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German and Japanese, have been very favorable to bondholders and the
prices of these issues have been extremely good.\(^7\)

In addition, political and economic stability have grown
immeasurably, especially in Europe where the Common Market is becoming
important. Despite some examples to the contrary, there has been some
progress in Latin America. Japan, of course, has been the bellwether
of the Orient in terms of economic progress. Specific indications of
such progress have been the rapid growth of trade in the above mentioned
areas and the progressive reduction of exchange restrictions. Foreign
exchange balances have been built up and partial convertibility of many
 currencies established.

Other significant changes have also taken place concerning
private foreign investment. A few institutions have been developed to
foster portfolio investment. One of these is the International Finance
Corporation, sponsored by The International Bank for the purpose of
stimulating the spread of private enterprise in various areas of the
world.\(^8\) Another significant change has been the growth of the investment
company as a vehicle for U.S. investment abroad. Although there are
some obstacles to the use of the investment company for the purpose of
holding foreign assets, recent rulings made by the Securities and
Exchange Commission allow the investment company greater freedom from

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\(^7\) H. J. Dernburg, "Some Basic Aspects of the German Debt Settle-
ment," The Journal of Finance, Vol. VIII, No. 3 (September, 1953), pp. 298-318; also see Foreign Bondholders Protective Council, Report 1953

\(^8\) The International Finance Corporation, August 10, 1956,
Washington, D. C.
interdepartmental consultation, and then, were presented to the Assistant Secretaries and the Secretary's offices for final approval. Commerce and Treasury deliberations were then forwarded to the Economic Advisor's office in the State Department for final disposition, or further consultation, and then the banker received his reply. Even with this liaison committee, implementing foreign loan policy, most consultations were extremely informal, frequently telephone conversations with scant notation sufficed; face-to-face consultations were noted with brief departmental memoranda, usually attached to underwriter's original request. Only when a controversy existed, or was contemplated, would an extended memorandum divulging considerations concerning policy be made. In brief, there was no codification of loan policy as such, only short memoranda, noting the decisions, and occasionally, a longer notation, divulging some of the considerations.  

During the first year of the Harding Administration, the Commerce Department and the Treasury Department were full partners with the State Department in formulating foreign loan policy. After March 3, 1922, the President limited the scope of our foreign loan policy by refusing to examine the investment merits of loans. This decision proved to be a

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85 Feis, op. cit., p. 18. Note: Feis states that there was a note prepared by Undersecretary Cotton in the State Department Files (July, 1929) which summarizes Foreign Loan Policy. Also see State Department Decimal Files, 824.51/615, August 3, 1931, a 55-page report by J. Whitla Stinson, "American Diplomatic Policy-Bolivian Government Financing"; and see various memoranda prepared by Frederick Livesey, especially Decimal Files, 832.41/475, April 30, 1927, and 824.51/D581/26, June 23, 1928.

86 Hoover, op. cit., p. 88.
major bone of contention in the relations of the Commerce and State
departments during the remaining seven years of the decade.

The difficulties of the Department of State and Commerce concerning
the formulation and execution of foreign loan policy began during
the fall of 1921. The nature of these difficulties concerned a variety
of items including the failure of the State Department to consult with
Commerce on certain loans. During the spring of 1922 the decision was
made not to consider the investment merits of loans as a basis for
objection; however, the Commerce Department was never quite able to
accept this verdict, and occasionally reopened the issue. The principle
of not lending to foreign monopolies sponsored by the Department of
Commerce also was subject to a number of limitations which tended to
render it somewhat ineffective, especially after 1926. 87 Mr. Hoover's
principle of full disclosure of the details concerning conditions in
countries abroad available to investors, bankers, and others, became
limited either by diplomatic protest, or the intervention of the State
Department acting for political reasons. As the decade ended, the
original concept of a full partnership in the formulation of foreign
loan policy was watered down to having the Department of Commerce advise
only on certain financial aspects of loans. 88

87 See U.S. State Department, Decimal Files, 825.51/237, October
18, 1926 for details of the Chile Mortgage Bank Loan; 832.51/466,
February 4, 1927 for details of the Rio de Janeiro Agricultural
Institute Loan.

88 Feis, op. cit., p. 13; Note: Mr. Hoover in his Memoirs, p. 56,
says concerning Coolidge, "He quickly dissolved our control over loans."
The interpretation by Assistant Secretary of State White of the objections of the Department of Commerce to foreign loan policy needs some explanation. Mr. White, in testifying before the Senate Finance Committee Hearings on Department of Commerce objection to foreign loan policy, conceived that Commerce objections sustained in the early phases of consultation, but which were finally overcome by State Department persistence, should not be regarded as objections, technically speaking. With this narrow interpretation of what constituted an objection by the Department of Commerce, the testimony rendered by this official tended to be somewhat inadequate if not inaccurate concerning the difficulties between the several departments. The discussion below will deal with a conception of the word "protest" or "objection" which will show items of disagreement, irrespective of whether the Department of Commerce in the final judgment stated an irrevocable objection or not.

One of the items that tended to create difficulties between the two departments regarding the formulation and execution of foreign loan policy, was the matter of notification and consultation about specific loans. Notification and consultation strike at the very heart of joint responsibility for foreign loan policy without which there can be no real effective cooperative policy determination. Since the State Department received virtually all original requests from the banking group originating the business, it became their responsibility to advise the other interested departments of the receipt of the request and ask

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89 Testimony of Mr. Francis White, U.S. State Department, Johnson Committee Hearings, Part I, pp. 1902-1904.
the department for their views on the business. The fact that the State Department did not choose to notify or consult with the Department of Commerce or the Treasury on a number of instances seriously weakened joint policy determination.

In the first place, the State Department did not feel it necessary or prudent to consult the Department of Commerce with respect to loans to certain Caribbean countries. These loans were usually made under a treaty, and involved in most instances, some form of supervision and or financial receivership. The State Department Economic Advisor stated the position as follows:

There are certain dangers to be considered in consulting other departments. . . . We did not initiate action to take up this matter with Commerce or Treasury because of a desire to avoid any discussion with other departments of delicate matters of financial control.90

In the case of the 1922 Equitable Trust Loan to Bolivia, the decision not to consult was certainly an extension of the Caribbean powers concept, as Bolivia had never been so classified previously.91 Furthermore, Mr. Hoover was not consulted partly due to his known interest in customs receivership.92 It was presumed that he might not

90 U.S. State Department, Decimal Files, 821.00/500, April 24, 1922. Note: for an interesting narrative from the bankers point of view see the testimony of Mr. Frederick Strauss, Johnson Committee Hearings, Part III, p. 1323.


92 U.S. State Department, Decimal Files, 824.51/97 and 824.51/93.
object. In any event, this loan, or at least the conflict of this loan with a subsequent one in 1928 did involve the Department of Commerce.93

(See below for extended remark.)

Finally, it should be noted that although the Department of Commerce was vitally concerned in all matters of finance relating to our foreign affairs, the Department of State, itself made the selection of Professor Kemmerer as head of the Financial Mission to Columbia. While it is true that the initial inquiry took place on a basis of a diplomatic request by the minister from Columbia to the State Department, surely the Department of Commerce should have been consulted as partners in policy making and execution.94

A major area of disagreement came on the matter of whether or not the policy makers should consider what later came to be called "the investment merits of loans." Prior to the spring of 1922, investment merits of loans were considered by the departments concerned, especially the Commerce Department. Mr. Hoover was against countries borrowing

93 U.S. Department of Commerce, Balance of Payments Division, File 1922, Letters by Grosvenor Jones to Mr. Hoover (May 30, 1922); see also Assistant Secretary Klein's memorandum dated June 5, 1922, attached to Mr. Jones' letter.

94 U. S. State Department, Decimal Files, 821.51A/2, September 28, 1922.
to cover budgetary deficits. In the case of the City of Soissons, France, loan he was instrumental in blocking the loan.\textsuperscript{95} The inquiry of the Department of Commerce was usually "whether the loan was for reproductive purposes" and whether the proceeds were to be spent in the United States.

Mr. Hoover's policy on "loans for budgetary purposes" was fairly pragmatic. When exchange conditions with Argentina became critical, Mr. Hoover quickly pushed a loan to Argentina, although the State Department was concerned with the consistency of this position vis-a-vis the City of Soissons' loan. Mr. Hoover, when asked as to the general theory on this loan, stated that "this loan ought to be treated on its merits."\textsuperscript{96}

The loan to Argentina, involved using the officers of the American Embassy to represent the firm of Kuhn, Loeb and Company in their efforts to approach the Argentine Government. Mr. Hoover was directly responsible for requesting the State Department to act in this matter. Unfortunately, the Argentine Government reacted unfavorably to the representation of Kuhn, Loeb, and Company by the Embassy, and the State Department was placed in an awkward position.\textsuperscript{97}

It may be that the Argentine loan and other incidents which took place in this early period influenced the State Department to take a position that it would not concern itself with the "details" of loans.

\textsuperscript{95}U.S. State Department, Decimal Files, 835.61/268, August 12, 1921.

\textsuperscript{96}U.S. State Department, Decimal Files, 835.51/336, July 29, 1921.

\textsuperscript{97}U.S. State Department, Decimal Files, 835.51/268, August 12, 1928 and 835.51/266, September 7, 1921.
or the "investment merits" of loans. It was also perceived by the Department that it was not equipped to deal with numerous investigations involving the quality of these issues.\(^{98}\) Finally, it may be said that perhaps the Secretary of State was influenced by a letter from Governor Strong of the New York Federal Reserve Bank in which the Governor strongly protested the government's role in the supervision of loans.\(^{99}\)

By early spring, our loan policy regarding the investment merits of loans was changed, and the State Department was no longer required to agree to objections to loans on a basis of their investment merits. The President's communique to bankers of March 3, 1922, indicates this point.\(^{100}\) On March 10, 1922, in an inquiry concerning the disposition of a municipal loan to Antwerp, the Secretary of State replied to Secretary Hoover, "State does not regard other details a matter of official comment.\(^{101}\)

Despite the fact that the "investment merits" of loans no longer constituted an official part of our foreign loan policy after this time, the Department of Commerce persisted in concerning itself on these grounds whenever it felt justified. It raised objections to some of the

\(^{98}\) Testimony of Assistant Secretary of State Francis White, Johnson Committee Hearings, Part III, p. 1911; also there are numerous references to this point by various State Department officials in memoranda after 1923. See Chapter II of this dissertation for further reference.

\(^{99}\) Hoover, op. cit., p. 86.

\(^{100}\) New York Times, March 4, 1922, p. 2.

\(^{101}\) U.S. Department of Commerce, Balance of Payments Division, Letter from Secretary of State Hughes to Secretary of Commerce Hoover, dated March 10, 1922.
Brazilian state loans which were especially shaky from an investment point of view.\textsuperscript{102} It gave a qualified approval to a French Railroad issue which, as Mr. Jones of Commerce stated, "had run at a deficit for several years.\textsuperscript{103}

After 1928, when the general quality of issues began to decline markedly, Commerce objected to several loan issues in a somewhat more vigorous manner. On the basis of persistent commercial attache reports, that lending was proceeding "unbridled" and calling for some form of protection for "unsuspecting" investors, the Commerce Department finally took a firm stand.\textsuperscript{104} In protesting the $23 million loan to Bolivia by Dillon, Read & Co., during 1928, a note to the State Department stated in part:

The financial position of Bolivia at the present moment is so precarious that failing to obtain this loan, the Republic must default upon at least part of its obligation. . . . Apprised as our Government is of the difficult financial and political conditions in Bolivia, it would be derelict in its duty toward the American public and remiss in the conduct of our foreign affairs, if it did not take a decisive stand in this matter.\textsuperscript{105}

\begin{flushleft}
\textsuperscript{102}U.S. Department of State, Decimal Files, 832.51/C32/3, dated July 15, 1922. Also see 832.51/280, dated June 22, 1922.

\textsuperscript{103}U.S. Department of Commerce, Balance of Payments Division, Letter from Mr. Klein to Mr. Jones, March 25, 1922.

\textsuperscript{104}U.S. Department of Commerce, Office of International Trade, Commercial Attache Hunt, Bogota, Colombia, to Director, Foreign and Domestic Commerce, June 11, 1928.

\textsuperscript{105}U.S. Department of State, Decimal Files, 824.51/D581/26, June 23, 1928.
\end{flushleft}
The Acting Economic Advisor of the State Department in an extended memorandum of 38 pages addressed to the Assistant Secretary of State noted in part:

This would be an innovation in view of the past policy of the government, in this regard best stated in the Report of the Secretary of the Treasury for 1925.

It is not clear to me why the U.S. Government is morally obligated to restrain American bankers from floating Bolivian bonds which may involve some risk of loss to the purchaser.... There is no national policy of discouraging speculative foreign investments.

... Grounds for objections must be found elsewhere, if at all.... Probably the Department of Commerce will eventually be prepared to assent to any considered action of the department [State] short of expressing objection on credit grounds.106

It is reported that the Secretary of State vigorously denied the grounds for objection by the Department of Commerce.107 Finally, the Department of Commerce backed down on its objection.

Thereafter, the Department of Commerce sought to accomplish its objectives concerning the investment merits of loans by other methods; namely, through their reports and releases to the public. Mr. Hoover also sought to influence lending through public speeches, such as a warning to bankers and borrowers to concern themselves only with productive loans.108

Probably the single most successful policy contributed by the Commerce Department was the position taken on loans to foreign monopolies

106. U.S. State Department, Decimal Files, 824.51/D581/38, memorandum by the Acting Economic Advisor to the Assistant Secretary of State, July 24, 1928.

107. Personal interview with Mr. Frederick Livesey (August 28, 1952) at his office in the Department of State, Washington, D. C.

wherein monopolistic practices had the effect, according to Mr. Hoover, in raising the prices of commodities to United States consumers, both industrial and final consumers.

Shortly after Mr. Hoover came to the Department of Commerce, he started an investigation into the extent of control which foreign producers have over the price. In early 1923, Mr. Hoover appeared before Congress to indicate the extent and importance of this problem. The following month Congress appropriated money to assist a commission headed by Mr. Hoover to make a further investigation leading to relief from the effects of foreign control over strategic commodities.

In late 1925, this new principle of our foreign loan policy was placed in operation. The Commerce Department, in this year, objected to two loans. The first of these loans was a coffee valorization loan for Sao Paulo, Brazil. In suggesting disapproval of this loan, Mr. Jones of the Department of Commerce, stated:

In my opinion there has been no change in the coffee situation which would warrant a change in our attitude toward a loan of this type. . . . There is grave danger lest the proceeds of the proposed loan be used to bolster coffee prices.

Upon being denied access to the American market, American bankers floated the loan in London and sold a large portion in the American market. A similar situation existed with respect to a large loan to

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111 U.S. Department of Commerce, Balance of Payments Division, Memorandum from Mr. Jones to Mr. Stokes, April 30, 1925.
control and some tax advantages. Since there are many millions of people presently owning shares in "Mutual Funds" and "closed-end" investment companies, the switch to international companies holding assets including foreign-dollar bonds and other portfolio investments would appear to be a logical conclusion where the yields make it profitable. Yield differentials between high grade common stocks and high grade bonds have, in the past several years, been distinctly favorable for shifts in investor accounts from equities to bond type of commitments. In fact, shifts from equities to non-equities have been taking place domestically for some time. Comparisons between yields on both equities and non-equities abroad with those domestically are distinctly more favorable for U.S. foreign commitments. It would thus appear that provided there is no further great disruption, portfolio investment including foreign-dollar obligations is likely to become an increasing proportion of total private foreign investment.

