no law providing for embargoes on imports, but that an old law was invoked to prohibit exports of certain food products, in order artificially to reduce the price of such commodities. This law was now in force and was one of the reasons advanced by the agricultural interests to excuse their favorable tax position.

Governor Strong said that, while in theory he inclined toward free trade ideas, as a matter of practice they were ~~quite unworkable~~ inapplicable under the present conditions. For example, any abrupt change in the American tariff policy would undoubtedly work injury rather than benefit to Europe, since it would provoke an industrial crisis in the United States which would destroy the very market for European goods which theoretically a tariff reduction might be expected to expand. However, he thought that some benefit might be obtained in France by restrictions on purely luxury imports.

Passing down to the question of securing a favorable public reception of the scheme, Governor Strong remarked that one of the barriers was the great secrecy which the Treasury maintained about its operations. He believed that the Treasury should publish regularly and ~~fortnightly~~ frequently its statement of income and expenditures and the position of the public floating debt.

Prof. Rist remarked that ~~under~~ the Experts' proposal that the Caisse was ~~obliged to~~

publish such statements, and he agreed that it would be desirable for the Treasury to keep the public informed.

Governor Strong added that if it were the United States, he would recommend that the Bank should secure a good publicity expert. In any event, it was important to remember that some of the most severe crises in French finance had been due to the sudden discovery of an unfavorable situation which had been running over a considerable period. When anything of an unfavorable nature is overhanging the market, candid disclosure and frank explanation is always preferable to a discovery, which sooner or later is bound to occur.

Prof. Rist remarked that this policy of secretiveness had grown up in the Government during the war and it had been since continued, so that the Government supplied its financial information, not publicly to the Chamber, but confidentially to commissions of the Chamber.

Governor Strong remarked that this all complicated the securing of public support for sound measures; that one of the ~~failures~~ weaknesses of the Experts' ~~plan~~ committee was the fact that ~~it~~ the plan was not "sold" to the public. It received very little attention from the newspapers and no effort was made to popularize it. Another policy should be adopted with regard to this program of stabilization, and every effort should be made to explain it to the public in words of one syllable, so that they should have the fullest idea of what was going on. This would be particularly desirable in view of the possibility or probability that its institution would be associated with a certain measure of hardship. The public would be much more ready and willing to accept this difficult period if it understood completely what was going on, and in fact such ~~an~~ understanding might ~~very well~~ reduce the actual hardships which would be experienced.

Passing to the question of the per capita circulation, Governor Strong recommended that in their studies of the probable amount required or justified, it was more desirable to make comparison with countries where similar monetary and banking

habits prevailed, ~~rather~~ than with countries which had entirely different habits. He believed that far greater value would be derived from studies of the per capita circulation of such countries as Belgium, Germany and Italy than by attempting to make comparisons with countries like the United States and England, where most of the circulating medium of the country was in the form of bank deposits.

Prof. Rist remarked that it was ~~very~~ difficult ~~anyway~~ to secure figures of bank deposits in France, owing to the fact that only a few of the banks published monthly statements, and not all of the banks published annual statements.

Governor Strong added that, it would be impossible to make too comprehensive studies regarding the changes which had occurred since before the war in prices and wages, in determining the amount of circulation required.

Prof. Rist remarked that the data for France was ~~extremely~~ incomplete; which Governor Strong recognized, and ~~recommended~~ suggested that probably the ~~only data they could get that would be helpful~~ most helpful data would be samples from various industries. He explained briefly the methods employed by Dr. Snyder of the Federal Reserve Bank of New York in getting his index of wages, and suggested that an account of this be sent to the Bank of France to assist them in making similar studies.

M. Quesnay remarked that the Reichsbank had developed a very considerable statistical organization of this sort, to aid in regulating the ~~relation of~~ credit supplied to specific industries. ~~and that~~ Whenever it was discovered that the price of any given group of commodities in Germany was rising faster than the world price of a similar group, credit was restricted in that particular industry.

Governor Strong then inquired as to whether France had any considerable liabilities for silver arising out of the Latin Monetary Union, except in the case of Switzerland.

Prof. Rist said that practically their only liability existed toward Switzerland, because the silver currency of all the countries of the Latin Monetary Union had drifted into that country.

Governor Strong then mentioned the advantages which would accrue to the State out of the reintroduction of a silver coinage, and stated that he did not think that the French Government could afford not to take advantage of the opportunities for a large enormous profit out of seigniorage which would arise from the introduction of a silver coinage. This of course involved the definitive breaking with the limitations prescribed by the Latin Monetary Union.

M. Quesnay remarked that at the present time it would be very difficult to put a new silver coin into circulation; a very considerable quantity of old silver currency was still in the hands of the public, and to some extent it still circulated at its face value. The public would hardly be ready to accept a new silver coin of approximately the size of the old silver franc at five times or six times the face value of the old coin.

Governor Strong then took up the question of the balance of payments and referred to M. MEYNIAL's ~~Menehoul's~~ estimate that the flight of capital during 1924-25 ran up to something like 10 milliards each year. This study of the balance of payments was ~~extremely~~ important in arriving at an estimate of the amount of gold or credits presumably required to carry through a stabilization scheme. Some help, however, could be gained from the study of gold movements before the war. For example, at the time of the panic of 1907, the United States received in a single year about 70 million dollars in gold. In the nineties, a larger similar figure was exported over a period of several years, owing to such conditions as industrial depression, Treasury difficulties and tariff changes.

In 1914, the United States exported 130 millions in gold in a period of a very few months. These movements would offer some guide as to the maximum amount of protection production which might be required under two circumstances: (1) provided there was no fresh inflation, and (2) assuming that the Bank was able to function in the money market. To meet this situation, the Bank already had over 700 million dollars in gold, and if to this were added 300 million or so in credits, the total would certainly be adequate, given ~~giving~~ the two conditions just mentioned.

Governor Strong then gave a brief description of the Belgian operation and its failure. This was a pegging operation, pure and simple. The commercial banks of Belgium did not cooperate in the scheme and indeed did not believe in it. Belgium secured ~~a~~ two temporary credits of 27 million dollars, each but whispers of the unsoundness of the proposals began to circulate and a flight of capital immediately set in on a large scale. The Bank did not advance its rate until the whole of the first credit had been exhausted, and indeed supplied to the market the very funds which it needed in order to finance its export of capital. There was then a brief period of restored confidence, during which the Bank and the Government were able to repurchase a part of the valuta which they had sold. The plan of stabilization was announced, but the bankers still refused to believe in it, because it involved the use of short credits, because it was thought that the rate of stabilization was too high, because of an unfavorable political situation, etc. Mr. Jannsen ~~announced~~ as it is indicated that he had secured a loan at a time when such ~~an announcement~~ a false was ~~entirely incorrect and when the market knew that it was incorrect.~~ not justified The result was another burst of selling, in which the Bank supplied the funds required to finance the export of capital, indirectly to the market through advances to the Government.

Prof. Rist then remarked that the Belgian episode was partly due to the presence of the dangerous domestic and foreign floating debt, and Governor Strong agreed that possibly it was the existence of this floating debt which was responsible primarily for the failure of the scheme.

M. Quesnay said that there was a certain relation between the Belgian and the French situation, in that they did not have the cooperation of the commercial banks. In Belgium the bankers not only had refused to cooperate, but having no confidence in the scheme made haste to sell the market.

Governor Strong remarked that under such circumstances, it might have been worth while to raise the Bank rate, ~~say~~ even to ~~7%~~ 10%. Whether or not this would have been effective, it was impossible to say, but it would have been worth trying. Germany, however,

had found under the period of the Rentenmark that even a 10% bank rate was scarcely sufficient to be effective. and rationing was necessary.

M. Quesnay then added that one of the reasons which had contributed to the failure of the Belgian scheme was the fact of the close relation which existed in everyone's mind between the rate on the Belgian franc and the rate on the French franc. It was hard for people to believe that the Belgian franc was worth 107 to the pound when they saw the French franc slipping from a similar figure to 120 or 130 and so on down.

Governor Strong remarked that this illustrated the advantage of simultaneous action in the three remaining countries looking towards stabilization, and again expressed his opinion that something might be stirring in Italy at the present time. It seemed to him desirable that France should act first, for the reasons given in the previous day's discussion.

M. Quesnay remarked that the idea of a common and simultaneous plan of stabilization in the three countries had been even discussed, but that it presented ~~certain~~ difficulties.

Governor Strong ~~added~~ agreed that it would be ~~very~~ difficult, and it was remarked by Prof. Rist that, because the position of the Bank of France was stronger than that of either Italy or Belgium, people would be inclined to think that under a simultaneous plan, particularly if it got into difficulties, the Bank of France was trying to carry those other countries. Further, M. Quesnay remarked that in the event of a failure of stabilization in one country or the other, it would be very easy for politicians to throw the blame upon the action of one of their neighbors.

Governor Strong then referred to the necessity of creating a money market, and added that the surest way to induce cooperation would be to create an unsatisfied demand for Government securities. To this end, he suggested that the Treasury refuse to sell Bons de la Defense to the banks and oblige them to secure such paper from the market. This would automatically create the beginnings of a market in this

kind of paper.

Prof. Rist said, however, that this presupposed ~~a~~ an urgent demand for Treasury paper on the part of the banks and that this ~~was difficult to put into effect~~ would not arise so long as the Treasury was dumping its securities into the market as fast as it could.

Mr. Warren called attention to the fact that the amount of securities which the Treasury was authorized to put into the market from now on reached very large figures. The ordinary Bons de la Defense were capable of expansion by some 5 or 6 milliards, in addition to which the Government was authorized to issue 5 milliards of a new type of Treasury bill and to borrow 2 milliards from the Bank.

