

PERSONAL AND
CONFIDENTIAL

September 13, 1927.

My dear Mr. Gilbert:

I am so glad that you wrote me as fully as you did in your letter of September 8. There is much in your letter which is enlightening and gives a point of view which is most difficult for us to develop here so far from the scene of events as to the Dawes plan, and a point of view not only as to the economic developments in Germany but as to the individuals concerned.

If what I said to Dr. Schacht has been of any service in improving his attitude, I am indeed delighted, and if it needs to be said again you may count upon my saying it or writing it or singing it or whistling it, because, after all, such an attitude as we discussed, among such men as Schacht, is certainly in the German interest.

We have no disagreement as to the Reichsbank policy, and while our information was, of course, deficient at the time, we rather seriously questioned Schacht's policy when we were discussing it at the time of his visit.

Putting the budget problem and the transfer problem into separate compartments is, of course, a mistake. My letter on that point was distinctly incomplete, and I agree with you that the record seems to afford every confirmation of the view that lack of economy in budgetary expenditure and excessive borrowing abroad for non-productive purposes, combined, can seriously undermine the German economy by producing extravagance and over-expenditure by the people, making it too easy to import luxuries, and consequently impairing capacity of transfer. The facts in brief seem to be that during the last year or two the extensive foreign borrowing, plus the \$250,000,000 of devisa lost by the Reichsbank from its reserve, have again furnished the means of effecting transfers as well as means for unnecessary imports of luxuries.

9/13/27.

I am so glad to have your views and your explanation of the situation, and it will be most helpful. I wish you could write me often.

In the meantime I have already had one opportunity, and shall have others, for a little quiet talk with Dr. Reinhold who was here yesterday and who made a very favorable impression.

I am anxious to see that letter of May 29. It may be that you would like me to do something about that, and if so, I will with pleasure.

Sincerely yours,

Hon. S. Parker Gilbert.

September 24, 1927.

My dear Gilbert:

While this letter will not be complete, I think I should write you an interim report on the discussions with Harris, Forbes & Company, following receipt of your cables, as I may not have time to do so until late next week, and I am cleaning up mail at home to-day so as to have a clear desk next Monday.

The first intimation I had of the Prussian loan was only a couple of days before the receipt of your first cable when it was stated in one of the New York newspapers that such a loan was being negotiated. I think you will agree that our situation is such in New York that it is unwise for us at the Reserve bank to take the initiative in advising or admonishing bankers as to the conduct of their business in these matters. Few of these loans are handled by the member banks, and it is only by a rather extreme construction of our responsibility to the general public that we can find ground for initiating proposals to the private bankers, and then we seek always to do so upon the theory that we have a general responsibility to the country in monetary matters which justifies us in furnishing them with information and even opinions, if asked, even though we are not willing to go so far as to offer advice.

I was amazed to learn by your cables that no intimation of negotiations had reached you, and further, I am astonished to learn that you had been quoted in Berlin as having assented.

Now, to elaborate my rather brief cable. Immediately upon receipt of your first cable which arrived Wednesday, September 21, I telephoned the contents to Castle in the Department of State, Secretary Kellogg being away. He informed me that Dulles had already called at the Department to discuss the loan, that he had stated to Dulles that the Department would maintain the position which it had

9/24/27.

previously taken as expressed in a former letter regarding the first Prussian Loan, and would not affirmatively object to the placing of the loan, but he did not hesitate to tell Mr. Dulles that they did not like the business. Dulles tells me that it was understood that the Department would address Harris, Forbes and Company in a similar letter to the earlier one.

Your second cable arrived Thursday morning, September 22. This I immediately communicated to Castle by telephone who then informed me that the Department had received some communication from Berlin, presumably our Ambassador, indicating the need of some caution in dealing with the Prussian Loan. I immediately telephoned to Mr. Lloyd Smith of Harris, Forbes & Company, and he and his partner, Bell, together with Mr. Allen Dulles and Mr. Crispell, their counsel, came to my office, and with Mr. Harrison present, I read that portion of your cable as to notifying Harris, Forbes & Company of your intention to publish the letter of September 20, 1926, should any Prussian Loan be offered. They were greatly astonished, and took the position that, relying upon their former discussion and correspondence on this subject and upon Mr. Dulles' opinion following the receipt of Sir William Lees' opinion, they had proposed to issue a prospectus in terms which they felt fully met the objections expressed in your letter to the German Finance Minister, that is, they felt that it disclosed to intending subscribers the secondary character of the security for the loan. They expressed great regret that the first prospectus, due entirely to an error, had included three or four lines to which objection had been made, and which they had really intended to eliminate. The prospectus is not before me, and I am unable to quote from it. They also expressed the view that the publication of the letter of September 20, 1926, would not only affect the issue, but might give rise to such doubts as to all German loans as to close the American market to further German borrowing and possibly have a serious effect upon the whole international position. They felt that the firm of Harris,

Forbes & Company had established a reputation in Germany for responsibility and probity in all of their transactions, and that unless they were prevented by some superior force from carrying out their contract they would be discredited. They did say that there was a force majeure clause in their contract, although the language was not given to me and I have no means of judging whether it could be invoked under the present circumstances.

It was finally decided that they would send you a cable as they have done and I took the liberty of suggesting that it should be as specific as possible in regard to the proposal to publish your letter to the Minister of Finance.

I really feel that they are, to some slight extent, the victims of an unfortunate situation which has arisen, principally due to some misunderstanding between you and they or you and the German Government which you may not find to be excusable but which is really honest on their part, and which they certainly greatly deplore.

In this connection it is important that you should know one thing about our conversations with Harris, Forbes & Company a year ago last March when the proposed Giro Centrale Loan and the proposed first Prussian Loan were being discussed. In your cable dated March 5 you stated:

"A rather good record of reducing obligations has been made but the Beretungs-Stelle still seems not able to resist political pressure. Examples of this are the intermediation of its present attitude towards proposed loan to Prussian State and the approval it recently gave to Giro Centrale loan although the loan was disapproved by Finance Minister and the Reichsbank. The latter loan was quite unnecessary and almost entirely bad and Prussian State loan would seem especially unjustifiable and contrary to interests of general situation."

I distinctly recall either reading this part of the cable or giving a paraphrase of it to Mr. Lloyd Smith when he was in my office discussing these loans, and pointed out to him that irrespective of any legal questions involved, or even irrespective of the goodness of these loans, I thought, as a practical matter, he should take notice of the attitude expressed in your cable as it seemed

to be a definite indication of what position you might be forced to take, even some years later, in case the transfer problem became acute and circumstances required a decision as to whether the execution of the Dawes plan might justify or require imposing some restrictions upon transfers to meet loans which were regarded as objectionable in order that transfers to meet reparation payments might be made. I recall stating that so far as I was aware this was the first time that you had ever expressed yourself as definitely as that, even privately to me. He did seem at that time very much impressed by this suggestion, and after he left the office at our first meeting and I had had an opportunity to refresh my memory by going through the files, I called him on the telephone, asked him if he did recall that conversation, and he admitted that he did, although it had not been given consideration in connection with this negotiation. I imagine that it was forgotten.

When Mr. Bell, accompanied by Mr. Foster Dulles and Mr. Crispell, called again on Friday to discuss the matter further, and I explained the substance of this conversation to them and pointed out that in view of the fact that they were acquainted with the terms of your letter to the Finance Minister, with the opinion of Sir William Lee, with the communication between the Reparation Commission and the trustee of the reparation bond issue of the German State, and in view of the fact that their acquaintance with these communications have led them to secure the opinion of Mr. Dulles which had guided them in their present negotiations, it hardly seems possible that they could claim any lack of knowledge of the position of the Reparation Agent, and, following what Mr. Castle had said, of the position of our Department of State and what I had said in our talks of March 26 of the position, quite unofficial and friendly, of the Federal reserve bank.

Since our talk with Harris, Forbes & Company on Thursday, I had a further talk with Bell, Foster Dulles and Crispell yesterday of about an hour, and reviewed the situation from our standpoint quite fully. I told them that I could not give

9/24/27.

them any opinion or advice or take any position as to the juridical questions involved, that, in fact, we had no responsibility or authority that necessitated our giving them any counsel or advice or information except on the broad ground of our general responsibility in monetary matters, that I felt that no opinion rendered by a lawyer, no matter how familiar with the law and the facts as Foster Dulles undoubtedly was, could be sufficient under existing circumstances to justify a conviction to be conveyed to investors that the interest and principal of these loans could under certain circumstances be legally paid and, that under those circumstances Prussia would practically be able to meet them. That was a question of business judgment. I gave them some little outline as to what the general problem of the exchanges and transfers and all those matters involve, and said that, in point of fact, aside from the legal and practical questions, there seems to be some moral question involved in offering a loan to the public in the position that this one was, when the obligation of the State of Prussia to pay dollars implied the obligation to transfer dollars, and that any statement which was adequate to bring the facts before investors might indeed be effective in making the loan unsalable. I was unable, nor would anyone else be able, to hazard any guess as to what the future had in store for the reparation plan or for decisions on these questions in case the Reparation plan encountered difficulties. It was solely a matter of business judgment but, in view of my own friendship with the firm of Harris, Forbes & Company, I certainly felt justified in giving them the bare facts so far as we knew them so that, in deciding these questions, they could not feel that they had not been informed.

As matters now stand, your long cable quoting your cable to them has just been received. Harrison has telephoned it to the State Department and to the Treasury and will send copies to-day. I personally feel that the cable is admirable in every respect except one, and possibly that might be avoided. You emphasize the objection on the ground of the secondary character of the security. I do not

see how you can advance any other ground without taking the very position which you have scrupulously avoided taking as to the goodness and propriety of these loans. But in emphasizing that point you do cut the ground out from under your feet in case they decide to issue a circular which makes this point absolutely clear to all investors.

I have been trying to consider carefully what the effect would be of the publication of the letter of September 20, 1926. It is difficult to say. The letter is quite long. You could hardly expect it to be published in full and to the extent that it was published it is quite likely that it would appear under heavy head lines with sensational comments which might have a really serious effect upon all German financing. I am in grave doubt of the wisdom of its publication on that account. I feel equally certain that it is unlikely that our Department of State, after the conversations which have already occurred, will take a definite and affirmative position with the bankers. The sudden death of the German Ambassador may add to the difficulty of making representations to the German Government as suggested in your cable, although when I last talked with Secretary Kellogg he said that he intended to take these matters up with the German Ambassador as soon as he arrived in Washington and tell him pretty definitely how he felt about them.

In general, it seems to me that there is not very much that the Federal reserve bank can do without assuming a great deal of responsibility, the warrant for which would be some representations to us by our own Government. In this instance, Mr. Castle asked me specifically to talk with Harris, Forbes & Company as he thought it would be helpful to the position of the Department, and I have certainly done so as fully as I felt justified. Little can be expected through cooperation among American bankers, as there always seem to be some, and always probably will be some, who are willing to handle these loans despite any expressions which our Government or the Federal reserve bank may be willing to make,

unless the position of the State Department is much more definite than has yet seemed to them possible. We must, therefore, conclude that if a suitable control is to be exercised it must be brought about in Germany, and I should think that this would involve a pretty definite stand on your part and pretty definite representations to the German Government by our Government. If you continue to maintain the position that you are not responsible for supervision of German foreign borrowing, and despite that position, you should assume responsibility of publishing correspondence which would, in fact, put you in the position of exercising an influence almost strong enough to be interpreted as a control, I hardly see how you can escape a certain responsibility for serious consequences in case they arise. My apprehension would be not as to the immediate future, but the longer future. If the publication of your letter should result in largely closing our markets to German loans, then, indeed, transfer difficulties may soon arise. If they do, the further impairment of German credit may make all transfers impossible. This would precipitate the tests of the Dawes plan at least a year earlier than seems to be desirable and possibly necessary.

I have had some feeling of uneasiness about the conversations which have already taken place. The Harris, Forbes group includes Brown Brothers, the Equitable Trust Company and, I believe, one or two others. These gentlemen are, of course, meeting and repeating what they have heard from you and what we have told them, and I imagine they will do so with rather grave faces, if I can judge by the reaction to the meetings already held in our office. Word of this sort passes around very quickly. If someone, in a fit of bad temper, should let this leak to the newspapers following the decision by the bankers not to offer the Prussian Loan, and if whatever appeared in the newspapers should include a statement, even though unwarranted, that you and we were responsible for the failure to carry out the contract to place the Prussian loan, I suppose the effect would be just as serious as though the letter to the Finance Minister was published.

I have cautioned them as fully and carefully as I could, but you know how inadequate these cautions are. I do not fear anything of that sort happening, of course, if the loan is issued. It is only in case it is not issued. So Harrison and I are going to send you a cable some time to-day or Sunday and this letter will be mailed either early next week or at the end of the week after the situation has developed further.

September 29, 1927.

The situation has changed so rapidly since dictating the above that I have held my letter for further elaboration. To give you a clear picture I am having a pretty complete set of clippings made which will exhibit the extensive publicity which the disclosure of the discussion has caused.

What seems to have happened in Washington may or may not have been unfortunate. As I understand it, when the newspapers called following the publication of the Journal of Commerce article, they were told that while the Department had not altered its policy and had so informed the bankers who had applied for "clearance," the Department, nevertheless, deplored the making of certain types of loans such as this one and that, of course, gave rise to all the publicity.

Secretary Kellogg has been away, but I am informed that one of the secretaries had a talk with Mr. Kiep, Councillor of the Embassy, who called to inquire about the incident, and he was told in rather vigorous terms that a flood of state and municipal loans in this country would be disturbing and disconcerting, and that some sort of a communication would be or had been sent to the German Government either formally or informally in some fashion. My knowledge of the incident is rather slender, but the conversation took place and I understand was pretty definite.