Another factor deserves some mention. The record of U.S. post-World War II private investments has been, until recently, one of large dosages of direct investment outlays. There has been considerable speculation by experts that although many advantages are possessed by direct investment vis-a-vis the exchange problem, some disadvantages


10 Lawrence M. Greene, supra, pp. 493-503.

the German Potash Syndicate. This loan, prevented from flotation in the American market, was floated with great success in Great Britain.\textsuperscript{113}

During 1926, the Department of Commerce began to experience difficulties with the Department of State concerning policy determination on various commodity valorization loans. On October 18, 1926, Secretary Hoover in a letter to Secretary Kellogg indicated that the Department of Commerce felt that a projected loan to the Chile Nitrate Producers Association and the Central Bank of Chile would not be advantageous to our national interest. In reply to Mr. Hoover's letter, the Secretary of State stated that the Department had information before it that the loan concerned itself only with ordinary current financing of nitrates, and as per Mr. Hoover's instructions on such financing, the Secretary of State requested Mr. Hoover's position on the loan in view of the new information provided.\textsuperscript{114} While the Department of Commerce conceded that the possibility of using this loan for valorization purposes\textsuperscript{115} was somewhat remote, they reluctantly backed down on the issue. In some instances, borrowing entities avoided the Commerce Department's monopoly-commodity-loan policy by borrowing for other purposes. A loan to the Brazilian state of Minas Geraes for refunding purposes accomplished virtually nothing since it had recourse to Great Britain for coffee valorization loans.\textsuperscript{116} A notation accompanying the

\begin{itemize}
\item \textsuperscript{113} \textit{New York Times}, December 19, 1925, p. 37.
\item \textsuperscript{114} U.S. State Department, Decimal Files, 825.51/237, October 22, 1926.
\item \textsuperscript{115} See Chapter II, page 45 for note on valorization.
\item \textsuperscript{116} U.S. State Department, Decimal Files, 832.51/M66/9, January 28, 1927.
\end{itemize}
above memorandum notes, "Mr. Hoover is evidently not pushing to extreme
his policy on coffee valorization."

A virtual collapse of Commerce policy on commodity valorization
appeared to have taken place in the instance of a loan to the Rio de
Janeiro's Agricultural Institute. In this case the State Department
raised criticism of the Commerce Department's objection to this loan, by
stating that the State of Rio had scarcely ten per cent of the production
of coffee of all Brazil, and since there was no authorization for the
purchase of coffee, it would seem questionable to place objection to
this loan. 117

With the gradual decline of the Commerce Department's control
over commodity valorization policy, the part that the Department played
in the supervision of loans was reduced to the minor role of reviewing
with the Department of State financial aspects related to broad political
and diplomatic implications. Indirectly, of course, information was
expanded on investment opportunities abroad. Unfortunately, this
information came too late to be of any practical use in preventing the
financial debacle which followed.

Commerce relations with underwriters, as well as other business
interests, were a matter of first importance to the Department during
the decade. The Harding Administration had been ushered into office as
a businessman's administration. Mr. Hoover was a zealous advocate of a
cooperative relationship with business interests. Indeed, under his
administration, he appointed business-oriented individuals as his

117 U.S. States Department, Decimal Files, 832.51/466, February 4,
1927.
associates. Furthermore, he advocated and obtained business committees which advised the policy-making group in the Department on most major decisions. 118

Underwriting groups seeking business abroad received top priority for government assistance under the policy of the Harding Administration. Mr. Hoover addressed himself to this goal with great vigor. Information was expanded on investment opportunities abroad. The consular offices and commercial attaché offices abroad were expanded, and were specifically directed to uncover new investment opportunities. These reports were made available in part or in whole to interested business groups. Later, as bankers developed finders abroad, the commercial attachés assisted these finders in obtaining contracts and loans through the official contacts and operations of our Foreign Service. Indeed, the vigor of the cooperative relationship produced such success, that foreign interests after 1926, planned counter measures against our businessmen and their official "helpers." 119

Some disadvantages of this close relationship became all too apparent after a time. On more than one occasion, the Department embarrassed the State Department by its overzealousness in assisting private companies obtain business. 120 Another bad effect was that the mere closeness of the association meant that policy which should not

118 Herbert Clark Hoover, op. cit.
119 U.S. State Department, Decimal Files, 825.51/205, October 2, 1925, U.S. Ambassador to Chile to Secretary of State; also see Ralph A. Young, op. cit., p. 33.
120 U.S. State Department, Decimal Files, 835.51/268, August 12, 1928.
have been divulged to the public was, unfortunately, disclosed by business interests, and quite frequently found its way to foreign governments, leading to considerable embarrassment, particularly for the Department of State.  

A not unexpected difficulty arose when commercial attaches abroad rendered special services to individual underwriters. This caused certain charges of favoritism to be levied against the Department, which finally led the Department to require that commercial attaches avoid personal correspondence directly with underwriters.

When the quality of loans began to decline markedly, after 1927, another difficulty developed. The government was faced with the dilemma that it could do nothing to deal with this situation, not only because of its prior decision not to examine loans from the investment point of view, but more so from the fact that the departments dealing with loan policy were especially susceptible to any criticism of this supervision by bankers themselves, who were members of various policy advisory groups in the government. This criticism was intensified by congressional examination and protest of our conduct of foreign affairs, especially in the Caribbean countries. Presumably, this criticism influenced Mr. Coolidge's decision, and thus that of the State Department, not to press for closer supervision at the very time when the decline in the quality of loans called for a reconsideration of loan policy.

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121 U.S. State Department, Decimal Files, 821.00/500; 821.51/196, April 24, 1922.


Although the Department of Commerce cooperated to the fullest extent with underwriters seeking loans abroad, the bankers did not always reciprocate. Despite the two requests by President Harding, and one request by President Coolidge requesting bankers to notify the Department of State concerning pending loan negotiations, some underwriters did not honor the request. In a number of instances, bankers tended to be somewhat slow in reporting loan negotiations; in many cases firms waited until the contracts were about to be signed, before consulting the State Department. 124

Department of Commerce publications, unfortunately, had little effect in persuading underwriters not to float loans of lesser quality. In the case of Columbian and Bolivian issues after 1929, the influence was more significant. Yet, the influence was achieved by virtue of the publicity achieved by the reports which in turn affected the market for the issues, rather than by receiving the cooperation of the bankers in refusing to float the issues. Indeed, this conclusion is supported by direct testimony of bankers, who generally conceded that information presented by Commerce was useful to them in the preparation for loans, but rarely did any banker accept the implicit conclusions about the poor quality of certain loans. 125

One last aspect of Commerce relationship with underwriters needs to be indicated. Shortly after the Harding Administration began, it

124 U.S. State Department, Decimal Files, 832.51/289, October 28, 1921; 832.51/268, February 16, 1922.

125 Testimony of Mr. Stralem, Hallgarten and Co., in Johnson Committee Hearings, Part II, pp. 1119-1120; also see Part II, p. 745.
became apparent that some discrimination among firms applying for approval of loans was taking place. This was true at the State Department, and it was also true at the Commerce Department. Although the discrimination always took place on the basis of experience and establishment, nonetheless, it constituted a discrimination of sorts that was effective. When confidential information was available for disclosure only certain firms would receive the information. In a few cases, early in the Harding Administration, some discrimination resulted from previous connections which Mr. Hoover had with individuals who had been previously associated with him. Perhaps some of the lack of cooperation between the government and underwriters regarding the consultation requests on loan applications stems, at least in part, from the reaction to discrimination among bankers competing for loans.

The type of information available to investors by the Department of Commerce was not very well suited to the specific needs of investors. The broad industry and commodity studies were couched in broad generalizations and were designed primarily for commercial and industrial usage. While considerable financial information was turned out by the Department relating to budgetary, exchange, debt and other aspects of the financial conditions of foreign countries, again, in the main, only broad generalizations were made, if at all. Only in a few instances did the

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126 U.S. Department of Commerce, Office of International Trade, Letter from Boston District Office to Finance and Investment Division (June 25, 1925) and Commercial Attaché Weekly Report (June 17, 1925), Bogota, Columbia, to Director of Bureau of Foreign and Domestic Commerce.

127 U.S. State Department, Decimal Files, 835.51/268, August 12, 1921.
Department allow its analysis of the financial conditions of countries to be specific enough so that the average investor might come to a positive conclusion about his commitment.128

As Mr. Jones, chief of the Finance and Investment Division, stated in the Senate Finance Committee hearings relative to the type and availability of Commerce information to investors as to the applicability of such information in developing the exact financial position of the countries under examination:

I would like to claim that much for my division, Senator, but I really can not.

... I would say this much, we had a great deal of information which would be helpful in guiding the buyers of those bonds.129

However, as Mr. Jones noted, it was quite unusual for any government publication to be specific regarding the conclusions of a situation revolving about a foreign country. In the cases of Columbia finances and Bolivian finances, the Department did make its analysis somewhat more sharp. Mr. Jones stated:

It was rather an unusual thing for the Department of Commerce, or any Government agency, to issue such a statement. We tried to be prudent in what we said about the facts, but the facts were rather obvious, and it created quite a little stir in New York.130

128 Johnson Committee Hearings, Part II, pp. 723-866.
129 Ibid., p. 743.
Note: Samples of Department of Commerce publications are available for inspection in the above hearings, pp. 730-866.
130 Johnson Committee Hearings, Part II, p. 730.
Indeed, as indicated through the testimony of Mr. Jones, that while the Department of Commerce has authorization to disseminate facts concerning commercial and economic and financial conditions abroad, there is nothing in the law which authorizes the Department to exploit its judgment concerning loans.131

While Department of Commerce officials, ranging from Mr. Hoover to Mr. Corliss have attempted to stress the availability of Commerce reports to investors, the evidence from the Department of Commerce subscriber lists as submitted show upon analysis that of approximately 836 or more names listed, better than 90 per cent of these names were underwriting firms and their sales affiliates, professional buyers of bonds such as banking and insurance firms, research agencies for the analysis of bonds, and the like.132 It appears that many of the non-professional investor names on the list to receive Commerce reports were investors apparently connected with large firms in the large cities, and can be presumed to be more substantial, if not more enlightened investors. Perhaps it was as Mr. Jones stated in the Hearings, "I do not know that we advertised our service very much. We may have kept our light under a bushel."133

Commerce treatment of investor inquiry by letter seeking information leading to the investment merits of certain loans, fared somewhat the same as did investor inquiry with the Department of State. Generally, the Department would make it clear to the inquirer that it "was not

131 Ibid., p. 847. 132 Ibid., p. 837. 133 Ibid., p. 745.
within the province of any Department to pass judgment on the value of securities." In some cases, the investor would be referred to a recent financial periodical or would be advised to consult the financial manuals. It is interesting to note that only in a limited number of cases would the investor be referred to Department of Commerce bulletins or other information, for which purpose these bulletins were being ostensibly prepared.\textsuperscript{134}

There were a few instances of discrimination among investors. In a few instances, investors who were well known to administration members apparently had more success in obtaining facts. It appears that large holders of bonds were given special treatment more frequently than small investors.\textsuperscript{135} In general, investors who wrote on the letterhead of the company they represented, received better treatment than did those who did not.

In conclusion, it would appear that the general presumption that Commerce aided investors greatly in obtaining the facts relating to their investment commitments is subject to some reevaluation. Since most of the Commerce reports and bulletins were of a general nature and were designed for and received largely by investment banking interests, financial, commercial and industrial usage, consequently their value to

\textsuperscript{134} U.S. Department of Commerce, Office of International Trade, Letter from Grosvenor M. Jones to (name deleted), Marysville, Washington, February 14, 1923.

\textsuperscript{135} U.S. Department of Commerce, Office of International Trade, (name deleted), American Steel Export Co., New York, to Mr. Hoover, 1926; also see 832.51/407, February 1, 1927 re: this request.
investors was very slight. Furthermore, since the Department did not aid investors appreciably, who corresponded about investment facts, it cannot be said that the Department was overly concerned about the status of the investor. Perhaps it can be said that investors were aided indirectly, to the extent that commerce reports on aspects of foreign obligations, and personal consultations regarding the analysis of the data, were obtained or made available to a few investment counselors who made this information, in turn, available through their financial manuals and other types of investor releases.136

Summary and conclusions

1. The Department of Commerce was partly responsible for the "Dollar bond disaster" of the 1930's, since Mr. Hoover and his associates were responsible, with others, for pushing this investment solution for the post-World War I problems to extremes with their intensive campaign and organization. The promotional aspects of U.S. foreign trade efforts were at least in part responsible for the ultimate decline in quality of issues and large-scale defaults.

2. The Department of Commerce also should share in the responsibility for the defaults since its approach to control over lending, while somewhat more positive than either the Department of State or the Treasury, was essentially one of laissez faire; that is, it was based on

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136 U.S. Department of Commerce, Balance of Payments Division, letter from Dr. Max Winkler of Moody's Investor Service to Mr. Grosvenor Jones, February 20, 1925.
concerning expropriation appear with the recrudescence of nationalism. Recent expropriations in Brazil are important examples.

Lastly, it should be stated that difficulties with the U.S. balance of payments and substantial deficits in the federal budget may bring about a significant alteration in the aid programs abroad. For some time, there has been increasing opposition in Congress to carte blanche programs. These opponents have suggested "trade, not aid" and if loans are required, they have suggested the regular institutions and the private markets for this purpose. The current Congress has demonstrated adequately this position.

If the above analysis is correct, and foreign-private-dollar-lending again becomes more important in the total picture, then there are some questions which will arise. Probably the most significant question is whether there may again be a repeat performance of the losses to American investors similar to that experienced in the 1930's? In seeking to answer this question, it may be well to remember that many of the publications bearing on this question were written during the period of the 1930's—a period of the great depression—which undoubtedly influenced some of the results of these investigations. Consequently, it may be timely and proper to again review some of the evidence of this period of lending and subsequent default.

Furthermore, additional data relative to this period of foreign-dollar lending is now available. It is now possible to assess the role

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12 See letter from Dr. Willy Feurelin, Department of Economic Affairs, United Nations, to writer dated February 19, 1951, in the Appendix of this dissertation.
voluntary executive influence with bankers rather than placing reliance upon direct controls.

3. The Department of Commerce also failed to see that its policy of close cooperation with private enterprise in promoting U.S. trade and loans abroad would prevent it from wielding effective executive control over underwriting offenders.

4. The Department of Commerce should also share in the responsibility for the defaults to the extent that it did not, or could not, make available to investors, more useful information to assist in making intelligent investment choices.