M. Quesnay suggested that the subscriptions now coming in to the Government through the sale of securities ought really to form the capital of the new Caisse de Gestion, instead of which they were being appropriated by the Government and used for the purpose of repaying the Bank sums which it would be empowered to reborrow from the Bank after the Caisse de Gestion had begun its functions. It was suggested that the debt to the Bank should have been included under the "plafond" which was prescribed for the Bons de la Defense.

M. Quesnay proposed that instead of these proceeds of subscriptions to the Bons de la Defense being used to repay the debt of the State to the Bank, they should be added to the current account of the Treasury. Under such a system, the item of advances to the State would not be reduced, but the deposits of the Treasury would expand. This would ~~of course~~ facilitate the organization of the Caisse de Gestion.

Governor Strong then asked if it would not be possible to introduce more energetic methods of distributing Treasury securities in France, in case ~~they~~ it were desired. He mentioned the fact that during the war, the Federal Reserve Bank had been a very active distributor of Government securities, but that once the war was over, the Treasury wished to resume some part of this function in its own hands. It was found, however, that the subscriptions steadily dwindled, and upon investigation it was discovered that the reason lay in the unbusinesslike and bureaucratic routine by

which the Treasury attempted to conduct this marketing operation. The duty was ~~again turned over~~ in fact performed by to the Federal Reserve Bank, with far more satisfactory results. Possibly there would be ways of inducing more businesslike methods into the French Treasury.

M. Rist remarked that it appeared that something could be done in this line, since the subscriptions to Bons seemed to be very sensitive to waves of sentiment. Gov. Strong ~~He~~ then requested that, before the next meeting, the Bank should prepare a list of the elements of the program which it considered absolutely essential and inflexible, and a second list of those elements of the program regarding which certain flexibility or latitude would be permissible, without destroying the effectiveness of the scheme. For example, it was essential to revalue the gold, but the question of how the profit of revalorization should be distributed was a matter for discussion. As a second example, it was ~~absolutely~~ essential that the program of stabilization should have permanence and continuity, ~~but~~ while the exact magnitude of the foreign loans required would ~~certainly~~ be a matter of question.

In conclusion, Mr. Strong stressed the importance of securing money market control and of the repayment from the State of a portion of its debt to the Bank.

Prof. Rist and M. Quesnay said that they were fully in accord that these were essential features of the program.

Governor Strong then added that, so long as the floating debt was overhanging the market, it would be ~~extremely~~ difficult to borrow abroad. Many eminent financiers upon whose help they would have to rely were of the opinion that stabilization was impossible so long as this floating debt overhung the market. He raised the question again of voluntary consolidation, but Prof. Rist remarked that the opportunities for this were now limited, since popular enthusiasm had already been exhausted by the campaign of voluntary contributions, and that the fuss made over the constitutionalization of the Caisse de Gestion had intensified the opposition to consolidation of the debt.

Governor Strong repeated that foreign bankers were ~~extremely~~ anxious about

this floating debt and regarded it as ~~an almost unsupportable~~ a menace.

M. Quesnay raised the possibility of consolidating a part of this floating debt in connection with the receipts of gold from the public. It might be possible to induce some persons who brought in gold to accept payment in a form which would consolidate a certain amount of the Bons.

Governor Strong then raised the question of the total income of the tobacco monopoly applicable to the floating debt.

Prof. Rist gave a figure of last year of about 1½ milliards, but agreed that it would be probable that under better management this revenue could be increased. However, it was clear that the capital value of the tobacco monopoly could hardly be put higher than perhaps 25 milliards. It was therefore, in Governor Strong's opinion, ~~impossible~~ doubtful wisdom to employ the capital value of the tobacco monopoly in a consolidation of the floating debt. It might be supposed that under certain circumstances perhaps 25 milliards of the floating debt could be funded in the form of tobacco securities, but it must be remembered that the constitutional status of every holder of the floating debt gave him a claim upon all the protection afforded by the revenues affected to the Caisse de Gestion. It would be impossible to employ the tobacco securities to fund a part of the floating debt, since the holders of the unfunded remainder could claim that the security back of their holdings had been impaired, and this security had been granted to them by the Constitution.

Altogether, Governor Strong said that he regarded the institution of ~~a~~ the Caisse de Gestion as a ~~thoroughly bad~~ in its present form mistake, since in appropriating the revenues of the tobacco monopoly to the floating debt, it would apparently ~~forever~~ debar the country from employing the capital value of the tobacco monopoly in funding the floating debt.

Debt to Bk. of France

Princess Hotel,
Paris, August 30, 1926.

PERSONAL

Dear Garrard:

Your letter of August 19th caused me a twinge of conscience, because it is a good while since I have written you; but I have been mighty busy, and the longer I stay the more difficult it is for Mr. Warren and Mr. Moore to keep up with the work.

I had a fine visit with Mr. Mellon at Evian. Gilbert was there, and we discussed everything from top to bottom. Mr. Mellon was somewhat uncertain about returning home via Paris, but Gilbert and I both were in Paris in time to make some judicious inquiries, and Gilbert returned with word that it seemed most desirable that he should. I think he really intended to anyway, but he arrived this morning, and I expect that he will call on M. Poincare today or tomorrow and probably see some others here, such as M. Briand, M. Berenger, and M. Moreau of the Bank of France.

Mr. Mellon looks exceedingly well. His rest has set him up and he is brown and rugged-looking, although as lean as ever, if not leaner, for he has been taking a lot of exercise, walking and rowing, and seemed to enjoy it immensely.

The situation here has fluctuated between optimism and pessimism, the possibility of ratification and stabilization and then its abandonment, until one hardly could tell from day to day just what the situation would be. The French objections to ratification are of course a security clause, the commercialization clause, and a feeling of hurt pride that if the agreement is ratified it is done under compulsion, because of the fact that they must have foreign credits, which means American credits, in order to stabilize and these they cannot get without ratifying.

The situation today would greatly facilitate stabilization beyond any previous period, because the sharp decline in the franc to nearly 250 to the pound resulted in a rise in the prices of consumer's goods, and while there has been some decline in these prices since the franc has advanced again to about 170, the decline has not been sufficient to again cause the dangerous disparity between the domestic and external value of the franc which existed before these occurrences.

Undoubtedly M. Poincare has vacillated a good deal between a desire to proceed vigorously with the complete program of reform and the hesitation to incur the risks of recommending ratification without a bridge over which he and others can retreat from their position against ratification, taken only a few months ago.

The important developments have really not been the establishment of the "Caisse de Gestion", the increase in taxes and the new convention with the Bank of France, so much as in the strengthening of the Bank itself and the consciousness which is growing within and without the Bank that the key to the situation largely rests with the control of the credit and monetary position. I like the new officers of the Bank very much. They have displayed a good deal of knowledge of the problem and have a great deal of courage in dealing with it.

Pat Harrison is in Paris just now, and while I don't expect to see him, a newspaper representative told Dwight Morrow that he thought the Senator would make a statement - likely, he said, to the effect that France could pay much more than was called for by the Mellon-Berenger agreement. This would be amusing to the Democrats, just after Secretary Baker puts out a statement that we ought to forgive the debts. Dwight Morrow has been here for a few days, and we have had some very interesting discussions.

I think the whole situation can be summed up in a few words by saying that, in my opinion, as matters now look the whole problem of stabilization could

be dealt with very promptly and successfully if France were to ratify the debt agreements, get the domestic floating debt into a more manageable and secure position, and turn the job of stabilization over to the Bank of France.

I have had a chance for some nice talks with Mr. Mellon about Federal Reserve problems, which you will hear about directly from him. The delay caused by my illness, which took about a solid month, and then the everlasting delays on account of the French situation here, will make it impossible for me to make the trip to Central Europe, so I am planning to sail for home on the "Mauretania" on the 18th of September with Dwight Morrow, although if I could get good passage on a boat sailing a week earlier, I probably would do so. Everything seems to be booked up.

I am glad you do not disagree with what I cabled about the Indian Currency report. Undoubtedly some disposition will need gradually to be made of the surplus silver in the reserves when they begin to accumulate gold instead, but we must not forget that, if they succeed in maintaining the price of silver, which is the intention of the plan, then this silver need not be exported or sold but will gradually get into the silver hoards, just as it has in the past. The suggestion that 200 or 400 million ounces of silver was to be sold according to the terms of the report is wholly unfounded, as no sum is mentioned for sale, but simply, as I recall the language, that the silver in the reserve will need to be reduced.

My best to you and the others in the Treasury. Am looking forward to my return and anxious to talk everything over with you.

Sincerely yours,

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

BS:M

(25)

MEMORANDUM BY R. B. WARREN RBW

CONVERSATION OF AUGUST 31, 1926

Place: Princess Hotel, Paris

Present: Governor Strong
Governor Moreau
Prof. Rist
M. Quesnay
Mr. Warren

The conversation was opened by Governor Moreau, who remarked that it appeared that they were in ~~perfect~~ harmony and accord as to ~~all~~ the essentials of the program. The few differences of opinion that had developed were by no means of such a character as to prevent the two banks from rapidly coming to a ~~necessary~~ working understanding, once the fundamental conditions necessary to such an understanding had been arranged by the political powers. The question uppermost in his mind was the magnitude of the credits which a stabilization scheme would necessitate. He was more than ever persuaded from recent conversations that the amount of French capital abroad was enormous. In his opinion, the best method of inducing its return was to support the scheme by a credit or a system of credits so large as to ~~be~~ make an imposing demonstration. In his opinion, about $400,000,000. would be necessary.