Since these publications there has been no end of discussion and some little uncertainty if not apprehension among the bankers as to the outlook. The position, as we gather it from those we have talked with, seems to be that while

in the early days they resented the intervention of the Department of State and claimed to be willing and able to exercise their own judgment as to the propriety and goodness of loans to German borrowers, this incident has now rather led them to desire some more specific and definite direction from the Department as a guide to their policy. It constantly recurs in our conversations that they wish to be told what to do and what not to do quite specifically. I have simply told them that we cannot tell them, that I understand you are unwilling or unable to do so, certainly more definitely than you already have, and the attitude of the Department of State has been made perfectly clear to them. I have discussed with two or three of them all of the various difficulties of setting up anything approaching a control, either through the lenders or through the Reparations organization, and inquired why the leading bankers do not meet and form a committee to formulate their views and submit them definitely and specifically in writing to the Department of State, and if they feel that the exercise of control in Germany is not adequate they should say so and ascertain whether our Government will not take steps to secure a more adequate control.

The fact is that this publication has been a bit of a bomb shell to the bankers and they are all of a twitter. On the other hand, up to date it seems to have had no effect upon the American values of German securities which rather surprises us. Harris, Forbes & Company tell us that in preparation for the issue of the new Prussian loan they bought a few bonds of the old issue, which advanced them from about 99 to 99 1/4 or 5/8. They discontinued buying when this publication occurred, and the bonds are still selling at 99 1/4. It is a little too early, however, to judge finally of the market effects.

You will be interested to learn that in my talk yesterday with Ray Morris he stated that when he called he had asked you in general what your attitude was about these state and municipal loans which are now being proposed, and that he had mentioned a Prussian loan as in prospect. He then repeated what he understood to be your position, which was not altogether favorable although disclaiming

responsibility, and immediately after that he attended a meeting of their group and repeated exactly what had been said in the conversation almost verbatim. I called his attention to the fact that his effort to seek from you unofficially or from us what he described as "guidance" without undertaking to impose any responsibility, nevertheless resulted in his quoting these views and opinions to others and that, if any difficulty did develop it was unavoidable that he and the others concerned would at once use these conversations as justification for what had been done, and I thought that his own statement to me would have the inevitable result of making us very cautious indeed as to what we might say and likely have the same effect upon you.

On the whole I cannot but regard the present situation as extremely unsatisfactory. If the impression grows from the present discussion that you and our Government and even the Reserve bank are frowning upon loans of a certain type to Germany it is quite possible that it will have rather far-reaching consequences in the market for German securities. It all points to the need for regularizing the situation. Our position is, as we have reiterated to everybody and as I personally feel, that our responsibility does not extend beyond directly advising our own Government, for whom we are fiscal agents, and endeavoring to conform anything that we say to the bankers to whatever policy our Government indicates to us. This rule, I think you will agree, we have carefully observed.

Morris tells me that when Dulles first called at the Department his discussion was entirely with Mr. Young who has succeeded Mr. Leland Harrison in handling these matters, and that he and Mr. Young had substantially agreed upon the terms of a letter to be written by the Department which, in fact, was drafted while Mr. Dulles was there, but that he now understood that some communication from the American Ambassador in Berlin had held up the signing and delivery of the letter although they had no doubt that the letter, having been promised, would in due course be signed and sent to them. It does seem unfortunate that after this conversation a responsible American banking house should be in the position where they

are unable to carry out a formal written contract. They think this is peculiarly unfortunate when, as I understand, two thirds of the proceeds of the loan are to be devoted exclusively to agricultural development in Prussia and the other one third to harbor works, all of which, they contend, are productive and will, in fact, improve Germany's capacity to pay reparations and your ability to effect transfers. I did point out that this argument might be specious were it found that lending \$30,000,000 to Prussia enabled the Prussian Government to appropriate the equivalent of its budget income to unnecessary and unproductive expenditure such as building opera houses, etc.

In our last conversation with Harris, Forbes & Company and Mr. Ray Morris I stated to them that their obvious effort to substitute the judgment or decision of some other authority for their own judgment or decision as to making loans to Prussia, etc., indicated to my mind that what they desired was to place the responsibility upon someone else rather than assume it themselves, as had formerly been the attitude of the bankers. I have asked them to consider whether (in case they cannot effect such a substitution of judgment) they are interested as bankers in the problem of whether the total borrowings of Germany abroad, some part of which may be for unproductive purposes or have the effect of releasing revenues for expenditure for unproductive purposes, may not, in fact, have the same effect upon German economy that over-issues and debasement of the currency have, and whether, in fact, the situation of a nation which has gone through bankruptcy and made a composition with its creditors is any different from that of an individual who has given a series of notes to his creditors and who thereupon borrows money in large amounts in order to maintain a large and extravagant establishment, motor cars and yacht, and indulge in lavish entertainment, etc. I have also asked them to consider whether there is any fundamental difference between an issue of a mark loan in the United States with the guaranty of Prussia or of the German Government that it will not only pay marks but will transfer marks into dollars to meet the service

of the loan at a fixed rate, and the direct issue of a dollar loan, and that if they rely upon the disclosure in the prospectus as to possible difficulties in the transfer, can they do so effectively to ignorant subscribers without destroying the market for the bonds? Finally, I have asked them to bear in mind always that we simply wish to be of some service, but not to assume any authority, and that naturally, as the Government's fiscal agents, whenever we are asked to do anything in these matters, if we are able to do so without assuming unwarranted responsibilities it is our duty to do so.

At this moment your cable of the 27th has arrived, and as I am uptown Mr. Harrison will communicate with Harris, Forbes & Company and Mr. Leon Fraser and answer as soon as possible.

I am sorry to burden you with such a long letter, but this matter is really reaching a point where it may result in any sort of a development, and I thought you should have a pretty complete record of what has transpired.

October 5, 1927.

With this addition the above narrative seems about complete. Mr. Bell of Harris, Forbes & Company, called to advise us that he was proposing to sail, and Mr. Fraser also had a talk with Mr. Harrison and gave him the substance of what was contained in our last cable regarding his interview with Harris, Forbes & Company.

Since Mr. Bell sailed there have been no particular developments save a good deal of newspaper publicity as to what the German Government proposes to do in the face of your opposition and that of our Government to the issue of the Prussian Loan. I hope it will all work out satisfactorily and will result in an adequate control being exercised in Berlin. That is where it belongs and I can see great difficulty in attempting it by any other method.

Copies of all cables that have passed between us on this subject are enclosed in confirmation.

Sincerely yours,

Hon. S. Parker Gilbert,
Agent General for Reparation Payments,
33 Luisenstrasse,
Berlin, Germany.

BS/RAH

Hotel Brighton,
Atlantic City, N. J.,
March 3, 1928.

CONFIDENTIAL

My dear Gilbert:

Illness has interfered with my writing you as I should otherwise have done some time ago about one or two matters which we discussed in New York during your hasty visit with me. Of course, I must write you in very strict confidence, and am sorry that deferring my trip to Europe has prevented my explaining in person rather than by the clumsy vehicle of a letter.

You recounted to me quite in detail your feelings about the general possibilities of a settlement of the reparation problem and its relation to the debts owing to our Government. I remember very distinctly the position you took, which is absolutely in harmony with the way I feel myself and I need not repeat it here. When Niemeyer was visiting us we had two long talks on this matter. I was careful to explain to him, of course, that I had no authority, very little influence and could only express to him my own views, not having discussed the matter in Washington for a good while. I told him very frankly that it seemed to me to be a great mistake to push for a general financial settlement made concurrently by all debtors and creditors. The opportunity for doing that passed a good while ago, and unless there were a distinct change of public opinion in this country it would do no good to make the attempt and might do much harm. It struck me that experienced people in Europe should be able to appraise Germany's capacity, agree among themselves as to what Germany could pay and what capital adjustment could be effected, etc., when the time came, and then, if they felt justified in approaching our Government subsequent to arriving at their own understanding as to Germany and their own

debts, why, of course, there was no reason why they should not do so. The Balfour note and like expressions seeking to put this country in the position of a harsh creditor and to force upon us the burden of any concession that was made to Germany, had so obviously been mistaken and been handled in such maladroit fashion that a revival of that attempt struck me as foolhardy. Niemeyer seemed much disappointed that I should hold this opinion, and said that it naturally implied that they would have to agree to a great reduction some day in Germany's payments, and reduction of payments among themselves, without any assurance that they could get concessions from the United States; that it was asking them to trust our generosity beyond what human nature could be expected to do. I tried to point out to him as gently as possible that there had been so many charges bandied about in regard to our military, financial and moral responsibility in connection with the war that I felt it was now necessary for them to do exactly that; namely, trust us. If the new administration proved to be willing to reopen the subject and review the debt situation, it might be that something could be done. But that was in the lap of the gods. I told him very frankly that the business of halting the Agent General will prove to be an unprofitable occupation. Your position was such that in the end you would command the confidence of the public, and that your recommendations, which were disinterested, were bound to carry more weight than anything which appeared from more interested sources, that is, from the chancelleries of the various governments, and I hoped that the creditor governments would continue the position of giving you their full support.

At times he displayed some tendency to be critical of the position you had taken as to the reparation lien and transfer priorities

3/3/28.

as indicated in your note to the German Government and the annual report. He thought possibly that was going a bit far in making commitments, etc., but did not give very much emphasis to that point. I may say that Niemeyer displayed a broader point of view and a much more understanding one on this subject than I have ever before heard his express. It is possible that I detected some change in the individual due to the influence of his bank surroundings, as distinguished from the atmosphere of Whitehall. This was the main substance of our talk. I was careful to quote no one.

The other matter that came up disturbed me a bit, and I am wondering if there is anything that I could do or should do in connection with it. He seemed to feel that some friction had arisen between you and Leith Ross. I hope there is nothing in it. Ross is probably the only man in the Treasury who knows anything about these reparation and debt matters now that the old crowd are all out. I have always had a pretty high regard for him, although I have known him much less intimately than either Blackett or Niemeyer. The permanent officials in the British Treasury have always been rather hard-boiled, as you know, but they have had pretty able men there and fellows with whom one can really do business. I am wondering what the trouble is, and whether Norman's and Niemeyer's influence may not be employed. This is going far outside of my own territory, but I thought you should know something of what transpired.

My illness has prevented my seeing Mr. Mellon and almost everyone else in Washington and New York, so I am not very well posted as to matters in which you would be interested. When I return to New York in a couple of weeks I am hoping to have a general survey made of

Hon. S. Parker Gilbert

- 4 -

3/3/28

the market for German securities, and of the atmosphere and of the feeling among the bond houses, for the time is approaching when the question of German loans must be looked squarely in the face. It is rather significant that the Prussian loan is the one selling more below the issue price than any other, as I recall, and most of the good industrial loans are selling above the issue price.

My plans are still indefinite, but I have a hope that it will be possible for me to sail some time in May, and if so, I shall count upon seeing you.

Please write me when you get a chance, but address me at the bank, as I shall not be here very much longer.

With best regards to you, as always,

Sincerely yours,

Hon. S. Parker Gilbert,
Agent General for Reparation Payments,
33 Luisenstrasse,
Berlin, Germany.

Gilbert

Washington, D. C.,
March 27, 1928.

CONFIDENTIAL

Dear Gilbert:

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It was very good of you to write me February 28 on the matter we discussed when you were at New York, and to send me a copy of your memorandum of February 24.

I have just read it through a second time and I can find no flaw in the arguments. In fact, it strikes me as a fine statesmanlike document, and as to the merits of the argument, timely in being expressed before any more of these unfortunate public commitments are made by men holding important office. They are altogether too prone to do that before they are fully acquainted with the facts and possibilities.

What troubles me about a practical conclusion along the line of your memorandum relates to that very human weakness. Search your memory, as I have just now, and you will find that leading statesmen and important men who influence public opinion, as well as the press of all of the large creditor nations of Germany, are committed almost beyond the possibility of change to the idea that any reduction of Germany's reparation payments will be accepted only if corresponding reductions can be made in payments to their creditors, and in this country, we being the largest creditor nation of them all, there is almost an equally definite record of like character that no reduction in the amounts paid under the debt settlement will be tolerated.

Without regard to whether this has been a wise attitude or not, it would appear to me to be asking a great deal more than is ordinarily humanly possible to get the nations of Europe now receiving these reparation payments to agree to any reduction, either in the hope that we will subsequently agree upon a reduction, or that they can justify it before their own people without a reduction by this country.

Practically, from the basis of the views held abroad, it is asking them to trust a good deal to luck or to our generosity in case the proposals of your memorandum involve a material reduction of the amount of the annuity or the termination of

3/27/38.

payments for any appreciable time less than sixty years. You may, however, have reason to believe that they will accept reductions without expecting reductions from us, but that I very much doubt.

Another situation which will complicate matters is the one I think we mentioned about the French settlement. They have the \$400,000,000 commercial debt falling due before long. This Congress will adjourn, most people say, in May or June at the latest and, of course, there will be no opportunity to effect a settlement and have it ratified by Congress even though no change in the present terms were attempted before this Congress adjourns. The next session is the short one, following the November election, commonly known as the lame duck session, where, as you know, nothing is ever done. The new Congress will not assemble, unless called to a special session, until December '29. So it looks as though nothing could be done there much under two years unless some miracle should happen. How, therefore, can anything be attempted along the line of your argument unless it be attempted quite independently of the possibility of any concession from the United States.

Then again, if no general settlement can be effected between now and, say, the winter of 1929-30, will the Dawes plan stand up as long as that, without a large accumulation of marks and the possible consequence of some impairment of German credit abroad which I have always felt would be likely to arise to some degree whenever it is found impossible to effect transfers completely. The one appeal for a settlement by some capital transaction which might induce creditors to attempt it prior to any attempt to readjust the American debt is, of course, the need for using the American investment market for cashing in securities which Germany may issue, such as the railroad and industrial bonds. Another difficulty in the way of any sort of an adjustment without dragging in the subject of our debt is the fact that it will require ratification by all the nations which participate, not only in the Dawes Plan but in the Treaty of Versailles. As one of the participants in the Dawes Plan we would naturally be made

Mr. S. Parker Gilbert

- 3 -

3/27/28.

a party to any such procedure, and how then could we escape, even if we desired to do so, a general debt discussion growing out of a general reparation discussion?