5. Lastly, it can be said that the Department of Commerce did not perceive quickly enough the great decline in the quality of issues and the inexplicable mania that subsequently developed, both here and abroad, although a large number of the Department's highly trained experts abroad were reporting changes in the quality on issues. One of the major reasons for this is the apparent difference in opinion existing at various departmental policy levels. Another reason was that Commerce felt blocked in its efforts to concern itself with the "investment merits" of loans at the Cabinet policy level.
CHAPTER IV

THE ROLE OF THE INVESTMENT BANKER IN THE FLOTATION AND
DEFAULT OF FOREIGN-DOLLAR BONDS

Introduction

On March 20, 1929, Sir George Paish, addressing the National Free Trade Conference in Manchester, England, made the gloomy prediction:

We are threatened with the greatest financial crisis the world has ever seen. The present policy of protection or safeguarding means the suicide of the world. Nothing can be done now to prevent a financial crash . . . I say with the highest authority, and I challenge anyone to deny it, that we are threatened with the greatest financial crisis the world has ever seen because the governments of the world have followed a policy of financial restriction, preventing debtors from paying their debts.1

Sir George unfortunately was quite correct in his prediction. In the several years following, the trade of the world began to shrink, until, by 1932, it was 74 per cent of the 1929 volume. In the process, international foreign investment also collapsed, and by 1933, not only did the flow of investment funds virtually cease, but a very large portion of non-equity investment was in default.2

Inevitably, in a collapse of this magnitude, legislatures begin to inquire as to the reasons for it, and the financial debacle of the twenties was no exception. On December 10, 1931, Senator Hiram Johnson


of California introduced a resolution in the Senate authorizing the Committee on Finance to "investigate the sale, flotation, and allocation by bankers, banking institutions, corporations, or individuals of foreign bonds or securities in the United States." The resolution was passed and hearings were held from December 18, 1931 to February 10, 1932. Later, a second hearing was undertaken by the Senate Committee on Banking and Currency. This committee's scope of investigation was much broader, being a general investigation of stock exchange practices; however, the original resolution was added to by two other resolutions, which were devoted to investigating investment banking practices. This hearing continued to the subsequent Congress and the Report of the Committee was finally released on June 6, 1934. The Senate Finance Committee Hearings were conducted by Senator Hiram Johnson and became known popularly as The Johnson Committee. The Senate Banking and Currency Committee Hearings were largely conducted by Mr. Ferdinand Pecora and it was similarly known as The Pecora Committee.

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3U.S. Congress, Hearings before the Committee on Banking and Currency, U.S. Senate, 72nd Cong., 1st Sess. on S. Res. 84, a resolution to thoroughly investigate practices of Stock Exchanges with respect to the buying and selling and the borrowing and lending of listed securities, the values of such securities and the effect of such practice, and S. Res. 56 and S. Res. 97 of the 73rd Cong., 1st Sess., resolutions to investigate the matter of banking operations and practices, transactions relating to any sale, exchange, purchase, acquisition, borrowing, lending, financing, issuing, distributing, or other disposition of, or dealing in securities or credit by any person, firm, partnership, company, association, corporation, or any other entity, with a view to recommending necessary legislation, under the taxing power or other federal process. Hearings under Senate Res. 84 began April 11 and concluded June 23, 1932. Hearings under S. Res. 56 and 97 of the 73rd Cong., 1st Sess., commenced in March, 1933, and ended with the Report of the Committee on June 6, 1934. These volumes, numbering 3 under S. Res. 84, 24 under S. Res. 56 and 97, are all entitled "Stock Exchange Practices." The Hearings under S. Res. 56 and 97 were conducted under the direction of Mr. Ferdinand Pecora, Counsel to the Committee, and associates. These will be referred to hereafter as The Pecora Committee Hearings.
In the process of the hearings, particularly the Pecora Committee Hearings, considerable antagonism was created. The Report of this Committee was quite vitriolic. It stated in part:

The record of the activity of investment bankers in the flotation of foreign securities is one of the most scandalous chapters in the history of American investment banking. The sale of these issues was characterized by practices and abuses which were violative of the most elementary principles of business ethics.5

Perhaps it was only natural that in the assessment of the hearings many of the scholarly works published were biased one way or another.6 It is thought that a reassessment now, with additional contributions, might help in the evaluation of the present problems of capital implementation of development.

The emergence of the U.S. foreign money market

The First World War created conditions in the major capital markets of the world which were very important to the development of the U.S. market.7 Prior to the war, U.S. investment banking facilities were small and largely related to the flotation of domestic obligations. The war, however, drastically changed this, and the number of firms and offices increased rapidly. With the shutting off of the major capital

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4Pecora Committee Report, Senate Report No. 1455, June 6, 1934.
5Ibid., p. 125.
6Compare for example, Madden, Nadler and Souvain, op. cit., Chap. XI with Max Winkler, op. cit., or Ferdinand Pecora, op. cit.
7This section is based primarily on J. T. Madden, and M. Nadler, The International Money Markets (New York: Prentice-Hall, Inc., 1935) and Ralph A. Young, op. cit., and George W. Edwards, op. cit.
markets during World War I, the United States had a temporary monopoly which allowed it to develop faster than it might have under more normal conditions. Fortunately for the United States, the Federal Reserve System was in operation and was able to help create the credit conditions necessary for the war effort, and it played an active role in helping to stimulate private foreign investments after the war, especially after 1921. Total deposits of all banks in the United States increased from about 35 billion dollars to nearly 58 billion dollars between 1921 and 1929. Interest rates were kept as low as practical through the influence of an appropriate central bank discount level. The huge importation of gold during the period, up to the middle of 1927, played its part, too. The United States gold stock increased by $1.450 billion to a total of $4.323 billion at the end of 1927. The adoption of a gold exchange standard by other countries allowed the United States to accept large short-term foreign balances, thus facilitating bank expansion; but, at the same time, making for a potentially dangerous situation later on.

This condition of active ease in the credit markets, underpinning the international capital market, was also influenced by the action of the United States Treasury's fiscal, budget, and debt management policies. The United States Treasury, after the big budget year of the war, attempted to reduce the budget, reduce taxes, and pay off the debt. Mr. Mellon, the Secretary of the Treasury, succeeded in reducing the debt by

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Governor Benjamin Strong of the New York Federal Reserve Bank played an active role in the encouragement of U.S. private foreign lending and especially foreign-dollar-bonds. He made many speeches and kept in close touch with both the foreign currency market and the U.S. long term capital market for international loans. See William Randolph Burgess, op. cit., Chap. XI, pp. 146-148; also compare with Herbert Feis, op. cit., p. 4.
nearly one billion dollars annually during the years of his office. This reduction of the debt was thought to have made some of the expansion into foreign securities possible as institutions and individuals had large sums annually for reinvestment purposes.

Institutional changes, likewise, helped to create a greatly expanded U.S. foreign capital market. With the Federal Reserve System came the development of an acceptance market. National banks were permitted to hold foreign acceptances as investments. A further contribution to the development of the money market came when National Bank members of the Federal Reserve System were permitted to own foreign banking corporations, thus facilitating foreign exchange transactions, procurement of foreign loans, and other activities.

The experience of American investors with the Liberty and Victory Bonds was an event that should hardly be overlooked. Institutional and non-institutional investors purchased some 21 billion dollars of these securities. The success in selling these issues was not wasted upon investment bankers, who were actively involved as individuals in the campaigns. The bankers were not unaware of the "educational" aspects associated with the success of the program. When the U.S. Treasury began retiring these obligations, after 1921, bondholders in many cases began to turn to other forms of investment, including that of foreign obligations. Yields were attractive, and the general attitude of many Americans of contributing to the stability of Europe and elsewhere was favorable.

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9See Chapter V of this dissertation for more complete development of this part of the story.
The political decision to promote U.S. private foreign investment

The decision to promote actively U.S. private foreign investment as the U.S. contribution to American and world recovery in 1921, after the Harding Administration came to power, is an involved and lengthy story. This constitutes much of Chapters II and III and will not be reiterated here, save to note that the role of the government was very active and deliberate.

Once the U.S. Government took an active role in the stimulation and development of private foreign investment, and particularly foreign-dollar-bond lending, the U.S. Government found that it was advisable to retain some measure of control over foreign-dollar-bond lending. The controls employed, however, were poor, and the discipline behind the control even worse. The U.S. Government found that a system of control based essentially upon a combination of voluntary compliance and moral suasion is next to impossible, especially when the group subject to discipline is largely members of the party which elected the administration. While it is true that there was no statutory power to control the situation, it is also to be noted that the administration not only did not desire legislation in this area, but attempted to preclude it, through the fiction of administrative action. It is thus felt that the administration should share in the responsibility for whatever abuse occurred during the period.  

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10 See Chapter II for a complete account of the role of the administration and the Department of State; Chapter III for the role of the Department of Commerce.
The role of investment bankers in post-World War I reconstruction and development

Bankers and others in the financial community were not indifferent to the potential solutions of the post-war reconstruction problem. Most of the bankers and other financial leaders suggested U.S. private long-term and short-term investment as a solution to the problems of post-World War I reconstruction. These views were translated to the President and the financial members of the Cabinet at several White House meetings. There is no doubt that these views received careful consideration in the policy decisions finally made by the administration to emphasize the role of private foreign investment. One factor, however, did perplex some of the bankers; this being the policy of increasing the tariff. Some of the bankers were exercised about this feature, others merely realized that this step virtually closed the door of adjustment in terms of accepting additional imports as a means of payment.

During the first several years of the 1920's, while currency conditions were disrupted and while the terms of funding the reparations were still being arranged, the money markets were somewhat disorganized. Availability of funds was somewhat low, partly because investors were quite cautious, and partly because bankers themselves were skeptical of lending conditions. Interest rates and yields in the first several

13 Ralph A. Young, op. cit., p. 31.
years were quite high, being 7.69 per cent for new foreign bonds in 1920. During this year, the differential between new foreign bonds and a weighted index of Standard Statistics sixty high grade domestic bonds was 1.8 per cent, the second highest for the period of the twenties.\textsuperscript{14}

Under these circumstances, bankers were quite deliberate in their contracts with foreign entities, placing escape clauses in them to protect themselves if the market conditions for selling the bonds took a turn for the worse.\textsuperscript{15} They also were quite anxious to develop the home markets for these bonds, and they were not unmindful of the experiences with the Liberty and Victory obligations. Consequently, bankers soon developed many techniques for creating and stimulating demand for these new foreign obligations. Elaborate brochures were prepared with pictures and descriptions to help salesmen with sales resistance. Bankers made speeches before civic groups to familiarize them with the need for foreign investment and particular issues.\textsuperscript{16}

Bankers soon recognized the value of articles which might appear in various media, usually just prior to the flotation of a new issue. Quite frequently, these articles were accompanied by statements or additional remarks by persons who held some position of prominence.

\textsuperscript{14}Ibid., p. 44.

\textsuperscript{15}See U.S. State Department, Decimal Files, 821.51/B27/6, August 19, 1923.

\textsuperscript{16}New York Times, April 6, 1921, p. 21.
frequently a person who had some connection or financial interest with the country whose obligations were being offered for sale.  

After the Dawes Loan was floated in 1924, confidence began to build in foreign issues. The profitability of underwriting issues began to attract new firms to the business and expand existing ones. A feature of the growth and development of underwriting facilities was the rapid expansion of the large Investment Affiliates of the New York banks. These affiliates developed during the decade prior to the war, but it was in the twenties that their real growth took place. The National City Company, the largest security distributor in the country, handled twenty billion dollars of securities in the ten years prior to the Senate Investigations.  

The number of offices of members of the Investment Bankers of America grew from 688 to 1902 at the end of 1929. These affiliates organized a distribution system which left virtually nothing untouched.

The National City Company had 69 branch offices in 58 cities and a total of about 1900 employees and 350 salesmen. In addition, it utilized about two hundred additional salesmen indirectly, who worked for other firms handling National City Company securities. This organization sold about two billion dollars of securities annually and was under the direction of Mr. Charles Mitchell, Chairman of the Board, and

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17 *New York Times*, February 16, 1921, p. 14; also *New York Times*, February 17, 1921, p. 21; also see the Reports of Chile American Association, New York City.

18 Ferdinand Pecora, *op. cit.*, p. 76.

19 George W. Edwards, *op. cit.*, p. 229; also see Chapter V, p. 11.
of the State Department and the Commerce Department in formulating and executing our national policy on foreign-dollar lending. A question relating to the role of governmental agencies is whether or not they deliberately fostered the lending of the period. A further question may be raised as to whether these governmental agencies attempted to protect the interest of U.S. bondholders.

Another phase of foreign lending of importance for reevaluation is the operations of the investment banker. To what extent was he responsible for the great number of defaults which followed in the 1930's? Was he guilty of contributing to these defaults by virtue of bad lending practice or was he merely swept up in the mania of this period, and thus was but a victim subject to severe and undue public abuse? Here too, new evidence is available on the subject.

What about the investor? Was he deliberately misled by false information about the securities he purchased or did he contribute to the debacle by his own greediness for capital gains and high rates of interest?

Finally, what can be learned about the period of the 1920's which is relevant to the present period of reviving portfolio foreign investment? Will the new institutions and laws prevent a recurrence of the defaults of the '30's? What, if anything, can be done to prevent even a modest recurrence of defaults? The analysis concerning these questions will begin with the role and operations of government agencies in the next few chapters.13

13The author had the opportunity of reviewing Department of Commerce and Department of State records relating primarily to the
Mr. Hugh Baker, President of the company. Mr. Mitchell, in discussing the growth and development of the National City Company and of its principle interest—securities—stated in part:

Where they are created is in the production end... An analogy is the manufacturing concern. We have a certain portion of our organization... devoting itself to the manufacture of long-term credits...

When Senator Couzens of Michigan suggested that the use of the word "manufacture," in connection with securities, was unfortunate, Mr. Mitchell stated: "It may be in your mind, Senator Couzens, at the same time, that has an analogy that I do not consider amiss."

Perhaps it was "manufacturing." According to Mr. Otto Kahn, of Kuhn, Loeb and Company, the volume of sales of securities during the late twenties was about six times the normal amount experienced before the war. Possibly the extensive rationization of the securities business by the security affiliates was partly responsible. The National City Company handled all aspects of the securities business from the negotiations of loans to the actual selling to permanent buyers.

Incentive systems were carefully employed by Mr. Baker to spur on sales. Contests were conducted between various divisions in the

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20 Testimony of Mr. Hugh Baker of The National City Co., Pecora Committee Hearings, Part VI, p. 2006; and Ferdinand Pecora, op. cit., pp. 70-74.


22 Ibid.

23 Testimony of Mr. Otto Kahn, Kuhn, Loeb and Co., Johnson Committee Hearings, Part II, pp. 397-398.
organization to "inject new life into the organization." These contests allowed "extra points" for selling "difficult" or "sticky" obligations. The merchandise had to be moved to obtain the proper amount of turnover. The prospects for this army of salesmen were in many cases turned out by the home office. In 1928, the home office sent out 122,332 prospects. Many of the prospects were people who had answered one of the bank's many advertisements. Surprisingly, many of the prospects turned out to be customers of The National City Bank.

Salesmen were not the only participants of the incentive system. All the officers of the National City Company shared in a percentage of the net profits of the company. After subtracting 8 per cent of the net profit, 20 per cent of the remainder was set aside for the "management fund." Out of this "management fund," Mr. Mitchell himself received 527,000 dollars in 1927, 750,000 dollars in 1928, and 500,000 dollars in 1929. Other officers shared spectacularly, if not equally, with Mr. Mitchell. It is just possible that there is a marked correlation between the high incentive system of the National City Company and the large degree of risk this institution was willing to undertake to procure and sell its merchandise. Perhaps the statement of Professor William Z. Ripley on the witness stand is of some merit here:

Mr. Mitchell thought he had to use the same methods in selling investments that you do in selling carpets....