Governor Strong said that French capital would come back fast enough, once capitalists were assured that they could get gold or its equivalent from the Bank of France on demand, but in order to inspire confidence in others, there must be no hesitation in the application of ~~the scheme~~ this principle upon the part of the Bank. Seeming doubt as to the success of the program on the part of the Bank would be the surest way of inspiring doubt in others. As for the sum of the credits involved, Governor Strong said that it might be possible to secure a Government loan of say $150,000,000. in the United States and $50,000,000. in European countries, and credits of $200,000,000 secured in various ways and distributed among the gold

markets of the world. These figures, however, he named under a specific reservation: at the moment they were probably out of the question, but they might be considered if conditions became more favorable than they were today. The hesitation and uncertainty displayed by the Government in tackling resolutely the problem of monetary reform had not inspired in the money markets of the world a feeling favorable to the flotation of loans of ~~any~~ such magnitude.

M. Moreau remarked that there was some evidence that the United States was changing its attitude on the debt, or rather that public opinion seemed to be undergoing some change. He referred to the recently published statement by Mr. Baker and remarked that it seemed to be becoming an acute internal political question.

Mr. Strong made a few comments about Mr. Baker, remarking that he was not by nature a controversialist, ~~and the fact that he had entered into this controversy might very well have been inspired~~ by persons prominent in the Democratic party. Mr. Baker was an extremely capable man who was, in fact, general counsel for the Federal Reserve Bank of New York, and he (Mr. Strong) hoped that this association would not lead people to attribute Mr. Baker's remarks to any conversations he may have had with Mr. Strong. Differences among democrats.

M. Moreau remarked that one of M. Poincare's greatest problems at the moment arose out of his fear that the debt controversy would ~~procure~~ produce an acrimonious debate in Parliament. This had indeed been his reason for postponing the debt question until after the recess. M. Moreau believed that M. Poincare was sincerely desirous that, during the interval, public opinion should become more reasonable and so would make it possible to bring up the debts upon the reconvening of the Chamber, under general conditions more favorable to a ~~calm and conciliatory~~ solution.

Mr. Strong remarked, speaking of Mr. Mellon's visit in Paris, that Mr. Mellon, although he was President of the Debt Funding Commission and Secretary of the

Treasury, was not legally authorized to negotiate on a matter whose status had been fixed by law and whose determination had been entrusted to an authorized commission. If something in the nature of a letter of interpretation was desired, it should be sought through the usual official channels. In this way, Mr. Mellon would be put in a position to discuss it with the French Ambassador in Washington. This, of course, was Mr. Strong's personal opinion and did not represent either ~~an official position~~ the view of the Government or necessarily the personal or official ideas of Mr. Mellon. Governor Strong added that Mr. Mellon was personally ~~very~~ desirous of visiting the Bank of France and making the acquaintance of its Governor, and if it were agreeable, he should like to have the pleasure of introducing Mr. Mellon to the Bank of France. Governor Strong cautioned them that Mr. Mellon was personally a man of ~~very~~ diffident and reticent manner, and for that reason he might seem, upon their meeting, somewhat reserved and distant.

M. Moreau remarked that of course this would be the first time, so far as the public was concerned, that Mr. Strong would have visited the Bank of France since the incumbency of the present administration. He suggested that the following day at 10:30 in the morning would be an agreeable time.

Governor Strong agreed to arrange this hour with Mr. Mellon, and assured them that in their conversations they could discuss anything they wished with entire ~~candor.~~ freedom.

M. Moreau then passed on to the general situation, remarking that at the moment the exchanges were quiet and the Treasury was in an easy position. It offered an ideal time for the Bank to discuss with the Government the changes necessary in its relations with the Treasury, and offered an opportunity for the Government to undertake more satisfactory plans for dealing with the floating debt. If the time were so employed between the adjournment and the reconvening of Parliament, it would be by no means lost.

M. Moreau, then referring to the conversations which had taken place during

the previous week, thanked Governor Strong for the thorough consideration which he had given to their problems, and said he was especially grateful for the detailed manner in which he had discussed the various subjects introduced in the unofficial memorandum of M. Quesnay. He requested Governor Strong to prepare a note, or rather an aide-memoire, indicating what the latter considered to be the indispensable conditions for monetary rehabilitation and also the conditions or factors which might be more flexible.

Governor Strong agreed to do this and remarked that, ~~of course,~~ under other circumstances, ~~even~~ certain conditions that seemed to be essential at the present time might be subject to modification. He further added that the note or memorandum which he would prepare on this subject must be under two reservations:

(1) that it applied to conditions as they were at the moment, and that these conditions might change, necessitating radical changes in the program;

(2) that in presenting these opinions, he would be doing so on his own account, and that it was possible that his conclusions might meet with the dissent of his associates in America.

He added that he had of course been away from the United States already a very long time, ~~that~~ He had discussed his long absence with Mr. Mellon, who had agreed that nothing that he could do in New York was so important to the welfare of the United States and its people as the very program on which he had been engaged during the past summer in Europe. Governor Strong added that, for the purpose of freer communication between the Federal Reserve Bank of New York and the Bank of France, he would send to the latter a code machine.

M. Moreau remarked that they were now engaged in the study of the problems connected with the concentration of a foreign exchange market in the Bank of France, and he expressed his thanks to Governor Strong for his acceptance of their proposal that the Federal Reserve Bank of New York should handle their dollar account.

Governor Strong asked what rate of interest the Bank intended to pay upon

those devisen that were deposited with it.

M. Moreau replied that they would pay 1% under the rate of interest which they actually earned on such devisen.

Governor Strong then explained the rates now in force in the New York money market, differentiating on the rates on commercial paper and the rates on Treasury securities, the latter being tax free. He ~~then~~ explained, too, the rates of commission charged upon various types of paper handled by the Reserve Bank on behalf of their foreign depositors, and also the terms charged on the earmarking of gold.

M. Moreau remarked that of course, in order to secure these deposits of foreign exchange, it would be necessary for the Bank to offer some inducement, and said that the inducement they had in mind was to offer such depositors exemption from the law on the export of capital, ~~but~~ This ~~of course~~ would require the consent of the Government.

Governor Strong said that the total operations of the Federal Reserve Bank of New York on behalf of foreign central banks were very considerable, and suggested that M. Moreau might very profitably make a visit to New York. He described at some length the vaults of the Bank, in which the earmarked gold was kept, and added that these important relations between the Bank and foreign institutions had aroused ~~a great deal of~~ interest and some ~~little~~ opposition in the United States. For example, he said that certain people in the United States complained that their undertakings with England had cost ~~them~~ the New York Bank its ~~their~~ own independence and that ~~they were~~ the latter was too much subject to influence of purely British considerations. On the other hand, in England the same complaint was lodged against Mr. Norman: that by undertaking these relations he had made the Bank of England subordinate to the Federal Reserve Bank of New York.

Governor Strong then said that the following factors, in his mind, were ~~absolutely~~ essential to monetary reconstruction in France:

(1) Independence of the Bank. This subject had been thoroughly discussed and there was no need of further elaborating ~~on~~.

(2) The Government must guarantee the capacity of the Bank to undertake its responsibilities and guarantee the continuity of administration until the end of the program.

M. Moreau stated that unless he could secure such a guarantee, he would not undertake the responsibility of the program.

(3) There must be more effective treatment of the floating debt. Four methods of treatment were possible:

(a) Consolidation, whether voluntary or forced

(b) Conversion

(c) Amortization

(d) A foreign loan.

(4) They must stop the printing of money.

(5) They must gain control of the money market through the repayment of part of the State's debt to the Bank out of an internal operation.

M. Moreau stated that it was the policy of the Bank, after it had cleared up certain doubtful items and made necessary adjustments of its capital, as the counterpart of a "gift" which the Bank would make to the State, to insist upon the mobilization of the remainder of the floating debt. As this of course involved the consent of the Government, he could not at the present time promise that it would be done.

(6) The control of the exchange market must lie in the Bank and not with the Government. The history of India, for example, shows the disadvantages and even the dangers which lie in giving the Government control of the exchange market. It would be especially needed for France because (a) there was reason to expect a large return flow of capital into France and (b) the international payments of France during coming years would run into very large figures.

M. Moreau remarked that this control of the exchange market ~~was actually~~ had been vested in the Bank of France during the war, and that they recognized it as an es-

sential fuction of the Bank.

Governor Strong remarked that if the Government, with the ~~enormous~~ large ~~funds~~ sums which it ~~had~~ would received out of the foreign loans and later which it would have to ~~make~~ transfer in payments on its charges, should ~~appear~~ operate at cross purposes with the Bank, it could very greatly hamper the effectiveness of the Bank in the exchange market.

Governor Moreau added that he recognized the truth of this, but that one thing that they would have to avoid would be creating new bonds between the Government and the Bank which might embarrass the action of the Bank.

M. Quesnay remarked, for instance, that they should not be put in a position in which they would be obliged to surrender foreign balances to the Bank without payment in francs on the part of the Government.

(7) There must be recognition that the gold reserve of the Bank belonged to the Bank.

M. Moreau said that this question had already come up with the Treasury, which took the position that the gold belonged, not to the Bank, but to the holders of the notes. M. Moreau had replied that this reasoning might be applied to those persons who held notes that were issued at the volition of the Bank, but it could not apply to the holders of those notes which had been issued at the demand of the State.

Governor Strong said that his reply had been somewhat different in detail, for he had said that if the State would agree to repay its debt to the Bank in ~~gold~~ notes, the Bank would be amply able to meet all its obligations on the note account in ~~the same metal.~~ Red.