I am just thinking aloud and raising questions which doubtless you have already faced, but which appear to me to be of much consequence to the success of your program.

I have written Jay fully about my plans and he will show you the letter.

My best regards to you, as always,

Sincerely yours,

Mr. S. Parker Gilbert,
33 Luisenstrasse,
Berlin, Germany.

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extra copy

Gilbert

Hotel George V,
Paris, June 27, 1928.

PERSONAL

My dear Gilbert:

Mr. Harrison arrived on schedule, and I have had two very delightful days with him, during which he gave me a report of his trip, including something of what transpired in Berlin. He tells me that you are very short-handed, and I gathered from what he said that there was not much possibility of my seeing you during my stay over here unless I were able to get to Berlin myself. This, I am sorry to say, will not be possible. If, however, you do find it feasible to spend even a short time at Evian, you must know how much I shall enjoy it and profit by it.

With practically all of your organization who are personal friends of mine absent just now, I must concentrate my messages upon Grandma, so please give her my love and tell her that, if she should come to Evian with you, it would cheer me tremendously and nothing would please me more.

Very sincerely yours,

Hon. S. Parker Gilbert,
Agent General for Reparation Payments,
BERLIN.

BS:M

Gilbert

Royal Hotel,
Evian-les-Bains, July 4, 1928.

PERSONAL

Dear Gilbert:

By good fortune, Jay and I had a visit in Paris. It was quite a chance, as he was looking for Harrison and found me. He spoke rather definitely of your intention to stop here some time during this month, so I am enclosing a memorandum making the best guess I can as to visitors, and if you are able to come and wish to, you can understand how delighted I will be to see you. Bring Grandma too if you can.

Of course, it makes no difference if you are here at the same time as some of the others, but if your time is at all flexible, take your pick. Only let me know in advance what accommodations you will wish, so that we can reserve rooms, as the hotel will probably be crowded after July 15th. They have promised to take care of you, however.

In view of some matters happening at home, it may prove to be rather important that we should have a visit, if you can arrange it. I am only sorry not to go to Berlin.

My best as always to you and Grandma.

Sincerely yours,

Hon. S. Parker Gilbert,
33, Luisenstrasse,
BERLIN.

Royal Hotel,
Evian-les-Bains, July 14, 1928.

PERSONAL

My dear Gilbert:

Your two letters of the 10th reached me last night, and I am disappointed at the thought that possibly I may not see you in Paris after all. You see, I must sail on August 1st, because of Phil's marriage in August, so shall arrive in Paris on the 24th and have just a week there. I have to see the Doctor and have some business still to attend to before sailing, and it looks as though it would not be possible for me to get down to Dinard on the way to Cherbourg; and furthermore, I hesitate to intrude upon Mr. Mellon at a time when he is so anxious, as I know, to escape business talks.

If there is any chance at all of your being in Paris between the 24th and the 1st of August, please let me know through Morgan & Company. The reason for my anxiety to have a chat, I am explaining separately.

Very sincerely yours,

Hon. S. Parker Gilbert,
18, Rue de Tilsitt,
PARIS.

Gilbert

Royal Hotel,
Evian-les-Bains, July 14, 1928.

PERSONAL

My dear Gilbert:

Your letter of July 10th was received yesterday after I had practically concluded talks with Dr. Schacht in regard to general questions, which inevitably included reparations. He has just left for Zurich and Berlin and I have had some last words with him this morning.

Nothing that he said to me gave me the impression which you have, as expressed in the second paragraph of your letter, that it might be best to wait for some years to come in the hope that reconsideration will be forced by transfer difficulties or a crisis. It just happened that the subject came up naturally and inevitably in connection with our money situation at home, and I pointed out to Schacht that it was impossible to forecast for what period of time domestic considerations would so affect our policy as to make it difficult for Germany to borrow on reasonable terms. I described our situation, and he agreed with me fully that it had to be dealt with. He then, without suggestion from me, made almost exactly the statement which you have made in your letter, that no general settlement of reparations would be possible without employment of German credit, and that beyond everything German credit should be maintained unimpaired, which meant that a crisis would be fatal to a general settlement.

Most of our discussion was given over to the credit position and its influence upon their situation in Germany, but we did review a great many of the difficulties which were inevitable in such a vast undertaking

as to define reparations and organize a plan for some sort of a general settlement. I did not undertake any discussion of figures at all, nor did he mention any figure. In fact, I deliberately avoided that, on the ground that I knew too little to have any opinion and that it would be misleading to discuss figures at all. I shall not recount all of the points raised in the discussion. You are familiar with them much more than I am, and he seems to feel that his exchanges of views with you are very complete and have been since early in 1927.

At the conclusion of our talks, I told him that I felt competent to advise him on only two points. One was that the development of such a crisis as would result from inability to effect transfers, if it did arise, would prove to be disastrous to everybody, but more disastrous to Germany than to any other nation. He has some doubt as to whether a crisis would result within Germany, but admits that it would gravely impair German credit abroad. The other point was in regard to a figure. He said that you and he were very far apart. He thought the figures you had in mind were impossibly high. I did not comment on that beyond saying that if Germany desired a settlement, which in my opinion would be the only thing to consolidate German prosperity, it would be necessary to make sacrifices to get it. If he earnestly believed that a crisis must be avoided, then some sacrifices would have to be made, and rather than approach the subject in a bargaining mood, it would be wiser for him to be very much more guided by your advice than he would be by the desire to keep the figure down. There were obvious reasons in support of my view,

the principal one being that as matters now stood there was no one capable of taking an effective initiative but you, and it would be most unfortunate if, at the very outset of any effort you undertook, it was found that you and he were in complete disagreement and very far apart, and besides that, I thought the creditor nations generally were much more apt to be influenced by your judgment than they would be by any opinion from the debtor as to Germany's capacity. Of course, there is a lot of bargaining to be done, and I understand all the difficulties, but I think so far as the influence of Schacht goes, it will be greater if he can first get some sort of an agreement with you than it will be under any other circumstances that I can imagine.

Now you realize that this conversation all preceded the receipt of your letter, which gratified me immensely and enabled me to reinforce what I had said more emphatically than I had at first been willing to do.

I find Schacht in a curious state of mind. He is very much disturbed by the evidence, which he thinks is complete, of a change of attitude on the part of one of the principal creditor nations. He feels out of touch and I think is hurt by the attitude recently displayed in that quarter. I cannot possibly attempt to give you in a letter an accurate picture of a state of mind. It would need a long talk. Nor in fact, in that connection, can I give you anything like a guiding opinion as to the situation at home except by discussing it fully.

We must of course consider our domestic situation from the standpoint of a bank of issue, and the facts, broadly stated, appear to be that

our policy of the last four years, up to this January, has been effective in accomplishing the purpose for which it was designed. It has enabled monetary reorganization to be completed in Europe, which otherwise would have been impossible. It was undertaken with the well recognized hazard that we were liable to encounter a big speculation and some expansion of credit. Speculation has not occurred in commodities, but almost wholly in stocks. In twelve months the volume of bank credit increased five billion dollars. Six months ago we faced the new year with practically all the European nations in a strong position in monetary matters, reserves restored, large balances carried in New York and London, and well able to stand the strain of a change of policy in New York. Our course was perfectly obvious. We had to undertake it. The conditions permitted it, and the possibility of damage resulting abroad were at a minimum. In view of this we have had the advances in our bank rates and we now have a really tight money market, with the member banks borrowing over a billion dollars from us and absolutely in our grip. How long this situation will be allowed to continue, I cannot now forecast. It will require much study on the ground, and it depends somewhat upon the facts as to the credit position and somewhat upon an accurate appraisal of the psychology of the country, and of course very largely upon developments in our industry and trade. No one realizes more than I do that the continued maintenance of very high rates in New York may ultimately present a real hazard to Europe and especially to the smooth operation of the Dawes Plan. It may indeed provoke the very crisis which you seek to avoid, and which should be avoided if it does not involve unreasonable sacrifices at home.

7/14/28.

My hope is that by Fall we can intervene in the money market preliminary to rate reductions, but at this distance and with my lack of knowledge of affairs at home, that is merely a guess or a hope.

These are simply the high spots and a text upon which one can hang a long discussion, and it is this matter and the reparation matter generally which led me to feel the urge to have a talk with you. Please arrange it if you can.

You will be seeing Mr. Mellon, and I wish you would give him my warmest regards and explain to him what my plans are.

As to health, when I came over here I had four distinct problems to face. One was my lungs, and Dr. Rist has given me an excellent report as to the conditions there. Another was the after-effects of the shingles, which left a severe neuritis, but that is about cleared up. The third was the terrible shock to my nervous system from the long and very painful illness, and that is better but not right yet, because I am not sleeping as well as I should, although much better than when I left home. The fourth is the general disturbances to the alimentary tract caused by copious doses of morphine. That is not right yet, but I judge from what the doctors tell me and from my own experience in the past that it is a matter of months or a year before such a condition can be gotten completely under control. It has been a discouraging experience and set me back a lot.

I wish very much you would take time, if you can spare it, to leave a letter for me at Morgan & Company in Paris, giving me some idea of the possibilities of our having a little visit.

6.

Hon. S. Parker Gilbert.

7/14/28.

With every good wish and many thanks for your letters,
believe me, as ever

Sincerely yours,

Hon. S. Parker Gilbert,
18, Rue de Tilsitt,
PARIS.

SP:M

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J. GEGOU,

MANAGER

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7972

THE SECRETARY OF THE TREASURY

Attached to
letter 9/8/27

My dear Governor -

The

enclosure I left
in New York. I will
try to remember to give
it to you there on
Wednesday -

S I J

Sept 10 '27

THIRTY THREE LIBERTY STREET
NEW YORK

*Strong
Lickert*

September 8, 1927.

PERSONAL AND CONFIDENTIAL

My dear Governor:

I have now had the opportunity of reading the long letter that you wrote to Pierre Jay under date of July 21, 1927. I understand that Jay has already acknowledged it, and I think it will not be necessary, in view of our talks in New York, for me to attempt anything like a full reply at this time. Besides, all of these problems of debts and reparations and of central banking are so interlocked and so full of complications that it is difficult to get any properly balanced analysis within the limits of one letter.

There are, however, a few special considerations that I should like to underline, and these may be worth putting down on paper:

First, a general word of caution about Schacht. I note what you say in your letter about "the atmosphere" in which we live in Berlin, and the good attitude that Schacht showed during the meetings in New York. I think that on the one hand you may be over-emphasizing the effects of the Berlin atmosphere, and that on the other you may not give sufficient weight to the fact that Schacht is as changeable and moody as can be. He is one thing today and another tomorrow, and it is quite impossible to get a reliable impression of him from a casual meeting once every year or so. I say this without intending in any way to minimize his

really great qualities. The fact remains that he is temperamental, and even mercurial, and one needs to see him in action day after day for months at a time in order to get a fair estimate of him. Besides, you will recognize that when Schacht is in New York with you and Norman and the rest he is on his very best behavior. He is naturally anxious to make a good impression and he is also free of all the local troubles and difficulties that might disturb his equanimity. In Berlin, it is quite a different story. He moves up and down in very short cycles, and frequently it is impossible to keep up with him from one day to another. He has gone through particularly violent changes during the past six or eight months, and for a good part of the time I think he followed a perfectly indefensible central banking policy. This was certainly true in March, April, and May, and at the very same time he was openly and actively working for a breakdown of reparation transfers. He had a change of heart in June and went to the United States in a better frame of mind. His trip to America and his talks with you helped very much to confirm his change of heart, and I think that ever since he has been following a more far-sighted policy.

I can give you a sample of what I have in mind by enclosing a copy of a confidential letter that I sent to Norman on May 29, 1927, on the general subject of Reichsbank policy in relation to reparation transfers. Norman's answer to this was a private and confidential letter to Schacht, which none of us has ever seen and

the contents of which I can only surmise. Schacht was so pleased with this that he immediately announced to the General Council of the Reichsbank, with the foreign members present, that the Governor of the Bank of England had written him a letter indorsing the Reichsbank's policy at every point and approving its refusal to raise its discount rate.

The result of the Reichsbank's policy in the months of March, April, and May was an increase of about 1 milliard of marks in the Reichsbank's portfolio, and at the same time a loss of a full milliard from the Reichsbank's holdings of foreign devisen. This is precisely the reverse of the gold exchange standard, as I understand it. In any event, I do not see how Schacht can defend his actions during this period on any grounds of central banking policy. If any further indictment of his policy were needed, it is easily enough to be found in the fact that after refusing for many months to raise his rate beyond 5 per cent, Schacht then found that the situation had gotten so much out of his control that even a 6 per cent rate was ineffective. A 6 per cent bank rate, if applied in good season, would certainly have given Schacht all the control he needed, but he had delayed so long that he was almost obliged to go to 7 per cent at the end of June. He is still in such a position that it may take a 7 per cent rate to give him any effective control, and it is almost certain that he would have had to go to 7 per cent before this if you had not reduced the New York rate a few weeks ago.

Second. I think it is impossible to put the budget problem and the transfer problem into separate compartments. It is difficult,

as always, to say which is cause and which is effect, but there is no doubt that the two problems are closely interrelated, and that the very great over-expansion of German Government spending is tending to restrict the possibilities of transfer, by over-stimulating internal consumption and encouraging increased imports of commodities for purposes of internal consumption.

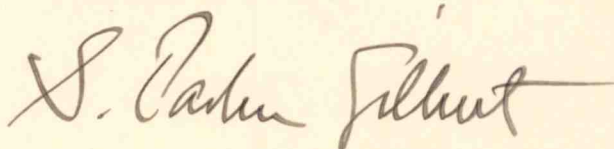
Third. I think there is much the same confusion between cause and effect in the statements so often made about foreign loans. Germany is not borrowing money abroad in order to pay reparations. Foreign capital is coming to Germany because of the great surplus of capital seeking investment, chiefly from America; because, generally speaking, investors have confidence in the capacity and industry of the German people; and because American bankers and others can sell German bonds and make good commissions by doing so. None of these things has much to do with reparations, and personally I believe that Germany would be borrowing more money from the rest of the world, including America, if there were no reparations at all to be paid.