24 Testimony of Mr. Hugh Baker, National City Co., Pecora Committee Hearings, Part VI, pp. 2010-2026.
25 Ibid., pp. 2010-2026.
26 Testimony of Mr. Charles Mitchell, Chairman of the Board, The National City Company, in Pecora Committee Hearings, Part VI, pp. 1780-1788.
The entire organization of great sales companies affiliated with the great banks ought to be abolished by law. Banking is one thing and investment is another.27

The great contrast between the practice of the old English type of banking house and that of the huge security affiliate is worth explaining. This difference came, in part, in the manner in which the investment banker obtained his business. The old fashioned English way was described by Mr. Kahn as:

The competition which exists is in my opinion a competition of service and of performance. The competition of attracting clients. Not by chasing after business. Not by trying to get another fellow out of business who is doing business legitimately and well, but by proving to the client that he would do better by coming to me.28

But, as Mr. Kahn went on to state, business ethics among bankers had changed. Bankers now chased after loans and competed actively for clients:

The kind of competition which we had between 1926 and 1928, when, to my own knowledge 15 American bankers sat in Belgrade, Yugoslavia, making bids—one out-bidding the other foolishly, recklessly, to the detriment of the public, compelling him to force bonds upon the public at a price which is not determined by the value of that security so much as by his eagerness to get it—and the banker who has been triumphant in getting that issue will very soon find himself regretful that he did get it. And—he will be under the compulsion for his own solvency, to try to get rid of it.29

With the increase of competition, especially after 1925, came a not unexpected feature, namely, the decline in the quality of the issues

28 Testimony of Mr. Otto Kahn, Kuhn, Loeb and Co., in Pecora Committee Hearings, Part III, p. 964.
29 Testimony of Mr. Otto Kahn, Kuhn, Loeb and Co., in Pecora Committee Hearings, Part III, pp. 964-965.
floated. Throughout both the Pecora and Johnson Committee Hearings, there is ample testimony on this point. Dr. Ilse Mints, in 1951, wrote a monograph sponsored by the National Bureau of Economic Research on *Deterioration in the Quality of Foreign Bonds Issued in the United States 1920-1930*. Among other things, Dr. Mints constructed a default index to measure the change in the quality of issues over the period of the twenties. Some reference to this work will be made although the emphasis of this study will be to provide institutional data to explain how and why these changes took place.

After the Dawes Loan of 1924, the market for foreign borrowing became much more secure. The events of improved currency conditions, a restored Germany, the peace pacts—all of these and many other factors, tended to produce great confidence among bankers and bondholders, that the world was headed, in the words of the late Warren Harding, for "normalcy." During this year, a total of 120 issues worth $1.217 billion of nominal foreign capital issues were floated in the United States market. In 1923, only 76 issues were floated for an insignificant $498 million. After this time, syndicate operations

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31 The term "nominal foreign capital issues" refers to the gross flotation of foreign capital issues, mostly foreign-dollar bonds, in the United States, measured by par value of obligation without subtracting those issues which were for refunding purposes, or subtracting for estimated purchases of these securities by foreigners, etc.; see Ralph A. Young, *op. cit.*, p. 6.

32 Ralph A. Young, *op. cit.*, p. 12; also see same author, pp. 32-39, for significant factors relating to the increase.
became quite profitable, and, not only did existing investment banking facilities increase, but a rash of new, small firms appeared upon the scene to enjoy the feast. Mr. Corliss, Assistant Chief of the Finance and Investment Division of the Department of Commerce, stated that at one time there were 29 representatives in Columbia alone. 33 Not only was competition keen, but in many cases bankers virtually threw themselves at borrowers. Mr. Grosvenor Jones, in his testimony on this point, stated:

One great trouble during this period was that so many banking houses of so little experience in international finance stepped into the picture in an attempt to bring out loans. 34

It should be noted, however, that not all of the investment banking firms indulged in rigorous competition for loans. The firms of J. P. Morgan, and Kuhn, Loeb and Company were among the large firms whose records were relatively unblemished. 35 Indeed, it should be further noted that both Kuhn, Loeb and Morgan actually reduced their loans during the last five years of the decade. 36 In contrast to this experience, the National City Company greatly expanded its loans during the last five years of the decade. 37

33 Testimony of Mr. J. C. Corliss, Finance and Investment Division, Department of Commerce, in Johnson Committee Hearings, Part II, p. 845.
34 Testimony of Mr. Grosvenor M. Jones, Chief, Finance and Investment Division, Department of Commerce, in Johnson Committee Hearings, Part II, p. 848.
35 Ibid., p. 742.
36 Ilse Mintz, op. cit., p. 57.
37 Ferdinand Pecora, op. cit., p. 104.
After 1925, when convertibility was reestablished in England, the English embargo on loans by English bankers was removed, and the British became more active in the loan market, particularly in Latin America, one of their traditional areas of lending.\textsuperscript{38}

As soon as the English returned as effective competitors, Latin Americans began to play one group against another. This was particularly true in Colombia and Brazil, and to a lesser extent in other countries in Latin America. One effect of such competition was for a lessening of contractual restrictions in the loan. The successful bidder quite frequently gave up contractual provisions, as well as price and coupon rates. Invariably, this made for a poorer lien, and the bondholder was, by far, the loser.\textsuperscript{39}

Mr. Thomas W. Lamont, in 1927, must have sensed this when he stated in part:

It is a tempting thing for ... Governments to find a horde of American bankers sitting on their doorstep offering them money. It is rather demoralizing ... to have money pressed upon them. That sort of competition tends to insecurity and unsound practice.\textsuperscript{40}

One of the manifestations of the increased competition for loans in the period 1926-1929 was the increased use of finders fees. Although it is true that bankers frequently paid "finders fees"\textsuperscript{41} for loans

\textsuperscript{38}Ralph A. Young, \textit{op. cit.}, p. 33.

\textsuperscript{39}See Finance and Investment Division, Letter to Bogota, Colombia, Commercial Attache, June 21, 1928, from Mr. Jones, Chief.

\textsuperscript{40}Testimony of Mr. Thomas W. Lamont, partner of J. P. Morgan and Co., in \textit{Johnson Committee Hearings}, Part I, p. 25.

\textsuperscript{41}Note: The term "finder" is an individual, partnership, or corporation engaged in the business of locating business and making this information, option or contract, available to other businesses who are in a position to use this information, or who wish to undertake
prior to the period of the twenties, in the period 1926-1929, they
came almost a conventional feature of loans. What is more important,
they frequently became excessive in amount. On numerous occasions, the
payment to individuals associated with governmental units constituted
illegal enrichment. While it cannot be said that many bankers deliber-
ately resorted to bribery to obtain loans, a large number made payment
for services that were questionable, and others accepted a commitment in
underwriting securities knowing that unusual fees for procuring the loan
had been made, but accepting this responsibility as the cost and risk of
remaining successful in business.

While some burden of responsibility for indiscriminate lending
may apply to those bankers using "finders" as described above, it would
be amiss to overlook bankers who shunned the "undignified" business of
negotiating loans. A number of firms who did not choose to participate
in the "scramble for loans," nevertheless, chose to participate in the
distribution thereof. It would be hard to excuse these firms from some
portion of responsibility, in as much as they implicitly sanctioned the

the contract. Bankers, who did not have their own representatives
abroad in foreign countries, frequently engaged private individuals;
usually local lawyers or bankers for this purpose. These individuals
usually received a fee ranging from 1/8 per cent to 1/2 per cent of the
gross contract value. The author wants to make it clear that, in the above
analysis of "finders," he is not criticizing the function of the finder,
per se, but merely the use or abuse made in individual cases, including
some excessive fees that were paid.

Testimony of Mr. Henry C. Breck, of J. & W. Seligman, in Johnson
Committee Hearings, Part III, pp. 1279-1305.

Testimony of Mr. Frederick J. Lisman, of Lisman and Company, in
Johnson Committee Hearings, Part III, pp. 1770-1775.

Testimony of Mr. Henry C. Breck, of J. & W. Seligman, in Johnson
Committee Hearings, Part III, pp. 1279-1305.
poor practices by their participation in the distribution of the securities.\textsuperscript{45} One problem did exist, however, in this regard. A good many small, purely distributing firms, particularly in the midwest, were not advised with respect to the details, good or bad, concerning loan negotiations. These firms relied primarily on the statements and judgments of the originating house.\textsuperscript{46} Even if they did have some qualms about a particular issue, it is doubtful that they would want to lose their place in the selling syndicate list, in order to protest.

In this connection, a few comments are important concerning the impact of the rationalization of the securities business, especially under the mechanism of the security affiliate of the big "city" banks. The centralization of authority for the granting of loans in a few hands made, it would appear, for great danger that should the quality of that lending decline, large batches of securities would be sold throughout the country without much in the way of recourse. When one examines the record of such a company, the largest investment banking organization in the country, the National City Company, this conclusion is quite inescapable.\textsuperscript{47}

\textsuperscript{45} Memorandum by Mr. Oliver Townsend, former U.S. Commercial Attache at Lima, Peru, February 10, 1927, sent to the U.S. Ambassador to Peru, printed in \textit{Johnson Committee Hearings}, Part III, pp. 1611-1613.

\textsuperscript{46} Testimony of Mr. C. P. Anderson, Jr., Chase, Harris, Forbes Corporation, in \textit{Johnson Committee Hearings}, Part II, pp. 527.

\textsuperscript{47} See testimony of Charles E. Mitchell, Chairman, National City Bank in \textit{Johnson Committee Hearings}, Part II, pp. 64-114; Mr. Victor Schoepperle, Vice President, National City Co., in \textit{Johnson Committee Hearings}, Part III, pp. 1623-1681; Mr. Hugh Baker, President, National City Co., in \textit{Pecora Committee Hearings}, Part VI, pp. 1889-2088; Mr. George F. Train, Foreign Department, National City Co., in \textit{Pecora Committee Hearings}, Part VI, pp. 2139-2151; Mr. Ronald M. Byrnes, formerly Vice President, National City Co., in \textit{Pecora Committee Hearings}, Part VI, pp. 2139-2138, and pp. 2298-2323.
It is quite apparent from the congressional hearings record that the risks undertaken by the National City Company with respect to the quality of the loans were quite unusual. The decision was made to make a loan to the Peruvian Government despite the fact that the National City Company had knowledge concerning the "finders fee" to the President's son, of some $415,000. The National City Company also had knowledge of facts making the loan to the Province of Minas Geraes, Brazil, in 1929, a very risky one, and yet they elected to undertake the loan. Although company records show that there was active objection by a number of officials within the company, Mr. Baker and Mr. Byrnes decided to override these objections, under the thesis that these risks being undertaken were no greater than other risks previously undertaken. Care was taken, however, that a good "educational" program was designed to sell the bonds, and that proper incentives for salesmanship existed, as these bonds received additional points under the National City Company contest system. Perhaps they were more aware of the contribution that this issue might make to the National City Company's management fund than they were about the fact that in the prospectus for the Minas Geraes loan, the statement "Prudent and careful management of the State's finances has been characteristic of successful administrations in Minas Geraes" was pretty much at odds with the National City Company's own correspondence which states that "the laxness of the State authority borders on the fantastic."48 Of course, one of the fears of banking

48 Testimony of Mr. Victor Schoepperle, Mr. George Train, and Mr. Ronald Byrnes of the National City Company, in Pecora Committee Hearings, Part VI, pp. 2088-2170.
houses was, that if their particular house turned down a loan, then several others were ready, willing, and able to consummate the deal.

Dr. Ilse Mintz, in a study on the quality of these issues, found some rather interesting facts which substantiate this thesis. Her study of the eleven investment bankers who submitted records to the Senate Finance Committee confirms the specific conclusion that there was a general quality decline in flotations during the period following 1925. When the firms are arrayed by order of their default index of their loans, from lowest to highest, two firms, who originated about two billion dollars of securities, had a default index of about 14 per cent; the next group of three firms had an index of more than 33 per cent on some $1.5 billion of securities, while the remaining six firms, with approximately $1.5 billion of securities, had an index of default of almost 90 per cent. Bankers who had originated about 40 per cent of the loans had 13 per cent of the defaults, as compared with bankers who originated 29 per cent of the loans who had 59 per cent of the defaults.

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Note: Dr. Mintz created an index of default of the foreign government loans originated by eleven bankers who submitted records to the Johnson Committee Hearings. These loans amounted to about $5 billion and were about 90 per cent of the total issues floated for the period 1920-1930. The default index is the ratio of defaulted loans to all loans issued. The definition of default is those loans in default on or before December 31, 1937. Loans that were partially paid, or full paid, by borrowers were considered in default if the borrower defaulted on any other issue by the December 31, 1937 date. Loans that were partly or fully repaid by borrowers who did not default on any of their debts in the 1930's were counted as sound, and not in default. By counting loans of the early 1920's as unsound, and in default, if a subsequent loan went into default, imparts a declining bias to the trend of the default index, which makes the result of the study, a rising index trend for the period, a more confident result. See Mintz, op. cit., pp. 32-37.
foreign-dollar lending to Latin American countries. He examined Ambassadoral Reports, Consular Reports, Departmental letters, Interdepartmental Reports, and letters and memos concerning the policy of the U.S. government during this period. This information relating to diplomatic data and other materials is used to present the formulation and development of the policy of the State and Commerce Departments relating to foreign-dollar loans. In the chapters dealing with investors' experiences and the role of the investment banker, the author has relied upon materials from the two departments, additional unpublished data from the congressional committees obtained at the time of the hearings during the 1930's, interviews with underwriters, discussions with salesmen, and unpublished letters from investors to Congressional hearings.
Dr. Mintz concludes:

Evidently the factors determining the quality of credit were not of uniform importance for all bankers. Some issuing houses must have been almost immune to the forces which caused the deterioration of credit.50

In another place, Dr. Mintz notes that since the investment bankers with the poorest default index concentrated their loans in the period 1925-1930, rather than the first period, 1920-1924, this would seem to indicate that the poor record of the 1925-1930 period was a function of time rather than bad lending characteristics. While the total default index for all bankers did rise from 17 per cent in the 1920-1924 period to 41 per cent in the 1925-1930 period, reflecting a general deterioration in the quality of lending, this fact should not be interpreted to mean that the increase in the default index was entirely due to the timing of loans. In each period, 1920-1924 and 1925-1930, there were banking houses with "good" and "bad" results. Furthermore, the first five bankers with the lowest index of default in the 1920-1924 period were still the best bankers in the 1925-1930 period.51

Dr. Mintz concludes that "from the viewpoint of the role of the individual issuing houses the rise of the total default index may be regarded as the resultant of two processes." The first is a decline in the quality of loans extended by individual banking houses. This alone accounts for an increase in the default index from 17 to 41 per cent. The second factor is that a greater proportion of loans were originated

50Ilse Mintz, op. cit., p. 56.
51Ibid., pp. 56-58.
by less careful or less competent houses. The remaining question to be answered is what induced bankers to accept more risky loans?

The relationship of the banker to the government

It has been noted in Chapter II and Chapter III that the United States Government developed its foreign loan policy and requested bankers to consult it on a voluntary basis. Since the development of that policy is covered completely in these chapters, no attempt will be made here to duplicate the effort. However, it does seem important to briefly discuss this relationship of the government and the bankers.