(8) Governor Strong emphasized the danger of an increased burden of indirect taxation. The recent tax laws had provided for some 11 milliards of new taxation, much of it indirect, in such form as to be passed on to the consumer, who was already underpaid and who, under the stabilization crisis, might possibly be unemployed. There was a possibility of social unrest sufficient to turn the Government out of

office. He recognized ~~fully~~ the need of wide sources of immediate revenue as an emergency measure, but he ~~recommended~~ thought that the tax system should be thoroughly examined and revised. The small man might suffer patiently for a while, but no country could continue to live on a salary schedule such as now was prevalent in France, in which thousands of bread-winners for families received salaries of 600 or 800 francs a month. He added that he sympathized very considerably with the position taken in the Experts' report by Dr. Jeze. It was true that a country could by slow readjustment accustom itself to almost any kind of taxation, but the process was painful and slow and might ~~very well~~ give rise to social disorders or discontent sufficient to imperil the stability of the Government or its program of stabilization. He apprehended that the ~~social consequences~~ perils to sound currency of an inequitable system of taxation in France might be as great as those growing out of the floating debt.

M. Moreau stated that he had had very considerable experience as a tax collector and that he had always found that indirect taxes were much easier to collect. In his opinion, they were the only kind of taxes that could reach the mass of the population, because of the numerous exemptions granted on all forms of direct taxation by deputies interested in protecting certain classes of their electors. In France direct taxes were already very considerable, and they fell almost entirely on the shoulders of a very small fraction of the population.

Governor Strong then ~~asked what were~~ inquired as to the principal sources of revenue, but no one was able to produce any very satisfactory answer to this question.

Governor Strong then drew a comparison between the economic effects of indirect taxation and those of inflation. ~~They~~ Both caused an increase in the cost of living, which bore upon the public without any regard to the capacity ~~of payment~~ of the various classes, and he added that he thought that most modern text book writers on the subject of taxation would support his view.

M. Moreau remarked that France was a country without ~~any~~ a great number of

persons of extremely large income; further, the recent changes in the indirect taxes scarcely brought the schedules in gold up to the levels of prewar years. He added that tax-dodging was a national vice in France and had to be taken into account.

Governor Strong then drew some illustrations from recent experiences with taxation in the United States. Taxes had at one time been so high on certain brackets that combined individual & corporation taxes ~~altogether they~~ had run up to the neighborhood of 86% on some very large incomes. Last year, however, after a tax reduction, receipts were some ~~$5~~ $500,000,000 in excess of the estimates, and it had been the experience of the United States that, as the rate of direct taxes had been reduced, the returns had steadily grown. One of the reasons for this undoubtedly was the fact that evasion was not worth the danger that it incurred.

M. Moreau remarked that much of this reasoning had been applied by the Experts in their report.

Governor Strong stated that there was still (1) no tax~~es~~ worth mentioning upon agricultural earnings, and (2) no very effective tax on real estate.

M. Moreau explained the small size of taxes on real estate as due to the fact ~~and remarked~~ that, owing to the rent restrictions, income from rented property was very much reduced. For example, rents were only double what they had been in 1914, while the charges of upkeep of property had multiplied several ~~seven~~ times. Altogether, the return on capital invested in houses or apartment houses in Paris was now, in paper francs, hardly more than it had been in gold francs before the war. Under such circumstances, it was incapable of supporting very heavy taxes. He was, however, in full agreement in regard to the desirability of applying a heavier schedule of taxation to agriculture, but remarked that the difficulty there was political, just as he had explained in an earlier conversation.

Governor Strong then stated that one could hardly engage in conversation

with anyone without hearing stories of tax evasion, the sums involved sometimes being small but in the aggregate undoubtedly totalling up to ~~enormous~~ large figures.

M. Moreau said there were several reasons for this, of which the greatest was the low state of efficiency in the tax administration. This was due to three principal causes:

(1) The personnel of the tax service had been subject to very heavy casualties during the war;

(2) The rate of pay~~ment~~ was so low that worth-while men would not stay in their positions, and there were many resignations. Those who did not resign were discontented and consequently shiftless;

(3) The pu~~zzling~~ complexities of the laws, which made it extremely difficult even for a tax collector to know how much anyone really owed.

Prof. Rist remarked that in the Experts' report, they had called attention to the low state of efficiency in the finance department and had recommended that measures be taken to retain and attract good men by increasing the~~ir~~ salary schedule, ~~even~~ regardless of the general provisions of the Civil Service.

Governor Strong remarked that these underpaid Government functionaries whose inefficiency had just been ascribed to their low income would be severely pinched by stabilization and the probable ensuing rise in the cost of living. Under such circumstances, there was reason to apprehend that the service would get worse rather than better. Referring to M. Rist's statement that the Experts had asked for salary increases in the Treasury, he asked if there was a probability that this increase would be granted.

M. Moreau replied somewhat vaguely that M. Poincare was reorganizing the Ministry of Finance and possibly there would be something done in the matter.

Concluding the conversation, Governor Strong asked Mr. Warren and M. Quesnay whether they wished to make any remarks. M. Quesnay ~~did not~~ offer~~ any~~ed no suggestions, and Mr. Warren said that he had thought ~~that~~ of four matters of detail which were

quite essential to any plan of stabilization:

(1) that the rate ~~in~~ and time of stabilization should be left entirely at the discretion of the Bank and not made subject to any governmental influence;

(2) that the plan should not be entered upon until the commercial banks were committed to its success;

(3) the matter of publicity; inasmuch as the provisions for the publicity of the Caisse de Gestion recommended in the Experts' report had been omitted from the law establishing the Caisse de Gestion;

(4) the necessity of securing adherence to the scheme of those foreign interests whose aid was counted upon, in order to avoid any misunderstanding such as had occurred in the case of the Belgian program.

X Add complimentary remarks & made about value of our trans discussion

MEMORANDUM BY R. B. WARREN RBW

CONVERSATION OF AUGUST 31, 1926

Place: Princess Hotel, Paris

Present: Governor Strong
Prof. Gaston Jeze, of the Faculte de Droit, University of Paris
Mr. Warren

Time: About 1½ hour.

Prof. Jeze was introduced to Governor Strong through the intermediary of his colleague, Prof. Rist, both being members of the Faculté de Droit of the Sorbonne.

Governor Strong opened the conversation with the statement that he had noted with ~~great~~ interest Prof. Jeze's reservation in regard to indirect taxation in the Experts' report. In the United States there was a ~~very~~ common ~~and vociferous~~ belief that the French people did not pay taxes, but the American coming to France soon found that one of the commonest complaints of the French people was that they were overtaxed. Governor Strong was ~~extremely~~ desirous of reconciling these contradictory opinions and of coming to a just conclusion as to the tax burden borne by the French public.

Prof. Jeze said that the reservation which he had entered in the Experts' report represented a ~~profound~~ conviction on his part as to the ~~iniquities and~~ inequities of the present system of indirect taxation, which was virtually a tax on consumption, but because he was a minority of one on the Committee, and because he did not wish to impair the spirit which actuated the Committee or spoil the report, he had entered this reservation under the form in which it appeared. One of the ~~greatest~~ dangers under any proposed stabilization plan lay in the budget. On paper, the budget for 1927 [1] was ~~satisfactorily~~ balanced. As a matter of fact, Prof. Jeze doubted ~~very much~~ whether it would be possible to compress the expenditures of the State within the limits of the revenues which were provided under that budget. One of the ~~principal~~ reasons lay in the fact that the great body of civil servants of the State were ~~extremely~~ underpaid. As an ex-

[1] The budget for 1927 has not been formally presented. R.B.W.

ample, he stated the pay of a Professor at the Sorbonne was between 30,000 and 40,000 francs a year, or roughly $1200. This represented, ~~of course~~, an exceptionally highly paid position. In the lower grades, the salary was not a living wage, and this was rendering it more and more difficult to obtain or retain a man of any competence in the civil service. For example, he had been a member of an examination committee of applicants for one of the minor posts in the Ministry of Marine. Six positions were vacant, but the Committee had found it possible to fill only 2. Another time that he was a member of an examining board, they found that not one single candidate of those that presented themselves was worthy of consideration for the posts that were vacant. The situation was particularly acute in the Ministry of Finance, as had been ~~to some extent~~ explained in the Experts' report. Many of The older Bureau chiefs had ~~almost entirely~~ found better paying positions in banks or industrial enterprises. The result was that the most responsible positions were now ~~almost entirely~~ in the hands of young men between 30 and 35, who, as soon as they became measurably proficient in the work, would ~~undoubtedly~~ resign and seek more lucrative positions elsewhere. This situation was bad enough at the present time. Under stabilization, the plight of the salaried workers would be almost insupportable, and if to this condition of underpayment were added general unemployment, the consequences could hardly fail to be ~~very~~ serious. He believed that this situation should be recognized by the property-owning classes, not merely as a matter of justice, but as a matter of ~~elementary~~ prudence in their own interest. The property-owning classes should recognize the dangers which lay in provoking the great mass of underpaid salaried workers.

Governor Strong asked whether, in the opinion of Dr. Jeze, the discontent which was ~~only too~~ likely to follow stabilization would be sufficient to upset a Government that was carrying through stabilization, and possibly overturn the program itself soon after it was under way.