The advantages of foreign loans from the point of view of transfer are also greatly exaggerated. It is true that the loans do provide foreign exchange in the first instance, but the very existence of these foreign balances sets up a great variety of counter-influences which tend to exhaust the exchange and operate against reparation transfers. For the most part, the proceeds of foreign loans to Germany go to finance German imports. For the last six or eight months these

have been running at very nearly 300 million dollars per month, which is almost, if not exactly, as much as the monthly imports into the United States of America. The tendency, in other words, is for the foreign loans to set into motion within Germany forces which run entirely counter to the forces that one would theoretically expect to be set in motion by the internal process of collecting funds for reparations purposes. These internal forces, if allowed to operate, ought to be a powerful help for reparation transfers, but they tend to be neutralized when Germany borrows abroad as recklessly as she has been doing, for unproductive purposes. In addition, the foreign loans involve an annual charge on the exchange for interest and amortization, which in the long run may come into competition with reparation transfers.

This letter is already longer than I had intended, but it may be useful as giving you some of my general reactions. I have set these down very fully and frankly, just as they came to mind, and you will, I know, treat them as strictly confidential.

Faithfully yours,

A handwritten signature in cursive script, reading "S. Parker Gilbert". The signature is written in dark ink and is positioned below the typed name.

Benjamin Strong, Esq.,
Governor, The Federal Reserve Bank of New York,
33 Liberty Street,
New York, N. Y.

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The German Government is releasing for publication in the newspapers of Sunday morning, November 6, 1927, the memorandum of October 20, 1927, from the Agent General for Reparation Payments, together with the German Government's reply of November 5, 1927. *[not here]*

Both the Agent General's memorandum and the German reply will undoubtedly be covered by your regular news reports from Berlin.

The full text of the Agent General's memorandum is, however, circulated herewith for your convenient reference, on the understanding that it is governed by the same release date and will not be used before the Sunday morning newspapers of November 6, 1927.

BROOKLYN

THE AGENT GENERAL FOR REPARATION PAYMENTS.

BERLIN, October 20, 1927.

MEMORANDUM FOR THE GERMAN GOVERNMENT.

I am presenting this memorandum for the purpose of calling attention to the dangers involved in the present economic situation, in the hope that by doing so fully and frankly at this time I may render some service to the German Government and to the German economy, as well as to the international situation generally.

I approach the problem from the standpoint adopted by the Experts' Plan, and reiterated in the conclusion to my last Report, "that what is in the interest of the German economy is also in the interest of the execution of the Plan."

In considering the interests of the German economy, I should assume that the general aim of Germany, as of other modern industrial states, would be the continuous development of industry and commerce, both domestic and foreign, with a view to the gradual improvement of the standard of living of her people. For this the most favorable conditions internally would seem to be the constant cheapening of production, accompanied by such increase of wages as cheapened production will permit and as will neither increase prices nor the cost of living. Stable

prices particularly favor stable trade. But the development of industry and commerce also requires a steady supply of new capital, based on savings at home or borrowings abroad; and under prevailing conditions in Germany there is need not only for the creation of new capital, but also for the rebuilding of the old liquid capital destroyed by the war and lost by inflation. In Germany, therefore, there is a special need and a special incentive for saving, and for careful spending as well. Under these conditions, sound and well-ordered public finance, which underlies the whole economic life, is of the utmost importance.

From the standpoint of the execution of the Experts' Plan, I accept at full value the often-repeated assurances of the German Government that its settled policy is to do everything within its power to fulfil the obligations it has undertaken. The aim of the Plan was to put the problem of reparation to the test of practical experience, under a programme which, as the Experts said, "adjusts itself to realities." It is fundamental to this conception that the German Government should permit the Plan to have a fair test, and, while the test is in progress, that the German Government itself should exercise prudence in the management of its affairs.

Recent developments in public finance do not appear to be in the interests either of German economic life or of the execution of the Experts' Plan. The evidences, in fact, are accumulating on every side, and more rapidly within recent months, that the German public authorities are developing and executing constantly enlarging programmes of expenditure

and of borrowing, with but little regard to the financial consequences of their actions. The rising level of public expenditure is already giving an artificial stimulus to economic life, and it threatens to undermine the essential stability of the public finances. If present tendencies are allowed to continue unchecked, the consequence is almost certain to be serious economic reaction and depression, and a severe shock to German credit, at home and abroad.

The remedies consist primarily in reversing the present tendencies toward over-spending and over-borrowing, and applying instead a regime of strict economy and of ordered public finance. These are remedies which lie largely in the hands of the German Government, and, if they will act promptly and effectively, the Reich and the other public authorities still have it in their power to prevent a crisis. The economic situation, though it is already showing signs of tension, does not seem as yet to have developed points of immediate danger. Moreover, some of the new expenditures that threaten the most far-reaching consequences are still only in the stage of discussion, and have not yet been authorized by law.

In presenting this memorandum, it is unnecessary to go much into detail. Each of my public Reports as Agent General for Reparation Payments has pointed to various sources of danger that seemed to me to have appeared from time to time; and my last Report, dated June 10, 1927, warned particularly against the tendencies of budgetary and credit policy. I have also had numerous conversations on these subjects with the Minister of Finance, the President of the Reichsbank, and, less frequently, with the

Chancellor of the Reich. In the following pages, I shall endeavour to bring matters up-to-date, with a review of recent events in public finance and credit policy, and to indicate the relation of these events to the economic situation in Germany, as well as to the execution of the Experts' Plan.

I. The Financial Policy of the Reich.

In my Report of June 10, 1927, I made the following general observations on the German budget:

"The point that stands out most clearly in the budgets of the Reich is the constantly mounting level of expenditure. The problem of checking the rising tide of Government expenditures has, in fact, become acute, and it requires the closest attention, not merely from the standpoint of the Experts' Plan but in the interests of the German economy as a whole. At the same time, it is clear that the essential stability of the German budget remains unimpaired, and that the problems presented by the budget should yield readily enough to a steady application of sound principles of budget-making."

The upward tendency of the expenditures and commitments of the Reich clearly appears from the following summary of recent events.

On December 17, 1926, the Reichstag voted a supplementary budget for the financial year 1926-27. This added about 1,000 million reichsmarks to the expenditures originally authorized for that year, bringing them up to a total of 8,534 millions.

On January 5, 1927, the draft budget for 1927-28 was submitted to the Reichstag, carrying estimated expenditures of about 8,525 million reichsmarks.

On February 16, 1927, the Finance Minister made his budget speech in the Reichstag, outlining the financial position of the Government. With regard to budget policy, the Minister said:

"We must arrange to get along with what we have even if we have to postpone and reduce expenditures for things which are desirable and useful ***** Our burdens are so great that we must take advantage of every opportunity to save ***** Our tasks during the next few years will be very difficult and bitter*** Years of restriction and struggle are facing us."

With regard to administrative reforms he said:

"A definitive financial settlement (between the Reich and the States and communes) pre-supposes not only a rationalized State administrative system, but also a private economic system which is not shaken by crises."

With regard to reparation payments, he referred first to the agreement made last year for the settlement of the supplementary budget contributions, and then said:

"I look into the future with grave anxiety. Under the Dawes agreement our payments out of the budget and for the service of Railway bonds and for the service of Industrial Debentures will increase next year a further 432 million marks, and in 1929 and onwards by a still further 290 million marks. At the present moment, in spite of the best will, I see no possibility of providing these sums, to which there will be added, beginning in 1929, supplemental payments on the basis of the index of prosperity ***** Germany will continue to do everything in her power in order loyally to fulfil the obligations she has assumed, but to this end she must be furnished with the necessary pre-requisites ***** For us the pre-requisite for the execution of the Dawes agreement is the strengthening of our economic life."

In the same speech, the Minister went on to propose that during the financial year 1927-28 further expenditures should be incurred by raising official salaries "to the extent of what is financially possible;" and he referred also to the importance of indemnifying those who had lost their

private property abroad in the war.

Following the Finance Minister's budget speech, the tendency of the Government's policy seems to have been in the direction of increased expenditure and enlarged commitments.

In spite of the necessity for economy urged by the Minister, the authorizations of expenditures carried in the 1927-28 budget were increased by 600 million reichsmarks before its final enactment on April 14, 1927. The only important reduction was one of about 45 millions in the appropriation for canal and other new constructions. Taking the so-called ordinary and extraordinary budgets together, the total expenditures authorized amounted to 9,130 million reichsmarks, as compared with estimated expenditures of 8,543 millions in 1926-27 and actual expenditures of 7,444 millions in 1925-26, - an increase of nearly 1,700 million reichsmarks in the two years. Of this increase, about 540 million reichsmarks were for reparation payments under the Experts' Plan, with 67 millions additional as a reserve fund for the controlled revenues. Both the 1926-27 and 1927-28 budgets showed an excess of current expenditures over current revenues, amounting to over 850 million reichsmarks in each year. To cover the 1927-28 deficit, the budget authorized loans of 466 millions and appropriated 390 millions from surplus and reserve funds. It also left undisturbed outstanding authorizations to borrow to the amount of 571 million reichsmarks, to cover outstanding extraordinary expenditures for 1926-27.

In the midst of the budget discussions, on March 14, 1927, the Finance Minister of the Reich appeared before the Taxation Committee of the Reichstag to urge the passage of a draft law postponing for a further two

years the definitive settlement of the financial relations between the Reich and the States and communes, and providing in the meantime for increased guaranties by the Reich to the States and communes. On March 17, 1927, I addressed a letter to the Finance Minister of the Reich, pointing out a number of considerations suggested by the Government's proposals and emphasizing their importance in connection with the fulfilment of the international obligations of Germany under the Experts' Plan, not merely as regards the immediate present but more especially as regards the future. On April 9, 1927, the law was passed, substantially in accordance with the Finance Minister's recommendations, with results for the public finances that I have already summarized in my Report of June 10, 1927. The Government of the Reich in the meantime had made another important concession to the States and communes, by agreeing to assume, as from April 1, 1927, practically the entire responsibility for advancing, when necessary, the supplementary funds required for purposes of unemployment relief beyond those furnished by employers and employees, though up to that time the States and communes had been obliged to furnish five-ninths of these supplements.

The present financial settlement between the Reich and the States and communes cannot be considered a provident arrangement for the Reich; and it is open, as pointed out in my last Report, to fundamental objections of principle. These criticisms are fully confirmed by recent events. The States and communes are now drawing larger payments from the Reich than ever before, and will get the principal benefits from any increased revenues that the Reich may collect from the income, corporation and turnover taxes in excess of the amount required to fulfil the guaranty already given. At

the same time, the responsibility for taxation and public expenditure seems to become more and more confused. Notwithstanding their increased transfers from the Reich, the States and communes are pressing new demands for still larger payments to meet their constantly increasing expenditures, and the Reich itself has added to the confusion by bringing forward new proposals for expenditure which still further burden the budgets of the States and communes.

After the adoption of the 1927-28 budget, the question of increasing the salaries of officials became active, and when the Reichstag adjourned in July it was understood that increases of about 10 per cent were under consideration. But, on September 11, 1927, before a meeting of Government officials at Magdeburg, the Minister of Finance announced that he had suggested and the Cabinet had approved "a considerable increase in the rate at first contemplated." The rates of increase, he said, would vary from 18 to 25 per cent, and the total cost to the Reich would be 325 millions annually, of which 155 millions would be for salaries and 170 millions for pensions and similar allowances. It is generally assumed that the States and communes, the Postal Service and the Railway will all make much the same increases. The total cost is variously estimated at from 1,200 to 1,500 million reichsmarks annually. To provide for the additional expenses which the action of the Reich throws upon them, the States are already insisting that increased transfers of revenue from the Reich will be necessary. As for the Reich itself, it appears from the discussion before the Reichsrat on October 13, 1927, that in the opinion of the Finance Ministry the Reich will be able to meet the costs of the salary increases in its own services during the coming year only if its hopes for an increase in tax receipts are realized.

The salary proposals of the Government are noteworthy, not merely because of the large expense which they entail, but even more because they have been made on the most sweeping basis, and in the way most likely to bring serious consequences for the general economy of the country. They are apparently intended to apply quite as much to pensioners and retired officials as to officials on the active list, while even for the active officials they appear to contemplate a general increase in salaries, without any effective attempt at administrative reform.

It is not for me to express an opinion on the merits of the salary proposals, but it would seem as if the German Government could have served its own interests better by using such substantial increases as an instrument for securing the reform in administration of which so many announcements have been made in the past two or three years. It may not even now be too late to make the salary increases serve this purpose. But as matters stand at present, they seem likely to hinder rather than to help the cause of administrative reform, and to saddle new and lasting burdens on the already heavily-burdened budgets of the Reich and the other public authorities.

In addition to these general increases in pensions and in the salaries of officials, the Government of the Reich is advancing two other measures which seem likely to involve large new expenditures, one, the proposal to compensate German nationals for loss or damage to private property during the war, and the other, a general school law for the Reich. Neither of these measures has as yet been enacted into law. The first of them, the draft law for indemnifying German nationals for property lost abroad, apparently contemplates expenditures of about 1,000 million

reichsmarks; but the draft law has not yet been presented to the Reichstag and it is not clear what means of financing are to be adopted or how far the budget is to be burdened with the proposed payments. In this connection, I have already suggested in my letter of August 29, 1927, to the Finance Minister of the Reich, some of the considerations that would be raised from the standpoint of the Experts' Plan by an external offering of preference shares of the German Railway Company; the same considerations, of course, would apply a fortiori to any external loan of the Reich that might be proposed for this purpose.