The Department of Commerce, throughout the years of its existence, attempted, among other things, to promote the economic welfare of U.S. citizens in their desire to sell goods and services abroad. The zeal of the Hoover Administration, in this regard, scarcely left anything undone. The use of Commercial Attaches and other facilities in this regard has been discussed. If anything is to be said, the Department of Commerce frequently assisted bankers obtain loan contracts in a manner which was beyond normal rules of conduct.

While the Department of State was, by its very nature, a more secretive branch of the government, it, too, acted occasionally beyond the bounds of good propriety in matters of statescraft to serve the interests of the business community. As Mr. Lancaster, one of the attorneys for the National City Bank, stated, "The Department of State

52 Ibid., p. 58.
53 See Chapter III of this dissertation.
felt that they were acting, among other things, as a commercial agent for the American people. . . . "

The question to be answered here, however, is how did the bankers respond to the voluntary request for notification and consultation by the Department of State and its colleagues? During the first year of the Harding Administration, bankers consulted sporadically. Most of the larger, more responsible firms complied, while many smaller firms evaded the issue. Even after the March 3, 1922, restatement of the request by President Harding, we find that there were numerous evasions of the President's request. Even more important than this, was the violation of the spirit of the request—that the notification and consultation be in good time. On a number of occasions bankers waited until virtually the conclusions of the negotiations before notifying the State Department. One large firm, in particular, was notoriously bad in this regard; on several occasions they notified the Department after the contract was signed.

Other acts of non-cooperation in connection with State Department policy on loans were even more serious. It appears that some bankers aided foreign governments to avoid the application of policy. These instances occurred with respect to U.S. policies against loans to foreign monopolies, and U.S. policy against loans for armaments.

The Department of Commerce attempted to provide interested parties with economic information about trade prospects abroad. Quite frequently these reports would contain warnings which would apply to business

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54 Testimony of Mr. Lancaster, Member of the firm of Shearman and Sterling, Consul, National City Bank, in *Johnson Committee Hearings*, Part III, p. 1688.
interests, including bankers, about conducting business with a particular country. Bankers learned to utilize the Department of Commerce for the data available—which bankers used in their prospectuses and other informational brochures. It is very interesting to note that, despite their utilization of such materials, bankers, by their own admission, did not heed the warnings of the Department of Commerce. According to one report of a banker reaction, it was stated that the warning of the Department of Commerce was noted, but it did not make any difference. Apparently, marketability was more significant than investment status. Moreover, on several occasions, the Department was requested to alter material which was not favorable to the sale of particular loans.

A similar situation existed with respect to the warnings issued by the Department of State and the reparations transfer agent for German reparations. In 1925, the State Department became exercised that the whole of German reparations might be placed in jeopardy through the rash of American lending to German cities and states. It was feared by the U.S. State Department that there might be "complications" in connection with interest and amortization charges on private-dollar loans from the United States. The Secretary of State took it upon himself to address letters to those American bankers contemplating further German loans, calling attention especially to Article 248 of the Treaty of Versailles.

55 Testimony of Mr. Grosvenor Jones, Chief, Finance and Investment Division, Department of Commerce, in Johnson Committee Hearings, Part II, P. 745.

56 Testimony of Mr. Grosvenor Jones, Chief, Finance and Investment Division, Department of Commerce, in Johnson Committee Hearings, Part II, p. 848.
under which a first charge upon all assets and revenues of the German Empire and its constituent states was created in favor of reparations. In the Johnson Committee Hearings, Mr. Swan of the Guaranty Company stated, "I do not think that those warnings applied to the loans we made." In general, the bankers took a position against the interpretation of the Treaty which was held by the Department of State and the Government of the United States. Thus, it may be said that bankers paid lip service and nominal compliance to the voluntary request of the government; whenever it was expedient in terms of profitability, they twisted government policy to whatever dimensions necessary to obtain their ends.

A reassessment of the role of the banker: some conclusions

It is very difficult for anyone to assess an area of business conduct as technically involved, and containing all sorts of judgments, as does this portion of the business conduct of investment bankers. To begin with, very seldom did the public have a front window seat at the exposition of the practices of the bankers. Investment banking practices have always been ultra-secret, except to those involved, and the public has been led to believe that these were distinctly above that of average business operation. To learn otherwise was a shock to the American public. In the confusion that followed, many unfortunate things were said by Congressmen and those concerned with the hearings. A look at

57 Letter of the Secretary of State to the Guaranty Co., in Johnson Committee Hearings, Part II, p. 880.

the scholarly works of the period indicates that some are inclined to
defend the bankers and others to attack them. To judge their business
conduct now in light of generally improved business conduct and new
statutory laws encompassing that conduct would not be justifiable.
Thus, it has been difficult to get a proper framework for this process
of assessment.

Several general comments about the practices of the investment
banker during this period are important. First of all, it must be noted
that the banker was not alone in the decision making and responsibility
for the debacle that occurred. The U.S. Government was an important
party to the event, as were the bondholders—a subject discussed in
Chapter V. Second, it should be recalled that the reconstruction prob­
lems of the world were also America's problems. Foreign countries were
involved but American capital was, for a long time, the only capital
available. Third, some account should be taken of the aura of unreality
emerging from the New Era Doctrine which swept nearly everyone up;
bankers, investors, government officials, and foreigners alike.

There is, however, a core of responsibility which was vested in
the banker in his dual relationship to borrower and bondholder that
involves specific and adverse evaluations. These are enumerated below. 59

1. Bankers did occasionally fail to check adequately materials
furnished by foreign governments. Some bankers, also, may have

59 These criticisms in the following enumeration are contained in
the "Report" of the Pecora Committee Hearings. Senate Report No. 1455,
p. 125.
"doctored" the material by seeking to expose only the better data, leaving out poorer data.

2. Bankers frequently, after 1926, did overlook bad debt records and moral risks, although they did so under extreme competitive conditions, when, frequently, borrowers were "playing off" one banker against another. Any banker who had the opportunity of refusing a loan of this type merely gave it up to several others who were quite willing to float the issue.

3. There were a number of instances when bankers did make loans to countries, suffering from political disturbances of one kind or the other; but, this is quite frequently the story of reconstruction, and, too, it was the political doctrine of the time that "dollars would heal."

4. The bankers did, in some cases, fail to examine, or only perfunctorily, economic conditions in foreign countries. Actually, many bankers devoted far more analysis to the determination of the market-ability of the issue and less to the mounting debts requiring service and foreign exchange. Indeed, the evidence shows that bankers actually were expanding their loan flotations at the very time the risk was increasing.

5. Many bankers, especially after 1926, when competitive conditions were more severe, became less exacting with respect to contractual conditions, including the proposed use of the proceeds. There were numerous diversions, and in many cases, the purposes were not particularly related to the eventual expansion of foreign exchange required for service and amortization.
6. Bankers have been accused in the Report of the Pecora Committee Hearings of failing to ascertain whether the loan proceeds were applied toward the specified purposes in the contract. It has been indicated in (5) above that there were diversions, and in some cases these diversions were implicitly, if not explicitly, with the sanction of certain banking firms. However, it should be noted that when contractual dealings are with a sovereign power, reliance has to be primarily upon the goodwill and desire to pay of the country, rather than on the imposition of supervisory conditions.

7. The Report also notes that bankers failed to check whether revenues, pledged for the service of loans, were collected and properly deposited in accordance with the agreements. There were a number of cases where evidence can be submitted on this matter. Despite the fact that the banker presumably has a sort of fiduciary relationship to the bondholder on matters of this kind, these are more properly matters for the trustee, who can, and should, review all details of the contract and its compliance. Perhaps the investment banker, who originated the loan, should, and may, be able to influence foreign governments when they are tempted to avoid compliance with the contract. It should again be recalled that these borrowers were sovereign powers and were under a compulsion of their credit standing to live up to their contractual conditions. The best remedial action the banker might take here is the precaution in the first instance not to lend to those governments who fail to honor their contracts.
CHAPTER V

THE ROLE OF THE PRIVATE INVESTOR IN THE FLOTATION AND DEFAULTS OF FOREIGN-DOLLAR BONDS

The pre-war experience of U.S. investors

Professor Edwin Kemmerer, when on the witness stand of the Johnson Committee, January 12, 1932, testifying as an expert with respect to the foreign-dollar-bond flotations, stated the following cynical words:

I do not see much prospect of heavy flotation of foreign bonds in the U.S., but I am reminded . . . that history teaches only one lesson, namely, that we learn nothing from history, and I suppose in the course of a short time we will go ahead again and repeat the same mistakes.¹

Dr. Kemmerer's remarks were not the words of someone given to making flippant statements. Indeed, similar remarks have been made by several other witnesses in the Johnson Committee and the Pecora Committee Hearings, as well as by observers to these events. Of course, Professor Kemmerer was referring to our ability to apply the lessons of the defaults of the '30's intelligently. Seemingly, this remark when applied to the capacity and interest of investors to discern between worthwhile and not-so-worthwhile securities, rates them quite low. However, the issue to be examined here—in terms of the above statement—is the general characteristics of the investor during the period; such things

¹Testimony of Professor Edwin Kemmerer, Johnson Committee Hearings, Part III, p. 1703.
as the factors influencing the investor, the sources of information available and utilized in making investment decisions, and his reactions to the defaults. Perhaps then we can judge whether the Kemmerer statement will apply in the post-World War II period.

According to the best information available, investor interest and holdings of foreign-dollar bonds were quite limited in the period prior to World War I. From 1900 to 1913, 247 foreign issues aggregating $1.087 billion were offered in the U.S. Market, with the greatest portion of this amount taken in the first six years. By comparison, the foreign issues purchased in 1916 exceeded that of the 1900 to 1913 period by more than $500 million. Furthermore, if the period 1900-1929 is divided into two equal periods, 1900-1914 and 1915-1929, in the first period there were 273 foreign-dollar issues worth $1.132 billion in par value terms sold, as compared with 1,936 issues in the latter period worth $13.742 billion.

During the period 1900-1914, the U.S. may be characterized as a mature debtor, being indebted to foreigners by approximately $3 billion on net private long-term account at the end of the period. Although

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3 Ibid., p. 12.

4 Ibid.

CHAPTER II

THE ROLE OF THE STATE DEPARTMENT IN FOREIGN-DOLLAR BOND-POLICY

Historical interest of the Department in foreign loans

The nature and content of the United States State Department policy with respect to foreign-dollar-bond flotation during the period of the 1920's was conditioned particularly by the approach taken by the Taft and Wilson administrations. President Taft, more than any other president, carried out the commercial policies instituted by Alexander Hamilton. Diplomacy during his administration was largely "commercial" accompanied by "idealistic humanitarian sentiments." His administration, more than any other, sought to integrate tariff policy and foreign loan policy with trade policy. The State Department was reorganized by regional divisions and foreign trade advisers were added to better develop "American interests in every quarter of the globe."  

President Taft also sought to achieve a unity of purpose in expanding dollar diplomacy through legislative and executive branch cooperation. He stressed the importance of a merchant marine, a system of American foreign branch banks, and a revised foreign service which

### Table 1

**TOTAL FOREIGN CAPITAL ISSUES, GOVERNMENTAL AND PRIVATE, PUBLICLY OFFERED IN THE UNITED STATES, 1900 TO 1930**

(in millions of dollars)

<table>
<thead>
<tr>
<th>Year of Issue</th>
<th>No. of Issues</th>
<th>Nominal Capital</th>
<th>Year of Issue</th>
<th>No. of Issues</th>
<th>Nominal Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>1900-13</td>
<td></td>
<td></td>
<td>1921</td>
<td>116</td>
<td>692</td>
</tr>
<tr>
<td>annual average</td>
<td>18</td>
<td>78</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1900-13 total</td>
<td>247</td>
<td>1,087</td>
<td>1922</td>
<td>152</td>
<td>863</td>
</tr>
<tr>
<td>1914</td>
<td>26</td>
<td>45</td>
<td>1923</td>
<td>76</td>
<td>498</td>
</tr>
<tr>
<td>1915</td>
<td>80</td>
<td>818</td>
<td>1924</td>
<td>120</td>
<td>1,217</td>
</tr>
<tr>
<td>1916</td>
<td>102</td>
<td>1,160</td>
<td>1925</td>
<td>164</td>
<td>1,316</td>
</tr>
<tr>
<td>1917</td>
<td>65</td>
<td>720</td>
<td>1926</td>
<td>230</td>
<td>1,288</td>
</tr>
<tr>
<td>1918</td>
<td>28</td>
<td>23</td>
<td>1927</td>
<td>265</td>
<td>1,577</td>
</tr>
<tr>
<td>1919</td>
<td>65</td>
<td>771</td>
<td>1928</td>
<td>221</td>
<td>1,489</td>
</tr>
<tr>
<td>1920</td>
<td>104</td>
<td>603</td>
<td>1929</td>
<td>148</td>
<td>706</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>1930</td>
<td>122</td>
<td>1,088</td>
</tr>
</tbody>
</table>

*Table 1 is taken largely from the Handbook published by the Department of Commerce and authored by Dr. Ralph A. Young. It was started as a rough compilation and intended for use by the Department as an indicator of the trend of U.S. capital movement abroad. While it contains most of the foreign-dollar bonds publicly offered in the U.S. for the period covered, it does not exclude all portions of these obligations sold abroad to foreigners. Nor is there any attempt to calculate and subtract from these issues amounts for amortization payments. Furthermore, no loans were reported for less than $1 million. Also, there is some question about whether the Handbook data is valid for use in compiling statistics for long-term capital. Although the compilers attempted to include only long-term obligations, occasionally short-term obligations (those less than 1 year) were included. Since bonds for U.S. controlled corporations or their subsidiaries abroad were also included, it also contains obligations which more properly should belong in direct investments. Along the same line of reasoning, those non-contiguous*
American territory investments should likewise be subtracted. Lastly, there are large amounts of foreign currency obligations, both stocks and bonds, publicly floated in the U.S., included in the list. They do not, however, include foreign currency obligations privately placed in the list. Compare the Handbook statistics with the list of U.S. net long-term foreign-dollar bonds presented in Table 3, page 165 of this chapter.


American family incomes were increasing rapidly, savings were being applied to domestic uses such as bank time deposits, life insurance, real estate holdings, and domestic stocks and bonds. Mr. Dwight Morrow, partner of J. P. Morgan & Co., in an article in Foreign Affairs in 1927, stated that his interest was kindled regarding how many foreign bonds were quoted in the Chicago Tribune in late 1926 as opposed to the number in 1916. He found upon inquiring that there were six foreign issues quoted in 1916 and 128 quoted in the same paper ten years later.

Despite the fact that there was but a small amount of foreign investment in this early period, some major changes were taking place which did help set the stage for the action during World War I and during the 1920's. The period from 1900 to 1914 was one of great domestic consolidation of business firms and corporate formation. Many of the great giant corporations, such as U.S. steel, were incorporated


during this period. Likewise, it was a period of rapid growth in the number of shareholders of both domestic stocks and bonds. Furthermore, a change was taking place in the type of investors; investors of modest means were, for the first time, holding certificates of stocks and bonds, instead of merely cash savings, real estate, and the like. Of course, the great growth of per capita incomes during this period which helped in creating these new shareholders was not continuous, and in the vicissitudes of recessions, like that of 1907, some of these investors lost their money. Yet, for those who remained, it was but a further step in risk assumption, with commensurate increases in yields, to turn to foreign obligations.  