Prof. Jeze said he did not believe this to be the case; that ~~undoubtedly~~

there would be political reactions in which deputies or candidates for the Chamber would make very radical and menacing speeches, but once in office, he did not believe that they would overturn any plan of stabilization. There were two reasons for this:

(1) That at heart, the French people themselves were ~~extremely~~ conservative,

(2) That there was a kind of inertia in the French Government that made succeeding Chambers and Governments ~~very~~ reluctant to throw over any sort of program ~~that was~~ actually under way. The 1924 elections were an ~~excellent~~ example of this. The elections were contested ~~very largely~~ in ~~a form of~~ opposition to the tax measures that had been introduced by M. Poincare immediately before. The deputies of the Left had been elected ~~almost entirely~~ upon their election promises to reduce taxation. Once in office, however, confronted with the responsability of conducting the Government, they not only had not abolished any of the Poincare taxes, but they had ~~actually~~ been ready to vote further taxation.

In the opinion of Dr. Jeze, the great obstacle to financial reform in France lay in the stupidity of the governing classes. There were three outstanding examples of this:

(1) The handling of the Reparation problem. At the time that the Treaty of Versailles was being negotiated, he had been called into conference with the then Minister of Finance, M. Klotz, who had talked to him of the fantastic sums which Germany was to be called upon to pay. The principal anxiety in the mind of M. Klotz was not the fear that they would ask of Germany reparations impossible of payment, but that they would set their demands too low. In M. Klotz's mind, there was no sum which was beyond Germany's capacity to pay, and as for the problems of transfer, Prof. Jeze was ~~absolutely~~ unable to make him recognize their existence. This want of realism in handling the Reparations program had persisted year by year, leading up in the end to the occupation of the Ruhr.

(2) The belief which many people persisted in down to a few weeks ago and which

many people still held, namely, that the problem of restoring the currency was solely ~~one of~~ psychological. If the people could be put in a proper frame of mind, this belief ran, the currency would stabilize itself. This had been the attitude of M. Poincare himself upon his assumption of the Ministry.

(3) The third example was the ~~illusory belief~~ illusion that France would be able to stabilize her currency without ~~any~~ outside assistance. He was happy to say, however, that an increasing number of people, including M. Poincaré, had already begun to realize that this was a fantastic idea. Discussion of foreign credits, however, ~~of course~~ involved the question of the ratification of the debts.

Prof. Jeze stated his attitude on the debts in all candor. His opinion was that France should accept the terms of the Mellon-Berenger agreement and should make every effort to live up to them. However, it was his opinion that eventually, it would be found that the sums proposed for transfer, not merely under the debt settlements but also under the reparation program, would be ~~entirely~~ beyond the capacity of the world to maintain. When this was clearly demonstrated, then it would be necessary to reconsider this whole series of problems, ~~in their entirety.~~

Governor Strong said that in considering the debt questions, it was necessary to take account of the American attitude on the debts. Two-thirds of the population of the United States was either foreign-born or the children of foreign-born parents. They had come to the United States, not merely for the purpose of bettering their economic condition, but also to avoid certain of the disadvantages of European life, particularly the liabilities of the military service and the horrors of the war which, for more than a generation, everyone had been expecting. This war finally came, as everyone had predicted, but it included the entry of the United States, which had not been generally expected. It would have been ~~entirely~~ possible for the United States to ~~have~~ limit~~ed~~ its effort simply to the protection of its commerce upon the high seas. This, ~~however,~~ was not done. The United States

threw itself into the war, involving as it did no ~~little~~ personal sacrifice and an enormous expenditure in money. It involved furthermore the abandonment of one of the great American traditions, perhaps the one political condition of our national life, namely, separation from European entanglements. ~~In the end, this war had involved an enormous financial effort~~. One of the principal reasons why this financial effort had not involved the United States in the same currency disasters as European countries lay in the fact that, as we entered the war some years after its commencement, it was possible to profit by the financial mistakes of other States. For this reason, the Federal Reserve System had ~~absolutely~~ refused to lend any money directly to the Government, although ~~they~~ it had cooperated in war finance, which had involved the creation of an enormous floating debt. The Federal Reserve System had insisted that this floating debt should be ~~entirely held by~~ placed the market, although it had supplied the funds to the market which enabled the market to hold it. As a result of this situation, when the time came for deflation, it was not necessary to secure from the Government political support for a program of amortization of a State debt to the Federal Reserve Bank. It had been possible to undertake the necessary program of financial restoration without raising the question ~~the necessity~~ of securing any laws or political support. The result had been, however, that those persons who had suffered from the inflation had been ~~extremely~~ bitter toward the Federal Reserve System. With the passage of time, however, it was more and more being realized that the hardships of deflation had been ~~absolutely~~ necessary for financial restoration, and the attitude toward the Federal Reserve System had ~~entirely~~ changed. In fact, it had changed so much that in a recent project of law, coming up many years before the charter of the Federal Reserve Banks would expire, it had been proposed to extend those charters for 50 years. Governor Strong said that he had personally not been in favor of this proposal. He would have preferred to make the charter of perpetual or indefinite duration, ~~but have provided~~ with the provision that the System should be subject to periodical examination by a committee representing

both the Government and the System, such a committee being authorized to make changes necessitated by the progress of events.

Prof. Jeze quite agreed with this position, stating that no bank charter should be perpetual, because economic conditions were constantly changing and what would be an excellent provision at one time might be ~~entirely~~ useless or harmful a few years later.

Governor Strong then remarked that if the question of the Allied debts had been shrewdly taken up immediately after the war, it might have been possible to effect some other form of settlement than that which was now proposed. As a matter of fact, they were allowed to drift along for a number of years, and presently they were seized upon by politicians seeking to make capital. It was ~~particularly~~ unfortunate that certain politicians in Europe had endeavored to convince their respective countries that these debts were in some way a moral issue and that the borrowers had some sort of moral right to ~~complete~~ cancellation. This position had even been taken that the money was not actually owed, and that it ought not to be repaid. The result of this was an inevitable reaction on the American mind, which was quick~~ly~~ to accept the idea that the debts were a moral question and that the moral obligation of repayment was the strongest feature of the question. Governor Strong had observed that whenever a responsible statesman came out with a candid recognition of liability ~~of~~ for the debt and expressed a willingness to effect a settlement and to do the utmost to make the payments ~~commanded~~ provided under the settlement, the debt shrank in size, both in the debtor country and in the United States. On the other hand, when the liability ~~on the debt~~ was denied, it assumed at once an unusual magnitude in both countries. The best thing under the circumstances was for the various debtor nations to make their settlements and stop agitating the question. This would give time for everyone to cool off and later approach the subject with a more open mind. As a matter of fact, in the case of France, what were the alternatives? By protracting the negotiations, France might be able to secure terms which would reduce

assets ~~which under certain conditions could be put at her disposal~~. The amount of French capital recently expatriated ran into enormous sums. Under certain circumstances, he believed this could be brought back and used under the guidance of the Caisse de Gestion in such a way as to lift the menace of the floating debt from the market.

Governor Strong raised the point that it would be ~~extremely~~ difficult to effect the repatriation of these large foreign balances without the existence of a flexible and well organized money market in Paris. It did not appear clear, however, that Prof. Jeze fully appreciated this fact, because he seemed to think that the problem could be satisfactorily handled simply by the return of these foreign assets, which would give the French people funds to support the floating debt or ~~even~~ facilitate its conversion.

In conclusion, Prof. Jeze said that there could not be any doubt that public confidence had in recent weeks been ~~enormously~~ stimulated. This was the time when, if France was to avoid ~~a tremendous~~ catastrophe, the problem of stabilization should be taken up and energetically pressed. Furthermore, since any program of successful stabilization would involve ratification of the debts and negotiation of foreign credits, it was ~~particularly~~ desirable that the program be handled under the political guidance of a man whose nationalistic tendencies were unquestioned, even by the extremists. Poincaré was the one man in France who seemed to have the qualities which were essential to the successful molding of public opinion in this direction.

the annual payments by a few million dollars, but by doing so, the French people ran the risk of permitting their currency to fall into complete disorder and themselves to be involved in a ~~great~~ national economic catastrophe. Between these two alternatives, there could be no doubt as to which was preferable. In fact, such a catastrophe might involve France in an agitation that her finances be put under some sort of a supervisory committee, similar to that constructed by the Dawes Plan, which nobody either in France or in the United States had the slightest desire for.

Prof. Jeze said that the problems of debts and reparations were quite similar. Europe in its post-war problems had been endangered by its politicians and saved by its technicians. It was a Committee of Experts which had rescued the Reparations problem from the confusion caused by the politicians. ~~mess which the politicians had made of it~~. It was the Committee of Experts in France which had indicated for France the only method of financial salvation after the debacle into which the country had been plunged by its politicians. Although financial restoration in France could not be effected without foreign aid, he did not believe ~~for a minute~~ that the Government of France should appeal for this foreign aid until it was able to appear before the world with a sound, well worked out program of reform. Such a program, he believed, was in the process of formation. The Poincaré Government had ~~in fact~~, notwithstanding the declarations which had preceded its entry into office, accepted the Experts' report ~~in~~ all except two of its provisions. Those two provisions were, first, the ratification of the debts, and second, the appeal for foreign credits. (Prof. Jeze had already indicated that in his opinion the attitude of the Prime Minister had fundamentally changed in recent weeks on the question of foreign credits).

Governor Strong then raised the problem of the floating debt, stating that he believed that it presented a very serious menace to any stabilization program.

Prof. Jeze, however, was inclined to believe that under the Caisse de Gestion, the floating debt might have been put out of danger. ~~France had enormous foreign~~

MEMORANDUM BY R. B. WARREN RBW August 31, 1926.

DOLLAR BILLS IN PARIS MARKET

Information sought for this memorandum was chiefly obtained from Mr. Llewellyn of Morgan Harjes & Company, and Mr. Berntsen of the Bankers Trust Co.