As for the new school law, no information is available regarding the probable costs, and apparently little consideration has been given as yet to its financial consequences. But it is noteworthy that serious misgivings are being expressed in many quarters in Germany as to the cost of the new law, and that the States and communes have already given warnings that they will not be able to meet the added expense from their own resources and will want more money for the purpose from the Reich. On October 14, 1927, the Reichsrat rejected the draft law for a variety of reasons, after first approving an amendment that would require the Reich to bear all the cost. Since then, the Government has submitted the draft law to the Reichstag, in its original form, with a statement from the Minister of the Interior to the effect that it is immaterial whether the Reich or the States have to bear the cost, because in any event the burden will fall on the German economy. The Government appears to have refrained, however, from making any estimate of the cost of the new law, on the ground that this cannot be done until its provisions are finally determined and the distribution of the cost becomes somewhat clearer.

I do not mention this series of new expenditures and commitments for the purpose of passing judgment on any of them individually. That, indeed, does not fall within the functions of the Agent General for Reparation Payments. The German Government, under the terms of the Plan, is left free to prepare and administer its own budget, and it acts throughout on its own responsibility. This very freedom, however, implies a corresponding responsibility for the natural and probable consequences of its own actions. These, it seems to me, can be summarized briefly, as follows:

1. The Reich, by failing to exercise proper restraint in its expenditures, is endangering the stability of its budget, the establishment and maintenance of which was the cornerstone of the Experts' Plan for the reconstruction of Germany. The situation at the moment is somewhat relieved by increasing revenues and declining unemployment. But any reaction in business would be likely to reduce the revenues of the Reich and increase its liabilities for unemployment relief. In these circumstances, and with increasing reparation payments to face, this does not seem to be the time to burden the budget with new permanent expenditures.

2. With its own expenditures constantly rising, the Reich naturally finds it difficult to induce the States and communes to bring their budgets into proper order, particularly at a time when the measures which the Reich itself

has initiated may add very greatly to their expenditures and throw many of their budgets still further out of balance. The States are already demanding the reopening of the financial settlement for the purpose of securing still larger transfers of revenue from the Reich. And the expected reduction of State and communal real estate taxes which it was announced in April would be one of the conditions of the financial settlement, now appears more and more unlikely of realization, while in some cases, at least, increased local taxation may be necessary.

3. The result is a general lack of effective control over public spending and public borrowing. In consequence, unsound public finance is increasingly prevalent in Germany; and the money which is so badly needed for the development of German agriculture and industry is being absorbed, through taxes and public loans, in a scale of public expenditure which seems to be incurred without regard for the loss of liquid capital which Germany has suffered and the urgent need of recreating this capital through economy and careful spending.

4. Still more broadly, in their effects on economic life, the measures taken by the Reich and other public authorities are tending strongly toward increased costs of production, increased prices and increased cost of living. The result is to negative, in large measure, the

benefits that might be expected to accrue from the process of rationalization which German business and industry have succeeded in carrying out since the stabilization of the currency. The tendency toward higher prices already exists, partly as a result of the high customs duties on imports of many staple products; and it would be greatly stimulated if, as now seems probable, the Government's salary proposals should lead, on the one hand, to demands for similar increases in general business and industry, and, on the other, to increased railroad tariffs, and the like. Manifestly, all these developments tend to raise the costs of production and thus to diminish the capacity of the German economy to compete for export. As the experience of recent months has abundantly shown, they operate also on the other side of the German balance of payments, by greatly stimulating German imports from other countries. Rising internal prices almost always have this effect, and under present conditions the tendency is enhanced by the additional purchasing power which is being placed in the hands of the public by the increasing expenditures of the Reich and the States and communes.

The consequences of Reich financial policy, which have been summarized above, must be considered also in connection with the financial policies of the States and communes, and with the currency and credit policy of the Reichsbank. There is naturally a close relationship between them, and an intimate connection between the results attributable to them.

II. Finances of the States and Communes.

There is little or no current information as to the financial condition of the States and communes, but their demands for additional grants from the Reich and their frequent borrowings at home and abroad indicate that as a whole they are living beyond their means.

The domestic long-term loans of the States, provinces and communes, and of the various public undertakings in which they are interested, have amounted to about 1,000 million reichsmarks since the beginning of 1926, when the domestic market first became available for long-term borrowing. This sum is more than twice the amount of long-term domestic loans placed in the same period by German industry and trade. These various public loans, taken together with the Reich internal loan of 1927, were mainly responsible for overloading the domestic market and bringing about the state of exhaustion which still obtains.

Foreign issues of the States and communes, and their associated public undertakings, have amounted since the beginning of 1925 to the equivalent of about 1,600 million reichsmarks, approximately the same as the foreign loans of German business and industry. Until recently, at least, additional loans appear to have been under negotiation between the States and communes and foreign bankers, up to a total of perhaps a further 1,000 millions. These foreign borrowings have made heavy drafts on the foreign credit of Germany, and those of the States particularly have tended to raise difficult questions under the Treaty of Versailles and the related provisions of the Experts' Plan, as I have already pointed out in my letter of

September 20, 1926, to the Finance Minister of the Reich, with respect to the Prussian external loan of 1926, and my further letter of November 12, 1926, as Chairman of the Trustees of the German External Loan, with respect to both the Prussian and the Hamburg loans.

The foregoing figures for the domestic and foreign loans of the States and communes, amounting altogether to about 2,600 millions, leave out of account entirely their short-term or floating debt. It is impossible from the available figures to make a close estimate of the volume of this debt, but from such casual evidence as has developed it seems already to be very large. In part it represents loans directly obtained from foreign bankers, in part loans obtained from German bankers but from foreign funds borrowed by them, and in part ordinary domestic banking transactions.

The question underlying State and communal borrowing is not whether individual loans should be placed in the domestic market or in the foreign market, or at short or long term, but whether they should be placed at all. To divert the borrowing of the States and communes from one market to the other, or to refuse it in one form and permit it in another, does not go to the root of the difficulty. Over-borrowing at home or abroad proceeds from the same source, namely rising public expenditures, and it is by reducing expenditures to the minimum that relief is to be found. On the other hand, balanced budgets and economical administration will give the best assurance that when credit is needed for essential public purposes it will be forthcoming.

It is recognized, of course, that the Reich does not control the States and communes in these matters. But, when the States and communes

go into foreign markets to finance their budgetary expenditures and internal improvements, they raise fundamental questions of foreign policy which have the most direct interest for the Reich. And under the Constitution itself the Reich has a unique opportunity and even responsibility for leadership, not merely because of its large transfers of revenue to the States and communes but also because of its power to prescribe the fundamental principles and main outlines of their laws in many matters of taxation and public finance. The force of these considerations has been recognized to some extent in the efforts that have been made for the past two years and more to supervise the foreign borrowings of the States and communes through an advisory organization established for this special purpose. These efforts, for whatever reason, have not been successful, and the results appear in the swollen figures for State and communal borrowings that have already been given. A new and truly effective supervision, based primarily on the principle of controlling public expenditures, is urgently needed at this time, both in the interests of German credit and to safeguard Germany's economic recovery against the dangers of over-stimulation and subsequent reaction as a result of over-spending and over-borrowing by the public authorities.

The German Government's announcement of October 7, 1927, is greatly to be welcomed, not only because it indicates that a revised procedure for supervising the foreign borrowings of the States and communes is under consideration, but also because it points out the sound basis for financial reform by stating that "in view of the entire present situation in Germany any expenditure that is not urgent or economic, whether made

out of foreign loans or from other sources, must be avoided." It is still not clear what practical measures will be taken to apply this fundamental test to the spending policies of the public authorities, but it is of the utmost importance that the Reich should exert a firm leadership in this direction and that its leadership should have the sincere and comprehending support of the States.

III. Credit and Currency Policy.

The present calendar year has also been one of expansion in the circulation of the currency and in the use of short-term credit, particularly that of the Reichbank. Any discussion of credit and currency must necessarily center upon the policy of the Reichsbank, which is charged under the Bank Law with the duty of regulating the circulation of money and with providing for the utilization of available capital. But however explicit the law may be, the financial operations of the Reich, the States and the communes have themselves assumed the proportions of a separate credit policy, frequently exercised in opposition to the credit policy of the Reichsbank. In effect, there have been two credit policies, both operating at the same time and one often neutralizing the other. The net result of these different policies, though opposed to each other in origin and purpose, has been in the direction of expansion, as is likely to be the case when the public authorities are on the side of expansion and spending.

The Reichsbank, for its part, reduced its discount rate on January 11, 1927, from 6 to 5 per cent, shortly before the offering of the 5 per cent internal loan of the Reich. The purpose, it was stated at the time,

was to recognize the easier money conditions then prevailing in the German market, and at the same time to diminish the inflow of foreign funds. The results of this policy were discussed at length in my Report of June 10, 1927. For a short period, it will be recalled, the policy achieved its purpose. But by the middle of March foreign funds began again to flow into Germany in large volume, not as long-term loans but in the form of short-term credits, frequently for purely speculative purposes and liable to be withdrawn on short notice. These funds, in turn, provided an additional basis for expansion, and a source of danger for the future. At the same time, the Reichsbank's discount rate became the lowest representative money rate in Germany, and in the first five months of the year, that is to say, up to May 31, 1927, its gold and devisen declined by about 1,000 million reichsmarks, and its holdings of domestic bills rose by about the same amount. In their broader consequences, the forces of expansion thus released gave a further impetus to an already highly speculative stock market, and a further stimulation to an already rising activity of business and a rapidly expanding volume of imports.

During this period, certain measures were attempted, notably in the direction of reducing the volume of stock market credit, but the Reichsbank left its discount rate at 5 per cent until June 10, 1927. It then raised its rate to 6 per cent, but by this time it had lost control of the market and the increase soon proved to be insufficient. The new rate brought no reduction in the volume of Reichsbank credit, and succeeded only during a short period at mid-summer in retarding its month-to-month increase. The expansion which reasserted itself in September brought the

volume of Reichsbank credit and the total German circulation to the highest points since stabilization. The 7 per cent rate fixed on October 4, 1927, recognized this situation and was itself the consequence of events which dated back to the spring.

The financial authorities of the Reich, the States and the communes, by working at cross purposes with the Reichsbank, have made the whole situation more difficult to manage and have contributed to the expansion. The part played by rising budgetary expenditures and borrowings by public authorities, involving heavy drafts on credit both foreign and domestic, has already been discussed. The Reich internal loan of last February, furthermore, was of peculiar importance, not only because it put an end for the time being to the domestic market for new issues, but also because its terms and market price furnished an additional obstacle to a timely revision of the Reichsbank's discount rate. The various steps which have been taken to manage the loan in the market since its issue have been expensive and on the whole ineffective. Another disturbing influence which must be mentioned is the management of the public funds and the public banks, which has been discussed at length in each one of my published Reports. It is unnecessary now to go into detail, but it is clear enough on the facts that the administration of the public funds and the public banks has tended very strongly to diminish the authority of the Reichsbank, and to deprive it of resources which it needed in the general interest of the stability of the German currency and exchange. It has tended, no less directly, to deprive the regular German banking system of its normal resources and to divert great quantities of liquid funds into channels which ran counter to sound credit policy.

The credit policy of the bank of issue and the public finances cannot for long be operated successfully on divergent lines; and there would seem to be every reason, in the general interest, for formulating and putting into effect a definite and comprehensive plan that will assure a properly coordinated policy. The need for the adoption of such a policy, based upon principles of ordered economic growth, and avoiding undue use of credit, is particularly clear under present conditions, in order that the prevailing expansion may not be carried to the point of danger.

IV. Conclusion.

I have attempted to bring together in the foregoing pages the accumulating evidences of over-spending and over-borrowing on the part of the German public authorities, and some of the indications of artificial stimulation and over-expansion that are already manifesting themselves. These tendencies, if allowed to continue unchecked, are almost certain, on the one hand, to lead to severe economic reaction and depression, and are likely, on the other, to encourage the impression that Germany is not acting with due regard to her reparation obligations.

Internally, it is evident that an economic crisis would have the most discouraging consequences for the German people, and that it would mean a serious set-back to the reconstruction of German economic life. It is now nearly four years since the first stabilization of the currency, and over three years since the adoption of the Experts' Plan. During this period Germany has made remarkable progress. She has re-established her

credit at home and abroad, her industries have been reorganized and her productive capacity largely restored, her supplies of raw materials and to some extent her working capital have been replenished, and the general standard of living has greatly improved. This has been achieved primarily through the industry and energy of the German people, but the people of other countries have also co-operated by making their savings available in liberal measure for the rebuilding of the German economy. It would be deplorable if what has been accomplished should now be imperilled by shortsighted and unsound internal policies.

From the standpoint of the Experts' Plan, it is only natural, as I have said, for the creditors of Germany to feel that reasonable prudence in the management of the public finances is a necessary element of goodwill; and it would not be surprising if outside observers should draw the conclusion that the financial policies followed in the past year have not been in the interest of Germany's reparation obligations under the Plan. The payment of the stipulated annuities to the Agent General for Reparation Payments at the Reichsbank constitutes, it is true, "the definitive act of the German Government in meeting its financial obligations under the Plan;" and the payment of these sums is amply secured by the assigned revenues and other specific securities. But the responsibilities of the German Government do not end with the internal payments. The Experts' Plan, though it put the transfer of reparation payments in the hands of the Transfer Committee, recognized clearly that the problem of transfer would depend in large measure upon conditions outside the control of the Committee. It placed a very definite responsibility upon the German Government by providing that "The German Government and the Bank shall undertake to facilitate in every

reasonable way within their power the work of the Committee in making transfers of funds including such steps as will aid in the control of foreign exchange." The Experts also emphasized in the strongest possible language the dependence of the stability of the German exchange upon Germany's balance of payments, and, in the long run, upon the course of German imports and exports. To the extent that German exports are hindered by obstacles interposed from without, other countries must bear the responsibility; but upon the German Government itself must rest the responsibility for actions of its own which tend artificially, by overstimulating imports and hindering exports, to restrict the possibilities of transfer.

All these considerations I am endeavoring to point out in good season, in the hope that their importance will commend them to the attention of the German Government, and that in the interest of the German economy itself, as well as of the discharge of Germany's international obligations, the German Government will take prompt and effective measures to meet the situation. Fortunately, as stated at the outset, the situation has not yet become critical, and the German Government still has it within its power, if it will act in time, to check the dangers which now threaten, and to bring the German economy back again to a sound condition.