Another factor of importance, which occurred during this early period, was the creation of the security affiliate. In 1908, in order to meet criticism which had been levied at the big New York National Banks, J. P. Morgan organized the First Securities Corporation, a subsidiary of the First National Bank. In a similar manner, the National City Bank created the National City Company, the security affiliate of the parent corporation. These were the first security affiliates which were the vanguard of many to follow during the 1920's and through which a large portion of the securities of this period were floated.  

Although the legality of the security affiliates were questioned by the U.S. Solicitor General's office in 1911, and an opinion offered that the

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9 Ibid., p. 171.
device was an open scheme to circumvent the National Banking Act, nothing was finally done.10

Still another factor of significance in the emerging market for foreign-dollar bonds, was the formation of the Federal Reserve System in 1913. The Federal Reserve System, among other things, permitted the development of an acceptance market by banks, which they previously had not been able to do under the National Banking System. The Reserve System also permitted U.S. banks to own foreign banking corporations to tie in with their own branches or units. Thus, with the development of a central bank, came the development of a money market and the conditions for foreign loan flotations.11

On October 23, 1914, President Wilson gave his consent to permit belligerent European countries the privilege of arranging bank credits in the U.S. market.12 Even before the change in the policy of the Wilson Administration regarding foreign private loans, the firms of J. P. Morgan and others had been preparing for such loans, although their informal inquiries revealed that it might be difficult to sell such bonds without much "education."13

After considerable negotiation, the "Anglo-French" loan of 1915 for 500 million dollars was floated. In the process of assuring the success of this issue, the Morgan Company formed the largest syndicate

12 Ibid., pp. 207-208.
13 Ibid., p. 209.
ever organized up to this time, consisting of 1,570 members. Of the total amount sold, 98 million dollars was sold to manufacturers and industrial corporations which were supplying the allies, and the balance was sold to the investing public. The issue proved to be "sticky," but it was sold. Probably this single issue did more to expand the foreign loan market than any other single issue. In the following months, with more "education," the United Kingdom loan for 300 million dollars was sold. By December 1, 1916, the total loans to belligerents reached $1.794 billion.\(^{14}\)

The task, however, of supplying the Allies through loans, repatriations of foreign held U.S. securities, shipments of gold, and other means of obtaining dollar exchange proved to be inadequate, and the Allies were relieved from a difficult situation when the United States declared a state of war with the "Central Powers" and arranged for the government-to-government loans.\(^{15}\) About ten billion dollars was lent to the various nations eligible for loans by the U.S. Government. The government obtained much of its funds by floating Liberty Bonds under the Liberty Loan Acts starting in April, 1917; the first Act being for three billion dollars. The Federal Reserve was requested by the Secretary of Treasury to assume responsibility of passing on proposals for securities. Later this "informal committee" gave way to the War Finance Corporation in April, 1918, under whose legal auspices flotation of securities took place.\(^{16}\)

\(^{14}\)Ibid., p. 209. \(^{15}\)Ibid., p. 211. \(^{16}\)Ralph A. Young, op. cit., pp. 29-30.
The war time flotations of the Liberty Bonds and victory issues, amounting to some 21 billion dollars, while not of direct interest to this dissertation, is of considerable consequence in relating the story of how so many bondholders became interested in foreign securities later. The magnitude of the U.S. war finances and the needs of the Allies became so great that it became necessary for a mass appeal and drive for funds on a huge scale. As stated above, the Federal Reserve was placed in a position of leadership to promote the drive for funds. It was decided that the drive be organized along lines of the Federal Reserve Districts and that a mass appeal be presented to attract people of all elements of the population. On the first drive, which set a goal of raising three billion dollars through the sale of Liberty Bonds, some 15,000 people were involved for 27 days. There were one hundred persons engaged in publicity alone. On this and subsequent drives, the appeal was through such slogans as "Win the war" by buying bonds, appeals to the foreign-born to "demonstrate" their citizenship by buying Liberty Bonds, and (let us) "join hands with those suffering people" (overseas). "Democracy" was declared to be under a "test." Business interests were pressured into increasing their purchase of bonds and to avoid the practice of "Business as usual." Professor W. I. King and associates were engaged in a study to ascertain what the savings capacity of America was in order to set goals for the purchase of bonds. Some idea of how many became interested as bondholders may be gleaned from the fact that on the Third Liberty Loan Drive, 836,000 people in New York City alone purchased 48 million dollars by subscription, to be paid by
one to two dollars per week. Perhaps no one knows how many total persons actually purchased bonds, but a fair idea can be had from the fact that in 1922 at least one million persons in the Federal Reserve District of New York failed to turn in their Liberty Bonds for new issues and thus failed to receive their interest. These were primarily people of small means with little knowledge of the intricacies of finance. These are the people who, later on, having tasted the joys and experiences of coupon clipping, became, in part, the subject of other "educational" campaigns for the sale of foreign-dollar bonds. They are also the people who became the prey for swindlers.

The Federal Reserve not only undertook the responsibility for the drives for the war loans, but they also attempted to provide credit facilities to promote the success of the drives.

Perhaps there is some truth in the caustic remarks of Lawrence Dennis who wrote:

It took no great sales effort to sell American munitions, raw materials or foodstuffs to people too busy killing each other. . . . It took just one thing: credit. Most of the sales effort was expended on the American citizen and bond buyer. First, he was sold the Allied Loan in 1915; then he was sold Liberty Bonds to win the war; and since the war, he

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17 William Randolph Burgess (ed.), *Interpretations of Federal Reserve Policy* (New York: Harper and Brothers, 1930). These are a collection of speeches of Governor Strong who headed the War Bond Drive; also see Cleona Lewis, *op. cit.*, pp. 360-362.


has been sold all sorts of foreign bonds to finance interest payments for the war debtors. The salesmanship has done its work at home. And it is the home folks who will do most of the paying for our war prosperity.21

During the latter part of the pre-World War I period, and during the 1920's, there was a rapid expansion of investment banking facilities. These took place by the creation of new firms, and the expansion of offices of existing ones. The investment affiliate, noted above, was particularly important. In the period 1912 to 1920, the number of main offices of investment bankers, belonging to the Investment Bankers Association of America, increased from 257 to 485. The number of branch offices of these firms increased from 20 to 203 in the same period. In contrast, for the period 1921 to 1930, the number of main offices of firms increased from 552 to 615, while branches increased from 258 to 1,231. The importance of the security affiliates is to be seen in the fact that as late as 1927, security affiliates handled only 22 per cent of the total origination of new issues; whereas by 1930, they accounted for 61.2 per cent of the total (see Table 2, page 152).

The National City Company, representing the largest security originating and distributing organization in the country, grew in size until it had no less than nineteen hundred employees and sixty-nine branch offices in fifty-eight cities. Some 350 odd salesmen, selling securities, were employed by the firm, as well as several hundred others indirectly who worked for other firms which handled National City

TABLE 2
MEMBERSHIP IN THE INVESTMENT BANKERS ASSOCIATION, 1912-1930

<table>
<thead>
<tr>
<th>Year</th>
<th>Main office</th>
<th>Branch office</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1912</td>
<td>257</td>
<td>20</td>
<td>277</td>
</tr>
<tr>
<td>1913</td>
<td>354</td>
<td>42</td>
<td>396</td>
</tr>
<tr>
<td>1914</td>
<td>356</td>
<td>63</td>
<td>419</td>
</tr>
<tr>
<td>1915</td>
<td>340</td>
<td>176</td>
<td>516</td>
</tr>
<tr>
<td>1916</td>
<td>361</td>
<td>(a)</td>
<td>(a)</td>
</tr>
<tr>
<td>1917</td>
<td>407</td>
<td>204</td>
<td>611</td>
</tr>
<tr>
<td>1918</td>
<td>399</td>
<td>194</td>
<td>593</td>
</tr>
<tr>
<td>1919</td>
<td>433</td>
<td>186</td>
<td>619</td>
</tr>
<tr>
<td>1920</td>
<td>485</td>
<td>203</td>
<td>688</td>
</tr>
<tr>
<td>1921</td>
<td>552</td>
<td>258</td>
<td>810</td>
</tr>
<tr>
<td>1922</td>
<td>584</td>
<td>(a)</td>
<td>(a)</td>
</tr>
<tr>
<td>1923</td>
<td>607</td>
<td>(a)</td>
<td>(a)</td>
</tr>
<tr>
<td>1924</td>
<td>617</td>
<td>(a)</td>
<td>(a)</td>
</tr>
<tr>
<td>1925</td>
<td>620</td>
<td>312</td>
<td>932</td>
</tr>
<tr>
<td>1926</td>
<td>664</td>
<td>340</td>
<td>1,004</td>
</tr>
<tr>
<td>1927</td>
<td>676</td>
<td>377</td>
<td>1,053</td>
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<tr>
<td>1928</td>
<td>690</td>
<td>382</td>
<td>1,072</td>
</tr>
<tr>
<td>1929</td>
<td>665</td>
<td>1,237</td>
<td>1,902</td>
</tr>
<tr>
<td>1930</td>
<td>615</td>
<td>1,231</td>
<td>1,846</td>
</tr>
</tbody>
</table>

*a Information not available.

Company securities. This firm handled between one and two billion dollars of securities annually.\(^22\)

**The conditioning of interest of investors in post-war reconstruction**

Long before the U.S. Government took an official stand on the implementation of capital assistance following World War I, business leaders, bankers, and others were urging American participation in the recovery of Europe. Mr. Francis H. Sisson, then Vice-President of the Guaranty Trust Company of New York, in a speech in Chicago, told his audience that Europe could not continue to send her gold here, and that we must work out a way to regain the sale of our products abroad. The bankers of America must take the role of leaders in economic thought. He indicated that in his judgment the media of the great publications and newspapers were quite important in telling the story to the people.\(^23\)

Later on, during the Johnson Committee Hearings, Mr. Thomas Lamont, Senior Partner of J. P. Morgan and Company, was asked about the origin of the lending of this period. He indicated that, among other things, the impoverishment of the war attracted the sympathy of the American people, and both the investing public and bankers thought that these countries would ultimately be solvent, if we helped them; if we didn't help them, they would have been imperiled. Lastly, he said

\(^{22}\)Testimony of Mr. George Baker, President, National City Company, in the Pecora Hearings, Part VI, p. 2006, and Ferdinand Pecora, op. cit., pp. 70-74.

\(^{23}\)New York Times, April 6, 1921, p. 27.
would bring business into direct contact with it to promote commercial expansion.²

Philander C. Knox, President Taft's Secretary of State, actively facilitated a broad expansion of American investment in Latin America, and particularly in the Caribbean countries, with the aim of replacing European capital with American capital, thus implementing the national interest through vigorous dollar diplomacy. A further expansion took place in the Orient where in 1909, in the name of the "open door" principle, Secretary Knox demanded the privilege of American participation in an international financial syndicate, the so-called "China Consortium," organized to float a loan for railroad construction in China.³

The program of dollar diplomacy of President Taft's administration is in sharp contrast with the approach of President Wilson's administration. Mr. Wilson's views on international diplomacy were based on traditional concepts of American democracy expressed in "a priori or moral principles" and he thus opposed the methods of dollar diplomacy of his predecessor. He opposed the coercion implicit in dollar diplomacy and substituted cooperation to "promote in every honorable and proper way the interests which are common to the people of the two continents." Thus Mr. Wilson's approach was based on democratic theories and

²Ibid., pp. 105-106.

procedures rather than upon the use of the government to advance
economic interests in accordance with the methods of economic imperialism. It was, of course, expected that commercial intercourse would
naturally follow peace and stability.⁴

World War I introduced a new complication in the Wilson administration policy regarding foreign loans. For a while, the government
considered loans to belligerent nations as "inconsistent with the true
spirit of neutrality." However, in August 1915, the Wilson Administration stated that it did not oppose loans to belligerent governments.⁵
Shortly afterward, the Anglo-French loan was floated in the New York market.

In the main, however, the policies of President Wilson, both
domestic and foreign, ran counter to corporate development and to com-
mercial expansion under the impulse of dollar diplomacy. Under-Secretary
of State Huntington Wilson, who had been largely responsible for
modifying the dollar diplomacy of the Taft Administration, was greatly
dismayed by President Wilson's lack of desire to assist U.S. firms in
securing business abroad. He resigned in protest.⁶

Business interests soon developed considerable opposition to Mr.
Wilson's policies. Powerful interests began to formulate plans to seek
the political power to implement their desires.⁷ Perhaps it may be said

⁵John T. Madden, Marcus Nadler, and Harry C. Souvain, America's Experiences as a Creditor Nation (New York: Prentice-Hall, Inc., 1937),
pp. 236-237.
⁶Beard, op. cit., p. 125.
⁷Ibid., p. 126.
American money was cheap, and Americans were attracted to the higher yields of foreign investments. 24

An interesting feature of the development of the market for foreign bonds is the interest of many investors in foreign currency speculation. During the period 1920-1922, when currencies of Europe and elsewhere were quite erratic, exchange dealers and investment bankers who had exchange departments encouraged many small investors to buy supposedly undervalued foreign exchange. Many of these individuals who purchased these claims to foreign currency were nationality groups who had assisted relatives abroad by transferring funds during the famine days following World War I. 25 It was simple for exchange dealers and their representatives to contact them for the purchase of these funds as an "investment." When Mr. Hoover took office as Secretary of Commerce, he took an active stand against these sales. 26

Ancillary to the sales of foreign exchange for speculation purposes was the growth of a foreign currency security market. The British and other countries had disposed of some blocks of securities expressed in pound sterling, francs and other currencies. Some of these foreign currency issues were unsold portions of sterling loans authorized


25 See New York Times, January 23, 1921, p. 1; also personal interview with Mr. George Gazera, Washington, D. C., formerly with several exchange dealer firms in New York during the period above.

26 See Chapter III for more information on this point; U.S. State Department, Decimal Files, 832.51/D581/1, April 13, 1922.
in previous years by various foreign governments. British bankers, not able to sell these sterling loans in the London market at the time, sold them to U.S. bankers to re-offer in the United States. These issues were purchased by dealers for distribution and sale to those U.S. investors interested in speculating in currencies and for appreciation and yield. In some cases, these securities were in default and were sold as speculations to U.S. investors for recovery. After some considerable success, many dealers in these issues organized into an association in May, 1921.28

A factor of some importance in developing the market for foreign-dollar bonds was the fact that foreign development for harbor improvement, sewage systems, railroads and similar projects, particularly in Latin America, were held up by lack of dollar exchange, and both borrower and contractor were anxious to secure loans to complete their contracts. Contractors, in many cases, had close connections, including ownership, with investment bankers, which hastened the conclusion of lending arrangements.29

27 See the New York Times, November 7, 1921, p. 5 for advertisement of the firms of Fynchon & Co., and Payne, Webber & Co. for their offer to sell amounts of the 5½ sterling issue of 1909, due 1934, of the City of Rio de Janeiro; according to Mr. Ralph Kellogg, former partner, Baker, Kellogg and Co., U.S. bankers made regular trips to Latin America to buy blocks of repatriated sterling issues and other foreign currency issues to re-offer in the U.S. market, Appointment with Mr. Kellogg, December 4, 1950.