Mr. Llewellyn said that there were very few dollar bills floating in the Paris market. The principal exports of France to the United States are manufactured textiles, such as dresses, lingerie, millinery etc. The customers ~~of~~ in the United States are for the most part either department stores or buyers representing groups of merchandising establishments. Principally, the exports of France to the United States arise out of purchases in Paris by representatives of department stores maintaining permanent offices in Paris or coming seasonally. It is a regular business between the manufacturers and their steady clients. For the most part, these are cash transactions, the buyer paying for his purchase by direct payment into the account of the French seller in a New York bank; the latter draws against such an account for the sums which he wishes to return to France.

Somewhat similar methods are followed by the buyers for the big New York department stores, ~~all of~~ which maintain permanent offices in Paris and make direct payments for their purchases. In this way, no bills arise in the market and there is no probability that the market will ever resort to bills for this kind of transaction.

For other kinds of transactions, the market is of course under peculiar influences at the present time, owing to the unwillingness of French exporters to repatriate ~~any~~ more of the proceeds of their exports than is absolutely necessary for the continuance of their business. Possibly over one-half and something less than three-fourths of the French exports to the United States are financed in this

direct manner. Of the remainder, possibly half is financed through bills of exchange stated in francs, and the other half in dollar bills. These dollar bills, however, ~~were~~ are extremely rare and ~~were~~ are very much prized by all of the French banks, for which reason they were accorded extremely favorable rates. They did not, however, float in the market, but arose always in connection with the regular established accounts of particular clients. Practically the only industry which financed its exports to the United States with the use of dollar bills was the walnut trade.

In a conversation with Mr. Berntsen of the Bankers Trust, the latter said that, so far as he knew, there were no dollar bills in the Paris market. In his experience he had never seen such an instrument.

From these conversations, it appears that there is only an insignificant quantity of dollar bills in the Paris market. Furthermore, the character of the market is such that what few bills there are, are only likely to find their way into banks handling the general banking business of the exporter. No bank which was not prepared to engage in all forms of banking business in Paris could hope to secure the slightest fraction of this sort of business, for which it would have to depend solely upon its own clientele. No market in bills, whether drawn in dollars or in francs, exists at the present time in Paris.

There has never been in Paris a market in commercial bills. At the present time, the entire export business of the country has organized its efforts to avoid the repatriation of as much of its dollar and sterling balances as it can possibly retain outside the country. To a certain extent, there is no doubt that, with the stabilization of the currency, these peculiar features will pass and there is reason to expect that gradually there will develop in Paris an organized bill market. There is, however, no particular reason to believe that this market will ever include any considerable amount of dollar bills. Before the war, even export

bills, I understand, were usually drawn in francs, but the permanent character of the export trade of France with the United States is such that it can be financed with perfect facility in exactly the way in which it is being financed now, and there is absolutely no reason to anticipate that, even after stabilization, it will change its methods into a form which would create any considerable number of dollar bills, nor that the dollar bills which might be created under certain circumstances would be sufficient in volume to justify the establishment of a financial institution designed to trade in such bills, unless this institution was prepared to supplement its activities in the bill market by engaging in every form of commercial banking.

MEMORANDUM BY R. B. WARREN

CONVERSATION OF SEPT. 1, 1926

Place: Princess Hotel, Paris

Present: Governor Strong
Governor Assen Ivanoff (Banque Nationale de Bulgarie)
Mr. Warren.

This conversation was arranged at the request of the First Secretary of the Bulgarian Legation, by M. Monnet's suggestion.

Governor Ivanoff opened the conversation with some remarks to the effect that the Bulgarian people had always enjoyed the friendship and aid of the United States and American influence had been very strong in the formation of modern Bulgaria, owing to the fact that a great number of its young men had received their education at American institutions in the Near East. Governor Ivanoff said that he wished to express to Governor Strong the feeling of gratitude of the Bulgarian Government to the American people for their continued friendship, and also, as Governor of the National Bank of Bulgaria, to make the acquaintance of the Governor of the Federal Reserve Bank of New York. Both before, during and after the war, the friendship of the two peoples had continued very largely through the good offices of Mr. Murphy. Governor Ivanoff hoped that these friendly relations would continue and expand.

The object of his visit was to acquaint Governor Strong with the recent conversations that had been going on between Bulgaria and the Bank of England. Governor Ivanoff had spent a month in England discussing with Mr. Norman the terms of the proposed Refugee Loan of £ 2,500,000. This loan was to be subscribed in several markets. The proceeds were to be paid into the National Bank of Bulgaria, which would be charged with the exchange operations arising therefrom. The disbursement of the funds in Bulgaria would be under the surveillance of a committee of the League of Nations, and the proceeds would be used entirely for the purpose of buying lands on which refugees would be settled, stocking

them with cattle, providing them with seed, and in general equipping them for productive farm work. These refugees had come from Turkish Thrace, Grecian Thrace, Macedonia, and the Dobrudja.

The conversations with Mr. Norman, arising out of the necessities and demands imposed by the Finance Section of the League of Nations, had necessitated the complete revision of the statutes governing the National Bank of ~~Belgium~~ Bulgaria. As Governor Strong knew, this Bank had been a State institution, all of its officials being nominees of the Government. Under the new charter, the directors would be representative of commerce and industry, only the Governor and the Vice Governors being appointed by the State.

Governor Strong remarked that evidently the Governor was intended to hold the balance between the demands of commercial interest on the one side and the Treasury on the other, but that he had remarked in the case of other banks with similar constitutions that the tendency invariably was for the Government directors, even though they had been appointed by the State, more and more to incline towards supporting the position of the commercial representatives on the Board, against the insistence of the Treasury.

Governor Ivanoff said that one of the principal problems confronted by Bulgaria had been the prewar debt. An understanding had already been concluded with the holders of 80% of this debt, who were residents of England, Holland, Switzerland and France. These terms provided for payments at the rate of approximately 45% gold, beginning with April of 1927 and thereafter increasing year by year until finally the full interest and amortization in gold would be provided for. The remaining 20% was held throughout Central Europe and particularly in Germany. They had not been able to make the same terms with these holders, particularly the Germans, because of the financial arrangements which had arisen between Germany and Bulgaria during the war. German banks, including the Reichsbank, had during the war extended credit to the Bulgarian Government in the form of

loans which had been accepted into the assets of the National Bank of Bulgaria to the amount of about 900 million marks. Against these German securities, some 3½ billion leva had been issued. The decline in the mark had of course destroyed the entire value of the assets lying behind the Bulgarian currency. As a result of this transaction, the Bulgarian Government found itself unable to come to the same terms with the German holders of its prewar securities as it had with the others. Nevertheless, they hoped that inasmuch as this remainder was only one-fifth of the total outstanding, some satisfactory arrangement could be reached. Such an arrangement might involve some sacrifice of principle, but the Bulgarian Government was anxious to get the thing cleared up.

The real object of Governor Ivanoff's visit, evidently, was to acquaint Governor Strong with the desire of Bulgaria that a certain fraction of the proposed Refugee Loan should be floated in the New York market. They had been besieged by an infinite number of intermediaries offering to handle this transaction for them, some of them representing banks with whose names they were familiar, but many of them representing concerns about which they had no information. They recognized that it was extremely important that the first Bulgarian loan floated in the United States should be a signal success, because they hoped in the not distant future to bring out a number of other loans. For instance, their Mortgage Bank wished to float some securities in the United States, and the Government had projects under consideration with Ulen & Company for railroad construction and irrigation.

Governor Strong remarked that under such circumstances, it was of the first importance that the underwriting firm with whom they opened connections should be a house of extremely high standing, and a firm that would not so much be interested in making a profit on the deal as one that would be interested in securing a permanent client whose interests they would seriously take to heart.

Governor Ivanoff said that their banking connections in New York at the present time lay with the Guaranty Trust Company and the Irving-Columbia. They were

uncertain, however, as to what houses they should approach for the proposed issue of bonds.

Governor Strong said that the Guaranty Trust Company was of course perfectly capable of taking care of the issue, but if they wished another name, he would suggest that of Lee, Higginson & Company. He reminded Governor Ivanoff that houses of high reputation were much more difficult to approach than houses of lesser standing, and that at first approach they might seem to be rather austere in their terms. However, such a connection would be worth-while, while one of any other sort, though possibly offering a seeming advantage at the moment, would in the long run be an undesirable connection. Governor Strong emphasized that, while American bankers and investment houses were interested in turning an honest penny, Governor Ivanoff could rest assured that never did any ulterior political motive lie behind an American loan.

Governor Ivanoff said that he appreciated this fact and that for this reason he was particularly interested in forming strong banking connections in London and in New York. They were less desirous of forming connections in Berlin, because of the political considerations that they would involve. He said that the Bulgarian Government had no interest at heart at the moment except the peace and economic welfare of the country, and that in this program he and the National Bank were prepared to give the Government their hearty support and cooperation. Personally, he was convinced that this loan was extremely well secured. In the first place, it was under the surveillance of the League of Nations. Second, the foundations of currency reform had been thoroughly laid in their conversations with Mr. Norman; and last, specific revenues of the State# were pledged to its interest and amortization. He therefore felt justified, both from these facts and because of his personal assurance based upon nearly 30 years in banking, first with the State Agricultural Bank and second with one of the largest commercial banks in Bulgaria, in endorsing this loan. In conclusion, he said that he hoped that Governor Strong would give this

#Specific revenues from alcohol, salt, matches will be paid into the custody of a commissioner; specific revenues now exceed the service demanded.

proposal to introduce a Bulgarian loan into the American market his friendly cooperation.