(signed) S. PARKER GILBERT

Agent General for Reparation Payments.

THE AGENT GENERAL
FOR REPARATION PAYMENTS

BERLIN
33 LUISENSTRASSE
TELEPHONE: NORDEN 11900-11910
TELEGRAMS: AGENTREP. BERLIN

5 *Tell*
L'AGENT GÉNÉRAL
DES PAIEMENTS DE RÉPARATIONS

PARIS
18 RUE DE TILSITT
TÉLÉPHONE: WAGRAM 2122-2123
TÉLÉGRAMMES: REPAGENT. PARIS

BERLIN, November 14, 1927.

PERSONAL AND CONFIDENTIAL.

My dear Governor:

I should appreciate it very much if you could send me a wire as soon as you decide definitely about your proposed trip to Algeciras. I am still undecided about my own Christmas plans, and under present conditions I am rather doubtful as to whether it will be possible for me to leave Berlin for a long enough time to make the trip to America. The question whether you are going to be in Europe or America will be an important factor in the final decision, and I should be much more likely to make a short trip home if I found that you were going to be there.

I should plan to sail, if at all, on the Leviathan on the 15th of December, and to return to Europe by the Aquitania sailing on the 6th of January.

With best regards, I am,

Faithfully yours,

A. Parker Gilbert

Benjamin Strong, Esq.,
Governor, The Federal Reserve Bank,
33 Liberty Street,
New York, N. Y.

Gilbert

THE AGENT GENERAL FOR REPARATION PAYMENTS

BERLIN, July 10, 1928.

PERSONAL AND CONFIDENTIAL.

My dear Governor:

I received your letter of July 4, 1928, and thank you for sending me the enclosed schedule of your probable engagements at Evian.

I have been uncertain about my own plans until I heard from Mr. Mellon, but I can now tell pretty definitely about the prospects for the next three or four weeks. I do not see any chance of coming to Evian, and I am afraid that we will have to count on meeting somewhere else, perhaps in Paris.

I am leaving Berlin on the 15th of July for Paris, and I have three meetings there on the 17th, 18th and 19th, successively. The meeting on the 18th is a meeting of the Reparation Commission, and it will involve, among other things, a long discussion on the finances of the German Railway Company. While in Paris I hope to have the opportunity for good talks at the Bank of France and also at the Finance Ministry and the Foreign Office, and I shall probably remain until the end of the week for that purpose. After that, I shall probably join Mr. Mellon for a week or two on the seashore. He sails, as you probably know, on the 11th of July, and he is planning to stay only a relatively short time on this side. I hope, therefore, to join him at the end of next week, though it is just possible that I may have to come back to

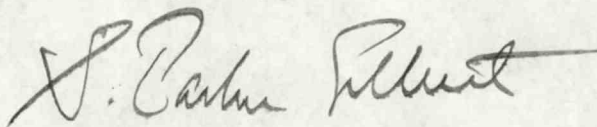
Berlin for a week or so in order to deal further with the Railway situation.

I notice from your letter that your calendar at Evian does not go beyond Monday, the 23rd of July, though I had thought that you were planning to stay fairly quietly there until around the first of August. I have forgotten the exact date of your return sailing, but I suppose that you will almost certainly pass through Paris on the way to the boat and that this may bring you to Paris some time between the 1st and the 15th of August. Perhaps this would give us the best chance of a good talk together before you sail. I cannot tell at the moment the exact dates when I might be passing through Paris before or after seeing Mellon but I shall almost certainly be there sometime between the 1st and the 15th and we can compare notes in the meantime with a view to settling on a definite date.

I hope that you are getting a good rest. This, after all, is the most important thing, and from this standpoint I think it may be better in the long run that you should not have to add me to your long list of prospective visitors. Incidentally, I have seen two of your list today, and both of them seem to be definitely bound for Evian. Dewey has been spending a couple of days with us and leaves tonight for London and then Evian. Schacht, I understand, is leaving by air tomorrow morning and will be with you the first thing Thursday morning.

Grandma joins me in best regards as always, and we shall both be looking forward to seeing you before long in Paris.

Sincerely yours,



Benjamin Strong, Esq.,
c/o Hotel Royal,
Evian-les-Bains, France

From American Papers
12

THE AGENT GENERAL FOR REPARATION PAYMENTS

BERLIN, July 10, 1928.

PERSONAL AND CONFIDENTIAL.

My dear Governor:

I do not know whether Schacht is likely to talk to you about reparations, but I think the problem is very much on his mind these days and it is almost certain to come up in the course of your conversations.

[Schacht is inclined very much to oscillate from one side to the other on the question of the reparation settlement, and just now I think he is going through a period of feeling that the best policy for Germany will be to wait for some years to come, in the hope that reconsideration will be forced by transfer difficulties or even by a crisis in reparation transfers or otherwise. He might perhaps admit one qualification on this general view, and favour an early settlement by mutual agreement if it could be made on terms that he would regard as sufficiently favourable to Germany. His ideas on this point, however, seem to me pretty far removed from realities, for he is apparently thinking in terms of something between 10 and 20 milliards, capital value.]

I do not need, after our conversations in Paris, to give you any long exposition of my own views, but in general I feel very strongly that the fundamental thing from every standpoint is that there should be a final settlement of the reparation problem. This is the main issue, and by comparison with it all the other questions, including that of amount, are relatively unimportant. [In the nature of things, the question of final settlement has the most importance for Germany, and I think that

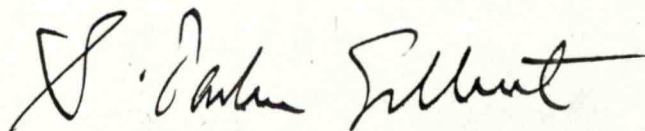
Germany must be prepared to pay, and to pay high, for the sake of getting a settlement. I think it is clear also that in order to get a settlement Germany must depend largely on the use of her credit. It is vitally important, therefore, to keep Germany's credit at the highest possible level and to deal with the whole situation while her credit is unimpaired. This, to my mind, shows the great dangers involved in the policy of waiting for transfer difficulties or a transfer breakdown, since then Germany's credit would tend to disappear and the essential material for a settlement would be lacking. In such circumstances, moreover, there would be the gravest danger of a new reparation deadlock, since the people on the Allied side who could not refuse, and might even welcome, a constructive settlement in the present atmosphere, would probably ask for a further period of trial, or perhaps begin speaking in terms of German bad faith, in case there should be a threatened breakdown or any real crisis. Germany, moreover, would suffer most from any new deadlock, and her credit would be terribly difficult to restore again after having already been twice destroyed during the past fifteen years, first by the war, and then by the inflation.

I think that Schacht is likely to be less farsighted in these matters than one might suppose and that he might even do great harm by ranging himself on the side of those who prefer to follow a passive policy of waiting until something happens to force a change. He is in some danger, moreover, of being led astray by his personal feelings, partly by his jealousy of some of the political leaders and also by his general lack of sympathy with the Socialists. In this connection, I enclose herewith an English translation of the Government declaration that was read to the Reichstag last week by

the new Chancellor. On pages 4 and 5 you will find some general remarks which put the new Government on record as favouring a definitive solution of the reparation problem as soon as possible. The Government's statement on this subject impresses me as both dignified and reasonable, and I think it is really important for the future. I am not sure what Schacht would say about it, but I think he will be tempted by his own feelings to under-rate its significance.

I mention all these things to you most confidentially in the thought that they may give you some helpful background for the purposes of your talks with Schacht. I do not believe you need to raise the question with him, but you can do a great deal to keep him on the reservation in case it comes up for discussion.

Faithfully yours,



Benjamin Strong, Esq.,
c/o Hotel Royal,
Evian-les-Bains, France.

1 enc.

TRANSFER COMMITTEE

ECONOMIC SERVICE

BERLIN, July 7, 1928.

PROGRAMME OF NEW GERMAN GOVERNMENTADDRESS OF CHANCELLOR BEFORE REICHSTAG, JULY 3, 1928.

(Translation from official report of Reichstag proceedings, July 3, 1928. pp. 38-46)

Ladies and Gentlemen! I have the honour to present to this House the new Reich Cabinet which has emerged from the Reichstag elected on May 20th. (Disturbance and cries among the Communists.) The election campaign has proven to the world that following the hard post-war years the German people has entered into a period of calm and steady development. The foundations of the new State of the German republic stand secure and unshakeable. (Renewed cries from the Communists.) It is the task of the Reich Government to build further on the basis which has now been consolidated and to work unceasingly to the end that the wounds of the war and the post-war period may heal more and more and that the work of resolute reform may be carried out in all fields; for only further energetic work along the line of social and political progress corresponds to the will which the German people expressed in the Reichstag elections. (Cries from the Communists.) The composition of the Reich Government serves such an aim. (Laughter among the Communists.) Even though it is not built on a coalition-like basis, its composition has nevertheless found the approval of the parties concerned. On this basis the new Reich Cabinet has taken up its activities. (Renewed cries from the Communists.) It will shape coming political tasks according to the following programme which I have the honour to outline to you.

As regards foreign policy the course which the Reich Government will follow is clearly prescribed. The foreign policy of Germany is pursuing

its aims in a spirit of peaceable understanding and renounces the idea of revenge. We shall adhere to this basis. On it, we shall continue to pursue the object of securing for Germany a position of equality among the nations and of bringing about, in frank collaboration with the other Governments, the political and economic consolidation of Europe. (Bravo! from the Socialists and in the middle.) Serious and important questions are awaiting solution and make it our duty to exert all our efforts to achieve their satisfactory settlement. I may mention firstly the question of the liberation of the territories on the Rhine and the Saar which are still occupied. In agreement with the whole German nation, the Reich Government is convinced of our well-grounded claim to an immediate liberation of these areas. (Warm applause.) We must state, however, that the occupying Powers have even now not drawn the given conclusions from the political development of the past few years and that it has for this reason been impossible up to now to arrive at a practical result in the varied discussions on the evacuation question. Only one and one-half years still separate us from the final Treaty date upon which the evacuation of the second zone is contemplated. (Cry from the National Socialists: Contemplated!) We all know that there would need to be no appeal to the loyalty and patience of the population of the occupied areas even if it should be necessary to hold out until the last Treaty dates. (Very true! among the Socialists and in the middle.) But if the evacuation should really be simply left to the expiration of the Treaty period, an important opportunity would thus be neglected of converting the policy of understanding into a reality even though all pre-requisites to this end existed. (Very true!) In this question the decisive factor for us, aside from the natural wish freely to exercise German sovereignty in the Rhineland and to liberate the population from the burdens of the occupation, is primarily the standpoint that the important thing is at last to throw down

this barrier which still exists from the period of the war and which stands in the way of establishing relations of real confidence among the nations. (Very true!) We most certainly expect that this standpoint will now be appreciated in the same measure also by the foreign Governments participating in the occupation. We further expect that, as regards them, every attempt made by another party to confuse the real issue by unjustly bringing in other problems will be in vain. (Very good!) The evacuation problem is simple and clear. Good-will alone is necessary to solve it. (Warm approval.)

We send our hearty greetings to the loyal population on the Rhine and Saar. (Applause.) The Reich Government is conscious of the great economic distress which has reached a high degree there owing to the occupation and which is intensified by the border conditions. We shall devote our particular attention to this economic distress.

Our activities in the League of Nations are most closely connected with the basic line of our foreign policy. We see in the League of Nations one of the most important factors of international life and, thus, also of furthering national interests. We are determined loyally to collaborate in all the tasks which must be solved in Geneva.

Of the general problems before the League of Nations the question of universal disarmament is now in the foreground of our interest. (Very true! from the Socialists and the Democrats. Cries from the Communists.) The disarmament of Germany has been carried out to the very end, and no State has done as much as Germany for universal security. (Approval.) This is proved by the Treaties of Locarno, our numerous arbitral conventions, the acceptance of the optional clause of the World Court and our active collaboration in the Geneva Security Committee. Germany was the first State to approve without reservations the general pact for the outlawry of war, which was recently proposed by the United States. We shall in the future also do our part to

realise this great plan, which places the guaranteeing of peace on the broadest conceivable basis.

All this gives us the right and duty to demand with all emphasis that universal disarmament should now at last earnestly be carried out and that thus the fondest desire of the nations who went through the terrible war should be fulfilled. The world must realise that in the long run it is an impossible condition for a great country like Germany, one-sidedly disarmed, to be surrounded by countries which are armed to the teeth. (Very true! in the middle and among the Socialists.) It will be the duty of the next meeting of the League Assembly in September to establish clarity on the course which the League of Nations is to take in this serious question.

The coming development of the reparation question will face us with an important task. It goes without saying that the treatment of this question will be of decisive importance for the whole economic and financial position of Germany for long years to come. Through the Experts' Plan and the London agreements of the year 1924, it has been possible to strip the reparation problem of political character and to make out of it a financial and economic question. Since then the execution of the Experts' Plan has proceeded smoothly. Germany has regularly and punctually fulfilled her obligations. The Experts themselves, however, described their Plan as only a provisional settlement and stated that it was necessary to supplant this provisional settlement by a definitive one as soon as circumstances make this possible. The execution of the Plan during a period of nearly four years has furthered in great measure the understanding of the general pre-requisites for the definitive solution. It may be that the time for taking up the definitive solution may not yet be precisely foreseen even to-day, but developments have nevertheless progressed far enough to create in all interested circles room for the conviction that the early accomplishment of this definitive solution is not only desirable,

but also possible. The success of all efforts toward the definitive solution of the reparation problem will depend upon their being handled by all those interested with the necessary measure of far-sightedness and upon their being carried out in accordance with methods of mutual understanding, with a sound economic policy and naturally with the assurance of a reasonable standard of living of the German people. Germany, for her part, will not fail to collaborate loyally in order to bring to a final conclusion a question which is of the greatest significance both for the German economy and also for the world economy.