28 New York Times, May 1, 1921, p. 3; Lewis, op. cit., p. 374.

The position of the U.S. Government concerning post-World War I rehabilitation was of great importance in the conditioning of the private investor. Since this has been carefully developed in Chapter II and Chapter III, only summary statements will be made. Although the Harding Administration, during the first year, did not have a fully crystallized policy on U.S. private foreign investment, it did attempt to stimulate actively U.S. private foreign investment. While this activity took place largely through the Commerce Department, which was organized more for this work, the State Department and Treasury concurred, if not openly, at least behind scenes. This activity was, of course, within the broad confines of policy established for foreign-dollar lending. Later on, the Commerce Department came to regret some of its earlier promotional activity when the "Frankenstein" of foreign lending became too big and ugly to handle. Furthermore, the Federal Reserve Board, through the strong auspices of the governor of the Federal Reserve Bank of New York, openly and actively suggested that private bankers take the lead in promoting world recovery through foreign-dollar lending.

It must, at least, be noted that certain business interests also played a part behind the scenes in stimulating the interest of the investor in foreign-dollar bonds. Quite frequently U.S. businessmen with particular interests in countries about to float loans would allow

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30 See Chapter II and Chapter III of this dissertation for the full story of the State Department and Commerce Department's relationship with investor.

31 See Chapter III of this dissertation, especially.

their names to be used in articles or statements in periodicals in connection with publicity about such loans. These endorsements, intentional or not, certainly played a part in inducing investors to buy the obligations. 33

One last factor which should be briefly examined in connection with the conditioning of the investor for the purchase of foreign-dollar bonds is the influence of religious and nationality groups. In the 1920's, America was still a land composed of various religions, nationalities, and other groups who were interested for one reason or another in the problems of post-war adjustments in Europe and elsewhere. Large funds were raised for the relief of people in Europe. 34 These groups were ideal sources for the salesmen of underwriters when foreign-dollar bonds were floated during this period.

**General characteristics of investors in foreign-dollar bonds**

Many questions have been asked about the characteristics of our foreign-dollar-bond investors. In fact, a number of studies have been made to learn more about the elusive investor. 35 Despite this, most of

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the material has rather large degrees of statistical unreliability.

This particular study has not been able to add much data which can be submitted to statistical analysis. The reasons for this fact lie in the age of the respondents, the lack of legal clearance to obtain data, lack of willingness of respondents to answer even official governmental inquiries, and the general unreliability of the data.  


36Note: The biggest, and perhaps most successful attempt to get statistically reliable evidence on investors and other aspects of the dollar-bond story was the Paul Dickens Treasury TFR-300 and TFR-500 series which was conducted during World War II under an executive wartime order from the President. The Treasury was assisted by other departments and agencies of the government, including the Department of Commerce. Although the confidence level of the census of the U.S. foreign assets was quite high, the level for foreign-dollar holding was much lower. From footnote No. 1, page 38, we have Dr. Dickens' evaluation. "There is no satisfactory method of ascertaining the degree of completeness of the TFR-500 data with regard to foreign-dollar bonds. Although the census was publicized widely by various means, it is believed that considerable number of persons owning only a few foreign bonds either did not realize they were required to file a report, or were not reached by the publicity." As many as 25 per cent of bonds in bank portfolios failed to report. Mr. Dickens estimates that for all foreign-dollar bonds, the census was 80-85 per cent complete, but, if you exclude Canadian issues, the census was probably only 75 per cent complete. See footnote, p. 38, TFR-500.
Despite the unavailability of data and lack of reliability of data, some generalizations and observations can be made. But first a few comments and evaluations concerning the data are essential.

Two sources of information about the investor available during this period should be briefly mentioned. Mr. Dwight W. Morrow, one of the former Senior Partners of J. P. Morgan and Company, contributed an article to *Foreign Affairs* in 1927 on the subject "Who Buys Foreign Bonds?" His analysis, based upon 24 investment houses handling five foreign issues aggregating some $380 million, showed that more than 85 per cent of the purchases were in small amounts, ranging from one hundred dollars to five thousand dollars. These small investors accounted for approximately 50 per cent of the total amount of the offering.

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In 1950, the author discussed with the Foreign Bondholders Protective Council, Inc., the possible use of their lists of bondholders for a questionnaire. While Mr. Kenneth Spang appeared very receptive to the idea, Dr. James Grafton Rogers stated he could not allow this because of the confidential quasi-legal nature of the Council. He felt that since he had prevented the U.S. Treasury from access to this data, he could not in good propriety allow others to use it. Mr. Spang later arranged for the author to spot-check the assent papers to the renegotiated consolidated Chile dollar bonds at the Schroeder Trust Co. The author feels that through the examination of this one issue and the unpublished letters of the Pecora Hearings that some reasonable generalizations can be made.

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Note: A rough calculation was made using the unchecked data of Mr. Morrow to ascertain the number of U.S. foreign-dollar bondholders at the end of 1930. Since the estimated statistical population was approximately $5,260 billion (adjusted) at the end of 1930, and small bondholders held about 50 per cent in the Morrow sample, the number of estimated small bondholders was obtained by the following: $2,630 billion/$3,269 = about 804,200. Since 804,200 represented about 85 per cent in the Morrow sample, we can solve for the large holders and obtain about 142,000. By the following division, $2,630 billion/142,000, about $18,500 was obtained, which represents the approximate amount held by large holders. In this calculation it was assumed that the statistical population was normal and that the mean and median were not far apart.
Mr. Charles E. Mitchell, President of the National City Bank, in his testimony before the Johnson Committee Hearings, stated that he thought the Morrow figures suggested a figure of some 2,400,000 foreign bondholders in the United States, which he thought was too high. He indicated that about a million and a half would be correct. One of his reasons was based on income tax returns for individuals in the U.S. for 1930 of about 3,376,000 individuals of which 2,613,000, or 77 per cent, had incomes under $5,000. Another factor was an estimate by Mr. McCoy, an actuary in the Treasury Department, who had estimated that there were but 1,300,000 individual domestic bondholders in the United States at that time. Evidence was given of holdings of some 643 million dollars of foreign-dollar bonds by members of the Federal Reserve System, of which 339 millions of dollars were held by county banks, 154 millions of dollars by Central Reserve City banks, and 150 millions of dollars by Reserve City banks. A report by 52 legal reserve life insurance companies showed foreign bonds and stocks of 581 million dollars, of which 517 million dollars were Canadian securities, and 64 million dollars were other foreign securities.\(^{39}\)

The TFR-300 and TFR-500 series census conducted by Dr. Paul Dickens seems to bear out some portion of the above testimony. Ownership of issues, according to the TFR-500 census, was concentrated in individuals, with insurance companies being next in importance by size

\(^{39}\)Testimony of Mr. Charles Mitchell, President of the National City Bank, in Johnson Committee Hearings, Part I, p. 70.
of holdings. While the TFR-300 and TFR-500 studies by the Treasury came many years after the period of the twenties, and the total dollar bond population size had shrunk to an estimated $1.564 billion as compared to a revised estimate of about six billion dollars at the end of 1930, it is interesting to note that it seems to bear out the Mitchell conclusions in regard to the proportion of non-individual holdings of foreign-dollar bonds. It seems probable that if one takes the adjusted figure for foreign-dollar bonds at the end of 1930 of about 6.2 billion dollars, subtract from this an estimated 15 per cent for non-individual holdings, the adjusted individual foreign-dollar holdings amounted to about 5.3 billion dollars. Accepting the Morrow estimate of about 50 per cent of the holders to be in the one hundred dollar to five thousand dollar range of purchases, it may be reasonably assumed that there were about 142,000 large bondholders, holding an average of $18,500 each, and some 804,200 small holders having about $3,269 average holdings. This would indicate the total number of individual holders to be about 946,200. Thus, it would appear that at the end of the period of the 1920's, there were slightly less than one million individual foreign-dollar bondholders in the United States.


41. Ibid., p. 38.

In the TFR-500 study of Dickens, he notes that by 1943, the actual number of respondents claiming ownership of foreign-dollar bonds, including both individuals and corporations, was about 100,000. But, because only an 85 per cent return was obtained on the overall foreign-dollar-bond census, and an estimated 75 per cent on the non-Canadian portion, Mr. Dickens suggests that as of the date of the survey, there easily could have been "double that figure." 43

Two criticisms have been made of the Treasury TFR-500 Study. The Foreign Bondholders Protective Council has stated that the number of bondholders, even as late as 1950, were over one million in number. The president of this organization stated personally that the study was very incomplete and inaccurate. 44 Mr. Charles MacQueen, former Commercial Attache and Financial Analyst in the Department of Commerce, stated that one major loophole in the TFR-500 census was that U.S. citizens were holding large amounts of these dollar bonds abroad in order to avoid the payment of taxes on capital gains. 45

However, it would appear that on several other grounds, the number of individual bondholders now is much less than the Dickens' figures suggest. In 1950, as indicated previously, the author examined some of the assent papers on the 1948 Consolidated Chile dollar bond issue which was the renegotiated consolidated issue offered by Chile to

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44 Personal interview with Dr. James Grafton Rogers, at his office in New York City, December 5, 1950.

45 Personal interview with Mr. MacQueen in Washington, D. C., November 29, 1950.
bondholders for the various outstanding Chilean issues previously in default. He found that the largest proportion of nominees to the assent were dealers in these foreign-dollar bonds. The firm of one dealer, Mr. Carl Marks of New York City, appeared most frequently. In discussions with Mr. MacQueen, formerly of the Department of Commerce, and for several years a research man doing consulting work for one of these large dealer firms, it was ascertained that the largest proportion of all dollar bonds were in the hands of either dealers, large accounts holding these bonds for their speculative value, or in trusts or estates awaiting settlement. Finally, it must be added that Dr. Paul Dickens of the U.S. Treasury generally adheres to the thesis that bondholders are highly concentrated, that the bonds are largely in wealthy speculators' hands and in the hands of professional dealers who bought them cheap and are awaiting renegotiation or resumption of interest and amortization.

According to the Treasury TFR-500 Study, foreign-dollar bondholders are located in each of the forty-eight states and the District of Columbia. While it is generally thought that bondholders were highly concentrated in the State of New York, it was found that there was little difference between New York City and the rest of the United States with respect to the percentage of the total held by individuals.

47 Luncheon appointment with Mr. Charles MacQueen, Department of Commerce Cafeteria, Washington, D. C., November 24, 1950.
48 Discussion with Dr. Paul Dickens at his office, Treasury Department, Washington, D. C., July 21, 1950.
that criticism of the Wilson approach to foreign economic policy was significant in conditioning the approach of the Harding administration which followed.

Government control over foreign lending during the Taft and part of the Wilson administrations was indirect; that is, the influence of the government relating to specific lending was made by suggestions or hints through the executive branch without the benefit of law or executive order. In the case of the Taft Administration, this indirect approach was more positively applied to guide American investment into areas deemed to have greater political and economic significance for the United States under a broad interpretation of dollar diplomacy. Thus the Taft Administration actively pushed and even solicited loans for certain areas where a particular political or economic advantage was desired, such as the Caribbean countries.

While the Wilson Administration was disinclined to promote economic advantage through dollar diplomacy, it generally followed the indirect approach exclusive of the war period. During the war the government chose to use the war time powers of the president to directly influence private foreign lending. The Wilson Administration was concerned about foreign lending lest funds be released to the enemy, the influence of foreign borrowing upon the ability of the United States

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8 The general background for the material relating to the various approaches to control over foreign investing has been taken liberally from the following: Herbert Feis, Europe the Worlds Banker, 1870-1914 (New Haven: Yale University Press, 1930), Williams, op. cit., Beard, op. cit., and Madden and Nadler and Souvain, op. cit.
Persons in four states besides New York, namely Illinois, Pennsylvania, California, and Massachusetts, accounted for about 55 per cent of the total.\textsuperscript{49}

U.S. investors purchased approximately \$6.2 billion of net face value foreign-dollar-bond obligations during the eleven years 1920 through 1930. The geographical distribution of the origin of issue of these obligations shows that European countries issued 40 per cent of this total, with Latin American countries next with 23 per cent, Canada with 22.6 per cent and other areas of the world issued 14.3 per cent. U.S. dollar bonds issued by Europe were at a peak in the years 1924 and 1925 (other than the single year of 1920) and fell off relatively after that time. Latin American issues were at their peak during the year 1927. All areas decline in terms of new dollar bonds floated during the latter half of 1928 and 1929. Although foreign-dollar bonds issued in the United States recovered in 1930, it was a short recovery, as 1930 marks the year of the beginning of the defaults.\textsuperscript{50}

The author was allowed in 1951 to examine several hundred letters which bondholders had sent to the Pecora Committee Hearings.\textsuperscript{51} These letters contained a great deal of information about the bondholders;

\textsuperscript{49} Treasury TFR-500 Study, op. cit., p. 41.

\textsuperscript{50} See Table 3, page 165.

\textsuperscript{51} These letters were found in a letter file, \#6201 under the file marking "Remedies." Some of these letters were filed under the banker who had floated the issue, and some were marked "general." They are all located in a large group of letter file boxes in the attic cage reserved for The Senate Banking and Currency Committee of the United States Senate Office Building, Washington, D. C.
<table>
<thead>
<tr>
<th>Year</th>
<th>Total Dollar Bonds</th>
<th>Per Cent</th>
<th>Face Value and Per Cent of Dollar Bonds by Area</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>Europe</td>
<td>Canada</td>
<td>Latin America</td>
<td>Other</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Amount Per Cent</td>
<td>Amount Per Cent</td>
<td>Amount Per Cent</td>
<td>Amount Per Cent</td>
<td>Amount Per Cent</td>
</tr>
<tr>
<td>1920</td>
<td>401.7</td>
<td>100</td>
<td>284.6 70.7</td>
<td>117.8 29.3</td>
<td>-6.7</td>
<td>-1.6</td>
<td>6.0 1.5</td>
</tr>
<tr>
<td>1921</td>
<td>469.2</td>
<td>100</td>
<td>182.5 38.9</td>
<td>127.5 27.2</td>
<td>135.6</td>
<td>28.9</td>
<td>23.4 5.0</td>
</tr>
<tr>
<td>1922</td>
<td>542.4</td>
<td>100</td>
<td>23.1 4.3</td>
<td>255.2 47.1</td>
<td>113.0</td>
<td>20.8</td>
<td>151.1 27.8</td>
</tr>
<tr>
<td>1923</td>
<td>256.8</td>
<td>100</td>
<td>43.0 16.6</td>
<td>91.1 35.3</td>
<td>51.4</td>
<td>20.5</td>
<td>71.3 27.7</td>
</tr>
<tr>
<td>1924</td>
<td>805.1</td>
<td>100</td>
<td>495.7 61.6</td>
<td>93.3 11.6</td>
<td>77.8</td>
<td>9.7</td>
<td>138.3 17.2</td>
</tr>
<tr>
<td>1925</td>
<td>779.3</td>
<td>100</td>
<td>487.6 62.5</td>
<td>63.3 8.0</td>
<td>115.8</td>
<td>14.9</td>
<td>112.6 14.5</td>
</tr>
<tr>
<td>1926</td>
<td>724.0</td>
<td>100</td>
<td>340.3 47.0</td>
<td>98.5 13.6</td>
<td>271.8</td>
<td>37.5</td>
<td>13.4 1.9</td>
</tr>
<tr>
<td>1927</td>
<td>1081.4</td>
<td>100</td>
<td>487.6 45.1</td>
<td>149.3 13.8</td>
<td>301.4</td>
<td>27.9</td>
<td>143.1 13.2</td>
</tr>
<tr>
<td>1928</td>
<td>760.8</td>
<td>100</td>
<td>311.0 40.9</td>
<td>78.6 13.0</td>
<td>223.3</td>
<td>29.4</td>
<td>147.9 14.7</td>
</tr>
<tr>
<td>1929</td>
<td>-67.3</td>
<td>100</td>
<td>-224.9 --</td>
<td>133.1 --</td>
<td>31.2</td>
<td>--</td>
<td>-6.7 --</td>
</tr>
<tr>
<td>1930</td>
<td>471.6</td>
<td>100</td>
<td>69.4 14.7</td>
<td>194.2 41.2</td>
<td>117.0</td>
<td>24.8</td>
<td>91.0 19.3</td>
</tr>
<tr>
<td>Total</td>
<td>6225.0</td>
<td>100</td>
<td>2489.9 40.0</td>
<td>1401.9 22.6</td>
<td>1431.6</td>
<td>23.0</td>
<td>891.4 14.3</td>
</tr>
</tbody>
</table>

The term net dollar bond refers to the face value of all foreign-dollar bonds issued in the United States exclusive of the portions sold abroad of these issues. It also excludes the estimated amounts retired annually. Net face refers to total face values less amounts retired.

however, it was impossible to obtain a statistically reliable sample for analysis purposes. Nonetheless, certain characteristics appeared which support the following generalizations:

1. People who wrote to the Committee and claimed to be bondholders were from every walk of life in terms of professional status, income and geographical location.