Governor Strong first asked to be reassured as to the question of whether there were or were not any outstanding debt controversies between Bulgaria and the Government of the United States arising out of possible Relief Loans. Receiving an assurance on this head, he agreed to take the matter under his favorable consideration and told Governor Ivanoff that within a few days he expected to be in London, when he would be able to discuss the matter at greater length with Mr. Norman. In the course of these conversations, definite suggestions might develop as to the placing of such a loan in the United States, although of course the actual terms would have to be arranged by the issuing house. Governor Ivanoff must remember that, since this was to be the first Bulgarian loan in the United States, it would be necessary perhaps to offer rather attractive terms, but that these would be worth-while, because it was important that the first Bulgarian loan there should be an outstanding success.

The conversation then ended with an expression of gratitude on the part of M. Ivanoff for the courtesy of Governor Strong in permitting this interview.

Princess Hotel,
Paris, September 6, 1926.

Dear Mr. Harrison:

You doubtless have received the original of the enclosed letter from Dr. Schacht. I hope nothing is done about it until my return, except to make the necessary investigations, to find out something of the business and responsibility of Jerome B. Sullivan & Company, to get a copy of the advertisement and to ascertain, if possible, whether any subscriptions were actually received and what was done with them. We can talk it over on my return.

I have written Schacht as per enclosed copy.

Sincerely yours,

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

BS:M

(30)

Bank of England,
London, September 9, 1926.

PERSONAL AND CONFIDENTIAL

Dear Mr. Jay:

I wrote you by hand to Paris, fearing that I might not have opportunity to dictate a letter, as I shall be rather busy in London, so this will be simply an elaboration of what I wrote briefly yesterday.

The situation with the Bank of France is briefly as follows. We have been over all of the essential principles of a program of stabilization, without actually devising a plan, as that would not be possible until the domestic situation has developed further, until the debts have been ratified, and until more progress has been made in dealing with the domestic floating debt. Besides that, it is hardly possible to consider specific terms of the plan without consulting the bankers who would be called upon to sell a Government loan, and who of course would have their own ideas of these principles.

I have already send you certain words of caution in case you have not seen all of the mail going to the Bank, but there is one point on which you are almost certain to be questioned, where you should know what my attitude has been. I have exchanged letters with Governor Moreau making clear that no commitments are expressed or implied as the result of our talks. We could not, for instance, arrange even tentatively credits conditioned upon ratification of the debt accords. But of course, no discussion with the officers of the Bank of France would be of much practical value without expressing some view of what could be done. I have been in pretty close touch with Morgan, Harjes & Company, and through them by cable with J. P. Morgan & Company, and have gathered a fairly good idea of what the possibilities are. Based upon that, I have expressed the opinion to M. Moreau, which is no more than an opinion and with every sort of reservation as to

changes which might occur between now and the date of negotiation, that it should be possible for the French Government to place a loan as large as 150 million dollars in the American market, and another 50 million dollars in Europe. I stated that this could not be done at the present time, but I would expect that it would be possible with the improved atmosphere which would develop following ratification and in connection with the announcement of such comprehensive and sound plan of stabilization as could be devised, based upon the principles which we have discussed.

As to credits, I told him that I thought, between all of the banks of issue in the gold standard countries, it should be possible to arrange credits of 150 million dollars, and if the commercial banks of France could be brought into the arrangement in some way, so that credits might be arranged with commercial banks in other countries, this amount might be increased to 200 millions. I was hardly in favor of an attempt by the French Government to place a large loan of say 200 million dollars in gold standard countries and at the same time for the Government to arrange a large bank credit as well. It seemed to me there was a duplication there which would have the effect of curtailing commitments for underwriting a large Government loan, as so many of our banks were underwriters of these foreign loans and might hesitate to make that commitment at the same time that they were extending the French Government credit.

In a general way, therefore, I am encouraged to believe as a matter of opinion that, with all the circumstances favorable, a loan and credits in all the markets aggregating from 300 to 400 million dollars would not be impossible. In general, I advocated keeping the permanent long-time Government loan as small as possible and arranging for as large bank credits as possible, as that was more economical. Bank credits could possibly be arranged for one year with a one year

renewal provision, or for two years with a privilege of cancellation at the end of one year. It was made perfectly clear that no such engagement could be made by the Bank of France, except in contemplation of ultimate gold payment if the credits had been used and were not cleaned up at maturity.

He and others have a strong leaning toward using the German railway bonds now in the hands of the Reparation Commission. I have discussed that with them, (explaining that it was none of my business, so that I could only express personal views,) but I thought it was a great mistake at this time. I did not tell them so, but this is the conclusion I have arrived at after a long discussion with Gilbert, and very confidentially, he has explained his views very fully to M. Poincare. Neither the officers of the Bank nor the Finance Minister agree with either Gilbert or me at the present time, but I am satisfied they will before the time for stabilization arrives.

Now as to Italy, the situation has taken a sudden turn. Volpi and Stringher discussed with me various features of a plan of stabilization, and I emphasized the need for a further study than they had yet made before they were ready to take the final step, and also cautioned them on the peril of undertaking a program until the French had dealt with their situation. This they fully appreciated, but in the meantime they had gone ahead with certain preliminary steps, which havebeen published in the paper and which impressed me as being in the direction of good progress. Just before I left Paris, Mr. Fummi telegraphed me that he needed to see me. He came to Paris from Northern Italy for the purpose, and there made clear that Volpi was getting ready to go ahead with the program and was anxious to know whether I would be in Europe and able to discuss it again. He would not admit that he had been sent by Volpi, but I am satisfied that he was.

Mr. Mellon and I talked it over quite fully, and he was disposed to

recommend that I stay on, at least until after he had returned home, sized up the situation and was able to cable me as to the wisdom of remaining on for a further period, so as to continue talks with the Italians. But the cable from the Bank which you have read led me to go ahead with my plans to return home on the 18th, and I shall do so unless something important and unexpected develops between now and then.

So far as I can gather, the Italians and French are not at odds in their views on this subject. In general, Governor Moreau's view is that it would be helpful to France to have Italy and Belgium put through a plan, provided it was a success in each instance. An attempt at a plan which failed would be injurious all around. On the other hand, he saw no immediate chance for a plan of stabilization in France and therefore recognized that the danger in both of the other countries resulting from a possible further break in French exchange was considerable. My own feeling is that plans of stabilization undertaken by Belgium and Italy first would require much larger credits and more underwriting, so to speak, than if France put through a program first, as later, when France undertook a program of stabilization, their own character and temperament would lead them to make just as heavy demands for credit as though Italy and Belgium had not stabilized. Therefore, if economy in the magnitude of commitments is to be arranged, it should result from a French arrangement first and the others later.

One disturbing thing in Italy is that there appears to be no evidence or intention so far to make the Bank of Italy as completely independent of Treasury control as I would like to see it. They may set up a facade appearing like independence, but really the domination of the Finance Minister would remain unchanged. This needs further examination.

If you discuss these matters with Volpi and Stringher, you will find

that they have magnificent ideas of the amount of credit required, even going so far as to suggest another Government loan. That I believe to be a mistake. They have pretty large resources now, and what they need is probably a Government one or two year credit of impressive amount and then a central bank credit. In all three countries, the support and cooperation of private bankers is so important that I would like to see them in each instance brought into some consortium and committed to some program in a definite way, so that they would themselves lose money in case the program failed.

Now, replying to your letter of August 27th, which I was delighted to have.

First, as to the Indian Currency report, I had no idea of a public statement ourselves, but thought that possibly Winston or someone in the Treasury would be able to make use of a careful analysis of the report prepared by Sprague. I think the Bank should keep out of it.

I never heard of Fuller and presume he is an exploiter of some kind.

Your (3): I am glad the Board is not going to undertake the examination of State banks, but it is of academic interest to us, as I understand our examinations by the State Departments are all satisfactory to you. If the failure in Georgia and Florida was the result of some carelessness by the Atlanta Reserve Bank, it would justify the Board possibly in some action, but as none of them were member banks, I do not see why there is any excitement about it. The Board seems to overlook that for years they made no examination of the Edge Law banks, as the law contemplates.

(4) I will be on hand for the Conference in November, and my notion is to lay the foundation for any foreign transactions that may grow out of the plans now under way in Europe. That should be the principal business of the meeting, and I

have made sure that we can get Mr. Mellon's support.

(5) After careful inquiry in regard to Carroll, I have made up my mind to see him in Washington when I go there, and of course I will have a talk with Juliun Mason, but I am surprised to learn that he (Mason) has gone with the "Evening Post."

(6) It is interesting to note that when rates stiffen up in New York, the New York City participation in the Stock Exchange loan account goes down and lending by others goes up. There is not much that we can do about it, except deal collectively with credit as a whole, and forget that the Stock Exchange is a special subject of excitement.

I hope you have a bully trip, and suspect that you cannot help but become involved in the discussions about stabilization. It is just as well to get another direct line on the situation while we have the opportunity.

Please give my best to Mrs. Jay, and the same to you.

Sincerely yours,

Mr. Pierre Jay,
c/o Morgan, Harjes & Company,
14, Place Vendome,
PARIS.

BS:M

Belgium

(31)

MEETING AT BANK OF ENGLAND - Sept. 14, 1926 at 11:15 a.m.

Purpose: To consider Belgian matters.

Present: Messrs. Norman, of the Bank of England
Ter Meulen, of Hope & Company
Du Bois, of the Swiss Banking Corporation
Morrow, of J. P. Morgan & Co.
Whigham, of Morgan Grenfell & Co.
Peacock and
Arthur Villiers of Baring Brothers
Brown, of the Westminster Bank
Strong, of the Federal Reserve Bank of New York.
Osborne, of the Bank of England

Before I joined the meeting, Governor Norman outlined the present situation of the negotiations with Belgium, which I did not hear but which he stated to me covered the situation generally without more than a passing reference to the subject of the bank of issue.