Foregoing special mention of the other tasks of our foreign policy arising from our relations to the other countries, I shall now turn to questions of domestic policy. Execution of the Experts' Plan, reconstruction of the world economy and the interests of the German national economy itself demand in equal measure the facilitation and the cultivation of trade. In the words of the Experts themselves, the reparation payments can be made in the long run only out of genuine surpluses of the German economy. The world economy is suffering from protectionism. The German economy requires for its complete unfolding the development and intensification of its relations with the world economy. Consequently, the Reich Government will support all efforts tending toward this end, and will itself use its strength to fortify German economic forces through the cultivation and expansion of world economic activity. (Bravo! from the Socialists.)

The new Reich Government associates itself with the unconditional recognition of the results of the World Economic Conference at Geneva by the previous Reich Government. For its part, it will aim at their materialisation and energetically participate particularly in the work of lowering, through international agreements, the customs tariffs which were increased practically everywhere after the war. (Very true! from the Socialists.)

Alongside the work at Geneva looking toward a reduction of customs tariffs, commercial treaties continue to be the best means of removing hindrances to exchanges between the individual national economies. The expansion of our commercial treaty relations, particularly with the States to the east and south-east, is considered by the Reich Government to be an important task. (Very good! in the middle.)

It is pleased that negotiations have begun at Vienna looking toward a definitive and conclusive commercial treaty with Austria, which is a nation related to our own.

The Reich Government will also adopt the third method of activity in commercial policy which the World Economic Conference recommended in its efforts to facilitate the exchange of commodities: autonomous measures in the field of the customs tariff. The Reich Government will accordingly submit to the legislative bodies for decision the proposals for an autonomous tariff reduction, on which the Reich Economic Council has already rendered a report, relating to industrial items of the German customs tariff which cannot be utilised in commercial treaties.

The movement of prices on the German domestic market is important for the development of exports and for guaranteeing a reasonable real wage to the working population. Its influencing is served by a commercial policy aiming at the maintenance of ability to compete and above all by the correct attitude of the State toward the great monopolistic organisations which influence our economic life in the form of cartels, trusts, and similar bodies. (Very true! from the Socialists.) The forces in these organisations which are useful to the community at large and which increase production must be furthered; their detrimental tendencies must be curbed. (Very good! from the Socialists and in the middle.) To this end the leadership of a political system must possess the absolutely indispensable survey over as well as insight into these

organisms in order to be able to form a judgment on the manner and effects of their activity and to adjust its measures accordingly. To grant these possibilities to the constitutional authorities lies also in the well-understood interest of those organisms themselves, as they will then meet with better understanding of their measures among the community at large and will gain from the Government the confidence necessary for collaboration. As a result the application of legal measures against the abuse of positions of economic power can be restricted to the absolutely necessary measure. (Very good! from the Socialists. Laughter among the Communists.) In cases where such collaboration cannot be brought about, present legislation requires supplementation granting to the Government the necessary control, security and the possibility of determining in an expert manner whether the activities of these organisations are adapted to serve general economic progress. Corresponding proposals for expanding cartel and monopoly legislation, particularly in the direction of including the large enterprises which dominate the market, will be presented upon their completion. The findings of the Commission of Economic Enquiry, which has examined in particular detail precisely the fields in which such organisations exist, will furnish valuable material to this end.

The efforts to give greater publicity to the internal affairs of large enterprises. Such as are being pursued, among other ways, within the scope of a reform of joint stock company law, serve the general interests of the economy and the obtaining of capital.

The Reich Government is following with great care the development of conditions in the pit-coal mining industry. The difficulties existing here are not confined to Germany, but represent a problem common to all countries participating in the mining of pit-coal. The German Government

welcomes it that the questions connected herewith are being subjected to international study by the Economic Committee of the League of Nations, and, on its part, will collaborate most readily therein. (Laughter among the Communists.)

The development of transportation facilities and the public communications is of decisive importance for the prosperity of the economy. The Reich Government will adhere to the past transportation policy, and aim at creating the most favourable conditions for increasing sales through further organic development of the various means of transportation.

The Reich Government is conscious of the fact that large circles of the middle class in handicrafts, commerce and industry are in great distress and that, as the President of this House said a short while ago, when he took office, "have not yet been able to find a sound basis for their existence". The Reich Government will see to it particularly that protection and aid are accorded to these middle-class circles, as Article 164 of the Reich Constitution prescribes, and that reasonable limits are set to the expansion of those activities of public corporations which are not dictated by the requirements of the population. (Very good! in the middle. Laughter among the Communists.)

As regards handicrafts, the promise of the solution of several important questions of organisation is to be redeemed through the early presentation and passage of the bill amending the law on handicrafts. (Bravo! in the middle.) The co-operative self-aid organisations of handicrafts and trades are energetically to be furthered.

- 9 -

The settlement made by the creation for a restricted field of the decree on building contracts is to be expediently extended to the whole public order distribution system with collaboration of the interested circles. In this connection the middle-sized and smaller enterprises are to be given particular attention.

The training of an adequate supply of skilled workers to produce articles of high quality, particularly in view of the decline in births during the war and the lack of young workmen consequently to be expected, must be assured through a comprehensive settlement of the training of the growing generation in industry, commerce and handicrafts. (Laughter and cries among the Communists.) Its execution shall be guaranteed by equal collaboration of employers and employees through the competent trade organisations of industry. This purpose is served by the law on training for trades, which will shortly be introduced.

Article 165 of the Reich Constitution provides for the equal collaboration of employees in economic and social policy. The further execution of this article is served by the bill on the definitive Reich Economic Council, which will occupy the Reichstag in the very near future.

One of the most important and first tasks of the definitive Reich Economic Council will be to discuss proposals for the further execution of Article 165 looking toward an increasing participation of workmen in the whole economic development of productive resources. (Bravo! from the Socialists.)

The creating and guaranteeing of fruitful collaboration will be aimed at in all fields which are accessible to such collaboration. This must be done also in relation to the German border areas which, as a result of their situation, are exposed to a series of special difficulties and therefore require increased relief. The practical consequences must be drawn from the idea that the economy of these areas forms a unit, equally important for all, with the more favorably situated portions of the country. (Bravo! in the middle.) There is no isolated economy of individual districts but solely a united German economy. (Loud cries of Bravo!)

Likewise it is necessary to guarantee an adequate equalisation and treatment on a uniform basis to the various economic interests which within the Government are entrusted to various ministries for technical reasons and reasons of organisation. The Government will take care in this regard to cultivate close collaboration between the individual Governmental offices and to adhere to uniform fundamental ideas.

The distress of large circles and areas of German agriculture continues undiminished. The restoration of the profitableness of agricultural enterprises is the pre-requisite for their maintenance and thus for the maintenance of the German rural population which the German Reich so indispensably requires in the interests of its economy and of a sound structure of the German people.

Any permanent weakening of agriculture as a purchaser on the domestic market would not be without effects on industry and trade. (Very true! from the Socialists.) Likewise increased migration from the rural districts, which

would be the inevitable consequence of a long agricultural crisis, would burden the city labor market in an unbearable manner. (Warm approval from the Socialists.) The Reich Government is quite conscious of the danger that, with a decline of agricultural production, our food supply will become more dependent on foreign countries and that the then necessary increased imports of foodstuffs will burden our balance of trade. (Cries from the right.)

To combat these dangers and to alleviate the distress of agriculture, it is first necessary to apply all measures which are adapted - without causing the consumer to be burdened - to contribute to the restoration of the profitability of agriculture. Consequently the measures of the Reich to further the fertility of the soil and to improve the technical bases of agricultural production are to be continued. The application of all modern means of increasing the yields and the rational utilisation of the natural resources of the German soil are to be favored. Aside from the improvement of production, however, the marketing conditions for the products of German farmers and cattle-raisers must also be improved. (Very good! from the Socialists. Laughter on the right.) Special attention will be devoted to preventing such excessive fluctuations in the prices of cattle, grain and potatoes as hurt the producer and do not benefit the consumer. (Very true! from the Socialists.) On the basis of the program adopted by the last Reichstag to aid agriculture, the work to improve quality, to standardize important products and to improve marketing organisations, with special attention to agricultural products of a specially high quality, is to be continued. (Very good! from the Socialists.) The Reich Government is confident that these efforts will find indispensable supplementation and support from the vital forces of self-help within agriculture itself. (Bravo! on the left and in the middle.) It will therefore combat the splitting-up of the agricultural co-operative association system and will devote its attention to strengthening these institutions of self-help,

with the aim of creating a sure market for agricultural products by making it possible to produce good articles which meet the demands of the consumer.

(Cry from the Communists: What about protection?)

Together with the competent authorities, the Reich Government will support the efforts to keep the central institution of the co-operative associations in an efficient status and to expand it so that it can cope with its growing tasks.

The very greatest anxiety is caused by the still rising agricultural indebtedness at interest rates which cannot be earned, even in better times. (Very true! from the Socialists.) The amount of short-term credits comprised in this indebtedness continues to endanger the rational operation of the enterprises. (Approval on the right.) The conversion of these credits into long-term indebtedness and the reduction of the interest rates on all agricultural debts will be aimed at. (Bravo! on the left.)

In the past few years agriculture has met the public charges and burdens in great measure by encumbering capital and not out of the yields of operation. (General approval.) Moreover, the burden on agriculture has been very unevenly distributed up to now. In examining the public tax system, it will be considered to what extent relief and a just distribution of the burdens can be brought about.

The Reich Government will most emphatically further agricultural settlement with the aim of bringing about a healthy distribution of the population and its various groups between the city and the country. (Very good! from the right and in the middle. Cries from the left.) In this connection it will in particular see to it that new labor resources are provided for sparsely-populated border areas and help as many as possible worthy applicants for agricultural settlement, including such as can make only small initial payments, to places on which to settle. (Bravo! on the left and in the middle.) In agreement

with the States, it will aim particularly at a reduction of the costs of settlement in connection with the purchase of land and with the building of farmhouses and at a simplification and cheapening of the procedure. The Reich Government will devote its special attention to providing long-term credits for agricultural settlement. (Bravo! from the Socialists and in the middle.)

The social policy of the post-war period is one of the most important problems of our domestic policy; but it is also influenced by international social policy and on its part exerts an influence far beyond the limits of our own country. (Very true! from the Socialists.)

The Reich Government intends to ratify the Washington Agreement on the eight-hour day (Bravo! from the Socialists) and in the international negotiations it will collaborate with all its force in the removal of the uncertainty which at present exists concerning the revision of this agreement and in the removal of the hindrances which stand in the way of its general ratification. (Bravo! from the Socialists.) It will shortly (Cry from the Communists: Shortly!) present to the Reichstag a bill for a law to protect workers, which has already been passed by the Reichsrat, and also the draft of a miners' law, which is necessary for its supplementation. The regulation of working hours contained in these laws is based on the eight-hour day, avoids economic impossibilities and social injustices (Contradiction from the Communists) and corresponds to the Washington Agreement. (Laughter among the Communists.)

Of the remaining fields covered by the bill for the protection of workers particularly the social protection of the youth and the settlement of labor supervision require the greatest attention. (Bravo! from the Socialists.)

The Reich Government considers a uniform development of the authorities for supervising labor and their uniform activities under an expert central authority equipped with the necessary powers, with participation of the

employees, indispensable in the interests of effective labor protection.

(Renewed cries of Bravo! from the Socialists. Cries from the Communists.)

Aside from the law protecting workers, there must be furthered above all the revision of the decree on seamen, the tariff agreement law and the general labor contract law, (Cries from the Communists: The arbitral system!) in order to conclude as soon as possible the uniform labor legislation promised by the Constitution.

The law on the provision of employment and unemployment insurance adopted in the summer of last year has placed the organisation of the labor market on a new basis. The Reich Institution for Employment and for Unemployment Insurance is still in process of amplification. The local unemployment offices are not incorporated as yet. In the country they must in many cases be newly created. The omissions of past decades must be repaired here. Only when this has been done, will it be possible reliably to judge the effects of the new law.

(Cries from the Communists.) A question which must be settled in due time before the winter is the status of seasonal laborers in respect to unemployment insurance, to which end the organs of the Reich Institution have the necessary powers. They will make objective use thereof just as they have already done in other, not less difficult, questions. In this respect the Reich Government will most emphatically support them.

Emergency relief has already been prolonged beyond July 1st. At the same time there have been a number of further measures to meet the stagnation on the labor market which has been making itself noticeable of late. The new Reich Government will continue in this sense. Furthermore, the period of emergency relief to older employees and laborers is to be prolonged beyond the present limits. (Bravo! on the left.) This can be done by decree. It will furthermore have to be examined whether the harsh dismissal of older employees can effectively be curbed. (Very right! on the left.)

The Reich Government regards the support of unemployed persons as merely a last resort. Incomparably more valuable is everything that puts the unemployed to work again. (Very true!) The Reich Government will further such efforts in every possible manner. It will endeavour to overcome the scarcity of laborers in the country (Laughter on the right) and it will devote its very special attention to the great task of assuring in all branches of economic activity an adequate supply of trained young laborers. Among other things, the above-mentioned law for training in trades serves this end. From this standpoint, all efforts to train laborers for other trades and to facilitate the free movement of labourers, which is hindered greatly by the present dwelling conditions, will always find the most emphatic support on the part of the Government.

Within the scope of general measures of economy it will have to be considered how the Reich insurance can be made simpler, more economical and, consequently, more effective. In this connection a reduction of payments or a restriction of local administration cannot be considered. It will even have to be examined whether and to what extent the savings in the insurance system can in turn be made beneficial to the insured and their families through increased payments. (Bravo! on the left) In particular the insurance organisations will be able more exactly than hitherto to adjust themselves to forestalling and preventive measures, particularly to the struggle against wide-spread disease and to protection against accidents while working. (Renewed cries of Bravo!) Also the expansion of accident insurance to include occupational diseases which are not yet covered serves this end. A decree will enlarge, on the basis of a report of the Temporary Reich Economic Council, the list of occupational diseases for which indemnification is to be the same as in cases of accidents incurred while working. The Reichstag will at once receive the bill, which has already been passed by the Reichsrat, on extending

accident insurance so as to include further enterprises. Whether and how inclusion of still other circles in the accident insurance can be effected is to be examined in a memorandum to be presented to the Reichstag. (Cry from the Communists: Include the Cabinet! Laughter.)

The social insurance system must place itself in the service of our population policy, which emphasizes protection and aid to the family. In this connection, the age-limit at which insurance is obligatory in sickness and employees' insurance gains a special importance. It will therefore have to be considered whether and to what extent the limits are to be extended.

In the international social insurance the ways which have thus far been trodden with success will be followed further. In State treaties and in international agreements, rights under the insurance will reciprocally be granted to the insured even if they change their place of residence from one territory to another. Such treaties and agreements at the same time form the bridge between the insurance systems of the individual States and further the uniform adjustment of laws. The close collaboration with the International Labor Office, which has already led to fortunate and important results for German and international social policy, will be continued (Laughter and cries from the Communists.) This collaboration, on the other hand, obligates the Reich Government to secure for Germany the position befitting her in the international labor organisation.

It is in accordance with the unanimous sentiment of the German nation to improve the lot of the persons injured in the war and the families of dead soldiers. (Warm concurrence. Cries from the Communists.)

In like manner the Government will aim at improving public welfare as much as possible to the benefit of those in distress, strengthening the rights of those in need of help and extending public relief in its nature and activities. It will also further the helpful institutions of charitable

welfare (Hear, hear! and cries from the Communists); it will place the aid for small rentiers on a legal basis independent of the judgment of the local welfare authorities.

Housing distress continues to hinder our national life from becoming healthy. The Government will devote its special attention to keeping old dwellings available as dwellings and to constructing new dwellings and in this connection take into account in a preferential manner the requirements of circles of the people, who are without dwellings, but who have no funds or only small funds, particularly of newly-founded families and large families, as well as the persons injured in the war and the widows and children of soldiers killed in the war. (Very good! from the Socialists. Disturbance among the Communists.) Moreover, other measures must also be taken to alleviate the burdens of families with many children.

In the creation of new dwelling space, it will aim at keeping the rents in new dwellings at a bearable level through an economical and economic utilisation of the funds for the construction of new dwellings. (Cries from the Communists.) It will act against an unjustified rise in prices of real property and any other unjustified profits. (Laughter and cries among the National Socialists.) It will aid endeavours to lower building costs by more rational development of the building trade. All resources of public as well as private building enterprise are to be mobilised to expedite the construction of dwellings. The Reich Government regards it as an important task to strengthen its influence on as economical as possible a utilisation of public funds and to take care that new dwellings are constructed chiefly in those places where, as regards the more distant future, favorable opportunities for employment exist for the working population. (Very good! from the Socialists.) Since the construction of dwellings is considered productive, there are no objections, in case of urgent necessity, to providing funds through loans

insofar as general economic conditions and the condition of the capital market permit.

Fruitful work in the field of foreign, economic and social policy is possible only on the foundation of a solid political structure, (Loud cries from National Socialists: Very true!) the basis of which is our Weimar Constitution. (Warm approval from the Socialists and Democrats. Laughter among the Communists.) It is the chief task of the Reich Government to develop our State in a democratic sense on this basis and to demand the honoring and respecting of the republic and its symbols. (Animated concurrence among the Socialists and Democrats. Laughter and cries from the Communists.) It will present to the Reichstag without delay the initiative bill on Constitution Day which has been adopted by the Reichsrat. (Disturbance and cries among the National Socialists. Counter cries from the Socialists. Continuous disturbance. President's bell.)

It goes without saying that the Reich Government will protect the Constitution against any illegal attack, from whatever quarter it may come, with all the means at its command. (Very true! from the Socialists and Democrats.)

In this connection the Reich Government relies on the loyal collaboration of the officials. It will take pains to guarantee the rights of officials and to further their interests. Supplementing the resolution already adopted by the former Reichstag on a maximum limit of pensions, the restoration of such a maximum limit and the questions connected therewith will be examined. (Cries from the Communists: "Will be examined!") The Government will devote its special attention to a settlement of the legal position of ministers and the creation of a new law on Reich officials, in which the decree on official penalties, which was not settled by the former Reichstag, will be incorporated. Also the passage of the law for which reservation was made in Article 130, paragraph 3, of the Reich Constitution,

on organisations to represent officials, will be furthered in this connection. (Cry from the Communists: Will be examined! Laughter.) To be sure, a great many things must be examined. You, of course, do things much more simply! (Laughter.)

The Reich Government recognises the necessity of a reform of the laws on Reich and State citizenship in the sense of the resolution adopted by the last Reichstag.

The Reich Government will take up anew the electoral reform. It is known that the existing electoral law shows shortcomings which lead to an estrangement between the persons elected and the voters and to a splitting up of the party system. The object of the reform will be to preserve the system of proportional representation fixed by the Constitution, but at the same time to guarantee closer relations between the deputies and the voters. (Approval)

In the field of educational policy, the settlements to be made by Reich law, as provided for in the Reich Constitution, still await solution. The Reich Government will strive to develop the public school system organically and socially with the object of guaranteeing to all strata of the population an equal share in German cultural possessions. It will furthermore be its task to strive for the solution of the far-reaching problem of the Reich school law in the sense of elevating and improving the German school system, which is already highly efficient. In this connection the position of the school as an organism subordinate to State sovereignty, the structure and organisation of which is based on the provisions of the Reich Constitution, and the rights of religious associations as regards religious instruction and the constitutional freedom of worship, are to be protected, the rights of parents being taken into consideration. (Laughter and cries on the right. Counter-cries from the left.)

The improvement of the physical, mental and moral health of the German people will continue to be a serious care of the Reich Government. It will aid with all its power the institutions and measures for the investigation and combating of diseases, the reduction of the infantile death rate and the reduction of the abuse of alcohol and it will work for the systematic enlightenment of the nation in these respects. It will likewise devote its attention to the cultivation of physical training, which fortunately is gaining more and more ground as a means for increasing the physical strength of our youth. The Reich Government will consider its special duty to be the furthering of the great tasks of technical matters, research work, science and art with all its strength and to do away with the distress in this field.

An important task accrues to the Reich Government in the development of international cultural relations. The Reich Government welcomes it that since our entry into the League of Nations these relations in Germany have already been furthered greatly and that the German commission for international intellectual collaboration convened a short time ago to cultivate them.

(Approval)

The defensive forces of the German Republic will be able effectively to fulfil their tasks - protection of the borders and maintenance of peace and order within Germany - only if they are rooted in the people and have the confidence of all strata of the population. They will best obtain and keep this confidence through loyal work and through a purely patriotic and non-partisan attitude. (Cries.) But their tasks must not be made unnecessarily difficult by drawing them into disputes over political differences. With good-will on all sides it will be and must be possible no longer to treat the questions of the defensive forces from a partisan standpoint (Hear, hear!), for every German to look with pride on our defensive forces and to see

in them only an aid and a protection. The Government, which demands from the defensive forces that they should be a loyal and absolutely reliable support of the republic, will, for its part, take care that the defensive forces are provided, within the scope of their tasks and of the existing Treaties and in accordance with our financial capacity, with all the funds necessary for their tasks.

The great legislative task of the penal code reform - (Cry from the Communists: what about the warship?) - Gentlemen, if you have wishes, I am ready to discuss them with you in the debate. At present it is my task to read a Government statement. (Noisy cries from the Communists.)

The great legislative task of the penal code reform - (Continued cries from the Communists. President's bell.)

It was impossible for the Reichstag to conclude the great legislative task of the penal code reform in the last legislative term. The transitional law makes it possible for the House soon to take up this important task again. Under the experienced guidance of Dr. Kahl, the penal code committee has carried out thorough and valuable preliminary work. Of course the decisions of the committee on the penal code have no binding effect; the Reich Government, too, must reserve for itself the right to take an independent attitude toward the details of these decisions and of the bills which will now be submitted to the new Reichstag. In this connection there will have to be decided especially the question of the abolition of the death penalty. (Cries from the Communists.) But even now the Reich Government will suggest to the State Governments that they suspend death sentences until that time. (Bravo! from the Socialists.) In expressing the hope that it will be possible to overcome many a difference and to arrive at an understanding on the penal code reform, I know I am in agreement with the House. I am strengthened in this conviction by the fact that this great legislative work is at the same time destined to give new expression to the indissoluble

intrinsic relationship of the German Reich with its brothers in Austria.

(Bravo!) For the first time after a long period, Austria and Germany join hands in common legislative work which is to bring to us the first great step on uniform laws for Germans. (Cries from the National Socialists.)

There are before the House several initiative motions dealing with the question of amnesty for political offences. The motions depart from the consideration that for a number of offences, which were committed for political reasons in a period of great political excitement and some of which are due to the distress of the inflation era, the time has come for the State to forego further punishment. (Cries from the Communists: Release Hoelz!) The Reich Government hopes that in the discussion of the amnesty motions, which has already begun, the House will reach an understanding on extent, nature and limits of the amnesty, and, in agreement with the House, it attaches special importance to having, through speedy treatment of the motions, the legislative solution of the task concluded before the Reichstag adjourns. (Bravo! from the Socialists.)

In the education of young judges, higher administrative officials and lawyers, who are highly educated, filled with sympathy for the new State and able to satisfy the augmented demands of modern political, economic and cultural life, the Reich Government sees a particularly important and urgent task. In a continuation of the discussions with the States which have already begun, the Reich Government hopes soon to arrive at the adoption of a uniform educational procedure to include if possible, judicial and administrative jurists, but at the same time to take into account modern educational methods. In this way will be created at the same time the preliminary conditions for a far-reaching interchangeability of officials corresponding to the requirements of the unity of the Reich and for the realisation of the long-desired right of lawyers to practice their professions anywhere they choose in the country.

In the field of tax policy, the Government will devote its attention to the question of the extent to which it is possible to alleviate the oppressive burden of taxation which is specially heavy on the middle and lower classes. This would both increase savings activity and help in the formation of internal capital as well. (Hear! Hear! on the right.) Naturally the answer to this question is dependent upon the further development of our economic position and the judgment of the position of the Reich finances. (Cry from the National Socialists: Long live capitalism!) It will remain to be examined whether under these conditions it appears possible to make a moderate reduction in the income tax rates for lower and middle-sized incomes. Naturally this examination will be dependent upon the course of further developments in general, and this must be awaited. (Hear! hear! from the Communists.) Only in the autumn will it be possible to form a judgment.

It seems very urgent to consider the extent to which incomes up to 8,000 marks, whether liable to wage tax or to assessment, can be relieved of tax pressure in view of the fact that the receipts from the wage tax during the past months of the fiscal year have been such as to indicate that the legal maximum limit will be exceeded. It seems furthermore necessary to redeem now the promise made in the law and to levy that portion of the tax on property required to make up the deficit of 40 million marks in 1926 as compared with the budget estimates. (Cry from the right: Do you call that reducing taxes?) The bill to this end was submitted to the Reichsrat by the preceding Government. (Great amusement on the left.) It will now have to be adopted there and then go before the Reichstag. Through the proper choice of the date for this supplementary payment (Disturbance. Continual cries from Deputy Torgler. President's bell)

Through the proper choice of the date for this supplementary payment and through the method of its collection, particularly in regard to weak enterprises

care will be taken to avoid undue hardships in connection with the supplementary payments.

Special attention will have to be given to the financial relationship between the Reich, the States and the communes. The most important basis for a future development of the financial settlement, which is so important for the whole financial situation, is a uniform settlement of the material law on real taxes and the house rent tax; this is to be brought about through a tax simplification law, the draft of which is already engaging the Reichsrat. Such a law is to bring about a great step forward as regards a just distribution of all tax burdens and is to further an expedient Reich and administrative reform.

As to financial administration in general, it may be expected on the basis of the results of the expired months of this fiscal year that taxes and administrative revenues will amount substantially to the budget estimates unless some unexpected change should take place. Since on the other hand no surplus receipts may be expected the most economical budgetary practices are absolutely necessary in order to prevent any danger to the equilibrium of our finances, as such danger must be averted under all conditions. The size of the extraordinary budget and of the resulting loan requirements - in spite of the progress made in this respect in the recent past - continues to be the subject of grave misgivings. The present Government will continue with all emphasis the endeavours to improve the situation in this respect. In view of the increasing expenditures of the next few years and of the disappearance of several revenues still coming in this year, it considers itself obliged to do everything in its power to secure the orderliness of our finances from reversals. But financial problems cannot be considered without reference to the close connection between them and the reparation obligations of Germany.

This will require the greatest care, whether it is general economic policy or the borrowings and expenditures of German public bodies that are under consideration. It has been possible to arrive at a settlement of loan policy which has been made in close contact with the public bodies concerned. In future also foreign loans seem desirable only if they correspond to the economic principles of productivity and profitability.

The Government agrees with the conference of the States and with the whole nation that the present settlement of the relationship between the Reich and the States is unsatisfactory and requires thorough reform. (Very true! from the Socialists.) It approaches this vital problem in the consciousness of the necessity of a strong Reich power, of the significance of the manifold peculiarities of German national life and of the requirements of the most economical financial practices of the public budgets. It will endeavour to arrive at a satisfactory solution in close collaboration with the States.

The creation of a Reich administrative court as the next step toward simplification will be emphatically furthered. Fundamental agreement with Prussia has already been reached to the end that the Prussian Supreme Administrative Court is to be merged with the Reich Administrative Court.

Ladies and Gentlemen! the declaration of the new Reich Cabinet as put before you shows you that we earnestly and sincerely desire to solve the great tasks assigned to us with all the strength at our disposal. But the exhaustive program we have set for ourselves cannot be put into effect unless there is an end to the era of crises and until the political situation is so firm and consolidated that the whole energy of the Reich Government can be concentrated on the fulfilment of its functions. This is the unanimous wish

of our people and corresponds to the will of the Reich Cabinet. The Government lays claim to the leadership along the way to reconstruction, and trusts that the majority of this House will support its program.

(Great applause from the Socialists and in the middle. Cries from the Communists. Renewed applause from the Socialists and in the middle.)