Ter Meulen, who is most conservative anyway, then expressed some doubt about financing a bond issue, because of the way in which Francqui had handled the railroad preferred stock. Two hundred millions had been sold to Nederlandsche Handelmaatschappy they being close competitors of Hope & Company. The sale was made without consulting Ter Meulen at all, notwithstanding that Hope & Company had been the Belgian bankers in Holland for years and that his firm had stood by them through recent difficulties. He thought Francqui had recently disclosed some characteristics which he did not like and which shook his confidence in him. So far as he could gather from a telegram received yesterday, the offering in Holland had been unsuccessful, the market understanding that only 50 million francs out of the 200 millions had been subscribed. He felt that when some 4 billion francs of the preferred stock was delivered to the holders of Bons de la Defense Nationale in completing the consolidation transaction some time in December, there would be very large offerings of them and that their price might decline even as low as 94 or below and not only affect the price of the stock sold in Holland and Switzerland but make it difficult to successfully place a straight Government loan. He

thought the railroad preferred stock with a 6% dividend guaranteed by the Government was a somewhat better security than a straight Government obligation anyway. His first attitude was rather gloomy.

Du Bois of the Swiss Banking Corporation spoke quite differently. He said that the 200 million francs of railroad preferred stock had been successfully placed in Switzerland; in fact, they had sold 230 million francs, and the money was all on deposit there to the credit of the Belgian Government or the National Bank for its account. He thought the railroad shares were good and was hopeful as to their future market value. He distinguished between the stock issued on the consolidation and that which was sold through the bankers in Switzerland and Holland, as the latter was listed and the former was not.

Du Bois said that he would join in handling a loan for the Belgian Government and a credit, but he agreed that it would be better, as had been suggested to him, to reduce the amount of the loan and consequently the fixed external charges of the Belgian Government, and make up the difference by a banking credit to the Belgian Government. His only regret about the railroad transaction was that the actual properties of the railroad company were not transferred to the public corporation, instead of transferring their use under a lease for 75 years. He thought the former would be a better plan. He said very positively that he believed Belgium would be strong enough with this transaction arranged to stand up in the face of a collapse of the French franc, and that if they did not put through a stabilization plan now and France should have a collapse, the opportunity to stabilize would be lost for a long time. He said there were large amounts of Belgian expatriated funds ready to return immediately that stabilization became effective. He wound up by stating that he had no doubt that when matters had progressed and Ter Meulen had satisfied himself of his doubts he would be glad to go along with Hope & Co. to handle the business, to which Ter Meulen did not dissent, although he laughed.

There was then some general discussion in regard to the renewal of the existing credit, of which $15,000,000 was still unliquidated and which falls due the end of September. It was generally understood that those present who were interested would renew for 3 months with a commission of ½ %, instead of ¼ %. The last commission of ¼ % was made so small because the previous one was regarded as too heavy.

Governor Norman and M. Du Bois then discussed at some length the question of the form of the loan and the credit, and the amount, and they both agreed and the others seemed to assent, that it was preferable to keep the Government loan as small as would be justified considering the amount of actual reserves required by the National Bank. The indication was that the reserve should be approaching or in the neighborhood of 50%, which would mean substantially 70 millions cash from the loan that would be a definite completed transaction. The balance of the amount, whatever was finally decided, would be in the form of a banking credit to the Government running for a short period, which would be used in the event of emergency but which would not involve a long permanent external fixed charge on the Treasury. They seemed to think that the bonds would be improved marketwise if the bondholders were given the right to convert the bonds into the preferred stock of the railway company. It would not hurt the bonds and might give them some speculative value, and it would not appear to the Belgian people as collateral security.

Mr. Morrow stated that his firm would be much embarrassed by any discussion of collateral or security for the new Government loan, and he would prefer not to consider it.

Governor Norman stated that it was his understanding from the London bankers with whom he had been in touch that they would not be willing to place a Government loan and arrange Government credits unless at the same time the banks of issue would arrange a credit for the National Bank of Belgium, as they realized the

importance of this support. Without expanding this subject, he said that he and others with whom he had discussed the matter felt that Francqui's plan of an intermediate period of "de facto" stabilization and the arrangement of a Bank credit later when he was ready to undertake "de jure" stabilization, was not satisfactory; that once the loans and credits were arranged, the issue made and the plan completed and announced,"de jure" stabilization on the plan and at the rate agreed should become effective at once; and he then raised the question as to what should be said to Francqui, where he should be seen, and when it could be arranged.

There was considerable discussion of the possibility of disclosure of the meeting in case anyone went to Belgium, and even greater possibility in case Francqui came to London. That subject was thoroughly threshed out and it was finally arranged that Messrs. Ter Meulen and Du Bois would meet Mr. Dean Jay in Paris Thursday morning for breakfast, that Francqui should be invited to be in Paris Thursday morning for a meeting and the position of the bankers made clear to him. The question was raised as to what he should be told, and Mr. Peacock suggested that there were 3 things to say to him:

(1) That there would be no loans or credits arranged by the bankers for the purpose of stabilization unless the central banks were satisfied to extend a credit also to the National Bank;

(2) That the amount of the long-time loan should be kept as small as possible to meet the requirements of the National Bank for reserve,and that any additional amount should be in the form of credits to the Government for a period so as to avoid heavy foreign debt service;

(3) That "de jure" stabilization should take place at once that the plan was worked out and effective.

The total amount of the loan and credit by the bankers was not discussed except by implication from the fact that Francqui had asked for 100 million.

It was suggested that not less than 70 millions cash would give the Bank with its present resources a 50% reserve against its notes. Someone raised the question as to why a 50% reserve was necessary, whereupon M. Du Bois stated again that there were very large amounts of Belgian balances in foreign countries ready to return the minute stabilization was accomplished. Mr. Peacock, Mr. Morrow and others raised the question as to whether this would not force an inflation upon Belgium. I pointed out that for every $28,000,000 of gold or valuta returning to Belgium there would almost certainly be a corresponding increase in the note issue of the National Bank of a billion francs, unless the Bank were capable of otherwise contracting the note issue. Governor Norman pointed out to Ter Meulen that this was exactly what had happened in every country where they had proceeded with a plan of stabilization under the auspices of the League of Nations, which Ter Meulen admitted.

There was quite a bit of discussion of policy and management after the plan was made effective. Du Bois stated that he was thinking a good deal about this return of funds; he was satisfied that unless they would have an actual "de jure " stabilization, he did not want to handle the loan, but if they did, he was confident that it would weather any storm caused by difficulties in France.

There was some discussion as to the reasons for the intimate relation in the movements of the French and Belgian francs. Francqui explained it to Ter Meulen as being caused by the fact that all the Belgian press was dominated by the French press and when anything went wrong in France, Belgium was flooded with bad news. I repeated the explanation given to me by Bachmann at the Swiss National Bank as being partly responsible.

Down to this point, I made no statement whatever of the attitude of the Federal Reserve Bank, but just at the conclusion of the meeting made, in substance, the following statement:

M. Francqui had asked us for no credit as yet, although we had learned through

other channels that he had mentioned the possibility of it at a later date. At this meeting it had developed that the bankers would require as a "sine qua non" of any loan operation that a credit should be extended to the National Bank by other banks of issue, in order that they might gain the moral support thereby afforded and assurance as to the direction, management, policy, continuity and independence of the National Bank. My own position was briefly as follows:

The Federal Reserve Bank at the time of the earlier effort at stabilization had taken a sympathetic attitude and in fact had at that time undertaken, if called upon, to furnish $15,000,000 or thereabouts. Since then changes had taken place in the Belgian situation which made this a more favorable opportunity for stabilization than was the case six months or more ago. If the transactions discussed by the bankers were for the purpose of enabling the National Bank to stabilize the currency at a new value and to redeem it at once or ultimately in gold, obviously any such program required for its successful execution a very skillful management of the credit and monetary position in Belgium, without interference from the Government if it was to be successful. The entrusting of such a program to changing Finance Ministers would, in my opinion, be perillous. If the National Bank were to be entrusted with the program and it was a "sine qua non" that we should extend credits to the National Bank before loans could be made, I would, before willing to recommend such credits, wish to know about the condition of the Bank, what M. Francqui proposed in the way of reorganization, what effect the plan of stabilization would have upon the statement and affairs of the Bank, and what he contemplated in the matter of management and direction. Therefore, I was unable without more information and without consultation to make any statement as to what we would do.

We had originally been sympathetic and in fact had endeavored to assist in the plan of stabilization to Belgium, and I felt it was safe to assume that my associates at home had had no change of mind in that respect, but that we would only be willing to consider the matter this time upon a thoroughly sound basis.

They all seemed to agree that this was essential, and it was in fact the object of the particular statement that they were proposing to make to M. Francqui.

There were repeated statements throughout the meeting raising doubt as to the possible inflation involved in his proposal for a further issue of a billion francs of currency. They all had it in mind, but none of them seemed to have any suggestions or solution of the problem to offer. They were merely aware of the fact that Francqui had repeatedly stated that Belgium did not have an adequate supply of currency now. The impression I gained from the meeting is that they are all ready to go ahead with the program, that they none of them feel very intimately acquainted with the problems of central banking credit management, that they are most anxious that that matter should be dealt with by people in whom they have confidence, and as soon as they feel that it is so to be dealt with, they are pretty confident of a successful operation.