2. Usually, these individuals seemed by their remarks to be near or at retirement age.

3. Generally, with a few exceptions, they claimed to be small investors with usually no more than two or three $1,000 obligations (par value).

4. These individuals who wrote to the Committee appeared to be generally unsophisticated concerning investments.

5. About one third of the writers were either widows or maiden ladies near the retirement age.

6. Frequently, these individuals expressed anger about the low prices of their bonds, or they appeared to be very perplexed about the low prices and defaults.

7. In a large number of cases, the letters included stories or remarks concerning the manner or conditions under which the obligations were sold to them.

What were the factors which induced bondholders to purchase these bonds? Mr. Morrow, writing in 1927, thought that the average buyer of foreign bonds purchased them from the standpoint of the safety of the principal with the best possible yield. Mr. Morrow presumed that buyers of foreign bonds were largely purchasers of domestic bonds of various
types, rather than holders of equities. Lastly, Mr. Morrow thought the
bondholders were also influenced in their purchase "because they felt
that they were thus associating themselves in a fine venture to help
Europe back on her feet." Generally, the bond buyer, not being an
expert in the analysis of obligations, would purchase the obligation
because "he had confidence in the banker who offered him the invest-
ment."52

Undoubtedly, current yield was a significant factor in the
motivation for the purchase of foreign-dollar bonds, at least in the
beginning four years of the 1920's. Dr. Ralph Young in Handbook
constructed a table showing a comparison of high grade domestic bond
yields with an index of foreign bond yields. He found that the yield
differential grew and reached its highest point in 1926, after which it
declined.53 Significantly, the peak in the foreign loan market was
reached in 1927. On the other hand, it must be admitted, that in the
years 1920-1923, when the interest rate differential was at a near peak,
relatively smaller amounts were floated. Perhaps this can be explained,
in part, by adverse political and currency conditions, and, perhaps, by
the relative newness of investors to this form of investment.

The fact that foreign-dollar bondholders turned away from such
investments after 1927 may be explained, in part, by the growing
attractiveness of speculation in the stock market. The "New Era Doctrine"

52 Dwight W. Morrow, op. cit.

53 Ralph A. Young, op. cit., p. 44; also see Table 4, page 168, of
this dissertation.
### TABLE 4

THE WEIGHTED AVERAGE INDEX OF NEW FOREIGN BOND YIELDS COMPARED WITH THE STANDARD STATISTICS COMPANY INDEX OF HIGH GRADE DOMESTIC BOND YIELDS

<table>
<thead>
<tr>
<th>Year</th>
<th>Weighted average yield index of new foreign bonds</th>
<th>Standard Statistics index of yields on 60 high grade domestic bonds (a)</th>
<th>Excess of the average yields on new foreign bonds over the average yields on high grade domestic yields</th>
<th>Average yield index of new foreign bonds relative to the average yield index on high grade domestic yields</th>
</tr>
</thead>
<tbody>
<tr>
<td>1919</td>
<td>5.97</td>
<td>5.25</td>
<td>0.72</td>
<td>114</td>
</tr>
<tr>
<td>1920</td>
<td>7.69</td>
<td>5.88</td>
<td>1.81</td>
<td>131</td>
</tr>
<tr>
<td>1921</td>
<td>7.54</td>
<td>5.79</td>
<td>1.75</td>
<td>130</td>
</tr>
<tr>
<td>1922</td>
<td>6.63</td>
<td>4.94</td>
<td>1.69</td>
<td>134</td>
</tr>
<tr>
<td>1923</td>
<td>6.42</td>
<td>4.98</td>
<td>1.44</td>
<td>129</td>
</tr>
<tr>
<td>1924</td>
<td>6.56</td>
<td>4.85</td>
<td>1.71</td>
<td>135</td>
</tr>
<tr>
<td>1925</td>
<td>6.51</td>
<td>4.72</td>
<td>1.79</td>
<td>138</td>
</tr>
<tr>
<td>1926</td>
<td>6.51</td>
<td>4.60</td>
<td>1.91</td>
<td>141</td>
</tr>
<tr>
<td>1927</td>
<td>6.14</td>
<td>4.47</td>
<td>1.67</td>
<td>137</td>
</tr>
<tr>
<td>1928</td>
<td>6.09</td>
<td>4.49</td>
<td>1.60</td>
<td>136</td>
</tr>
<tr>
<td>1929</td>
<td>5.81</td>
<td>4.69</td>
<td>1.12</td>
<td>124</td>
</tr>
<tr>
<td>Average 1919-24</td>
<td>6.80</td>
<td>5.28</td>
<td>1.62</td>
<td>129</td>
</tr>
<tr>
<td>Average 1924-29</td>
<td>6.21</td>
<td>4.59</td>
<td>1.52</td>
<td>135</td>
</tr>
<tr>
<td>Average 1919-29</td>
<td>6.53</td>
<td>4.97</td>
<td>1.56</td>
<td>132</td>
</tr>
</tbody>
</table>

(a) Standard Statistics Co., 15 industrial bonds, 15 railroad bonds, 15 public utility bonds, and 15 municipal bonds.

was drawing many into its speculative vortex and, perhaps, foreign-dollar bondholders were, as speculators, nearer to equities than Mr. Dwight Morrow suspected. 54

One other factor that can be profitably examined is the patriotic motive used to sell some of the foreign-dollar bonds. Many nationality groups, such as the Germans, the Poles, and Italians, evidently felt compelled to purchase obligations to help out the "mother country." These groups were highly susceptible to propaganda from sellers. For example, it was found in the Treasury TFR-500 Study that more than 12,500 individuals and organizations were reported to have held one issue, the Polish Government 6's due 1940. In this case, the 11,380 individuals reported holdings which averaged two hundred dollars each and some 560 small mutual-benefit insurance organizations and other similar organizations averaged about six hundred dollars each. As Dr. Dickens stated, "No sale was too small and no place too obscure to attract the salesmen." 55

Sources of information available to bondholders

In 1928, one of the commercial attaches in Colombia volunteered the information to his superior in the Department that "not one

54 Dwight Morrow, op. cit.

bondholder out of ten could tell where the river Magdalena was." The question may logically be asked, what were the facilities for information to the bondholder? Was information available?

The answer to this question is that there was considerable information and facilities available to the investor, if he chose to use them. One of the bankers in the Pecora Committee Hearings deplored the fact that the investor would not avail himself of information. There actually were quite a number of investment advisory services ranging from Standard's and Moody's to lesser known services. In addition, the Department of Commerce made available circulars and reports on various countries in which businesses and others might be interested. The primary problem was that (1) the investor was frequently too lazy to dig out information, or (2) he was too naive to realize the need for information, or (3) he relied upon tips or advice from salesmen of investment bankers. While it is true that government policy tended to delay significant facts from reaching the investor, or minimized the danger in certain obligations, it is true also that much of this information was available through the various investment services. It is likewise true that certain responsible investment bankers and officials who had become alarmed over what many considered to be


57Testimony of Mr. Clarence Dillon, Pecora Committee Hearings, Part IV, pp. 2114-2115.

58See Chapter III.
"unbridled borrowing on the part of certain foreign countries," issued statements which appeared in many prominent newspapers throughout the land. However, it is equally true that the practices of certain underwriters with respect to the dissemination of information relative to the sale of securities left much to be desired, and were, in short, nothing less than bordering on fraud.

Practices of underwriters and salesmen in selling securities to investors

Bond salesmen during the 1920's were frequently recruited directly from colleges and universities. In many cases, there was little training other than a brief description of the organization and a few details on how to "close" a sale. These salesmen worked on a commission basis, with a drawing account. In some cases, salesmen would be assigned to certain clients, such as banks, insurance companies and other similar organizations, although this kind of client was usually reserved for more experienced bond salesmen in the organization. Frequently, new salesmen would be given leads from the home office. These would be from individuals in the territory who had written to the parent company concerning investment advice.

The sales practices of the bond salesmen varied considerably. Older, more mature salesmen were fairly circumspect in their dealings with clients. Some salesmen, particularly the inexperienced ones, made rash, if not completely inaccurate statements regarding the issues they

59 See Johnson Committee Hearings, Part II, pp. 889-898, for text of S. Parker Gilbert's warning on German Loans; also see copy of article by Thomas L. Lamont in Johnson Committee Hearings, Part I, pp. 47-51; New York Times, July 24, 1926, pp. 80-81.
were selling. Salesmen frequently indicated that the U.S. State Department had "approved" of issues, intimating that "investment merits" of the loan had been reviewed. Similarly, salesmen indicated that Professor Kemmerer was restoring the financial affairs of certain Latin American countries and "would see to it that these issues were paid."

In a few cases, unscrupulous salesmen took complete advantage of ill-informed clients, and an intensive series of sales and purchases were made in individual's portfolios. Frequently, these accounts were margined to permit more active trading. An analysis of a number of such cases reveals a significant downgrading of portfolios. In still other cases there is reason to suspect fraud.

Since much of the information relating to the practices of underwriting has been developed elsewhere, our discussion will be of a summary nature.

1. Many underwriters were guilty of padding their prospectuses with favorable information, leaving out essential data that were less favorable.

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60 Nearly all of the information presented here comes from personal interviews with Mr. George Gazera, Mr. Hillary Houston of Washington, D.C., Mr. John Henry of Cedar Rapids, Iowa, and Mr. Ralph Kellogg of New York; other information relating to specific sales practices comes from the unpublished letters to the Pecora Hearings and are located in the Senate Banking and Currency Committee files in the attic of this building; other information comes from letters which were published in the Pecora Hearings and which are located in the Appendix of this dissertation.

61 Testimony of Mr. Baker of the National City Company in the Pecora Committee Hearings, Part VI, p. 2070.
2. Many underwriters practiced discrimination against recalcitrant distributors and selling organizations, if they objected to less desirable or "sticky" issues, thus facilitating the sale of bad issues. 62

3. Many underwriters not only indulged in excessive competition for relatively poor issues, but then resorted to sales tactics which were designed to "clear" the less desirable issues. These involved huge "sales contests" and other promotional schemes. 63

4. There was active solicitation of new investment accounts on the part of firms. Frequently, these started out with a simple advertisement in one of the financial papers, or in the large daily papers which would state, "Are you going on a vacation?" Then the advertisement would subtly suggest leaving one's securities with the firm for management. Many tales of woe were read from the letters to the Pecora Committee which came from this practice. 64

5. An attitude prevailed among many investment firms and their salesmen that they really were nothing more than "merchants." Some bankers, when questioned closely about the ethical and fiduciary relationship between banker and client, suggested that this was a fairly "legal interpretation." Evidently, not too many agreed with Mr. Morrow and other conservative bankers such as Mr. Kahn, of Kuhn, Loeb and Co. 65

62 Pecora Committee Hearings, unpublished letters in attic cage of the Senate Banking and Currency Committee, Washington, D. C.


64 Pecora Committee Hearings, unpublished letter in attic cage of the Senate Banking and Currency Committee, Washington, D. C.

Government to raise funds for the prosecution of the war, and the extent to which interest and exchange in the American market were influenced by the competition of foreign borrowers. In general, the United States followed the example of Great Britain which used the indirect method for nearly a century.

The indirect approach may be contrasted with that employed generally by some European powers, and in particular, that of France. Here the approval of the minister of finance was required for the listing of foreign securities on the Paris Bourse. Without the listing privilege, the success of an issue would be in doubt and a greater degree of direct control over foreign borrowing was obtained.

The Harding Administration approach to foreign loan policy

The Harding Administration came into office at a time when affairs domestically and internationally were a bit strained. The policies of Mr. Wilson had been under considerable fire, and the heritage of problems that remained unresolved were quite extensive. The Harding Administration was elected partly as a protest to the manner of solution of some of these problems by the Wilson Administration.

Americans generally were unhappy with many provisions of the Treaty of Versailles. A key issue was the failure of the Allies to agree on the amount and disposition of reparations due from Germany and her Allies. The vindictiveness of France complicated and prolonged a settlement of reparations, which occurred at a time when foreign exchange conditions were precarious and when a substantial readjustment
6. Salesmen who sold securities to particularly naive individuals, frequently advised clients to sell off triple A rated U.S. Government Bonds and purchase distinctly low grade foreign obligations. As the letters to the Pecora Committee indicate, quite frequently there were rapid changes in the portfolio suggested, which would indicate that the salesman was attempting to "boost his commissions." 66

7. A rather subtle factor was the employment or retaining of professional reporters to "color" or embellish articles which would be timed to coincide with a new offering. Frequently, "big name" people with large stakes in the country for whom a loan was being negotiated would contribute articles at this time. 67

8. Lastly, but not unimportantly, the Kemmerer Missions 68 contributed enormously to the success of bond flotations. Bankers and

66 Pecora Committee Hearings, unpublished letter in attic cage of Senate Banking and Currency Committee, Washington, D. C.

67 Ibid.

68 On September 30, 1922, Dr. Olaya, Ambassador to the U.S. from the Republic of Colombia, asked the U.S. State Department for assistance in locating an American expert to help in (1) the revision of Colombia's Customs procedures, (2) advice on foreign loans to Colombia, and (3) advice in setting up a central Bank of Issue for Colombia (see U.S. State Department, Decimal Files, 821.51/A/2, September 30, 1922). Later, the U.S. State Department recommended Dr. Edwin Kemmerer of Princeton University to the Government of Colombia. Dr. Kemmerer was appointed by Colombia to head a team of experts in February, 1923 (see U.S. State Department, Decimal Files, 821.51/A/19, February 13, 1923).

In later years, Dr. Kemmerer headed Missions of a similar nature to Bolivia, Chile, Peru, and three other Latin American countries. He also was on financial missions to several European countries, and he served on one to the Republic of China (see Johnson Committee Hearings, Part III, pp. 1694–1704).
salesmen were extremely quick to point out the fact that Professor Kemmerer and his associates were devising protection for their loans abroad. Whether these missions were designed to encourage foreign borrowing from the United States or not, they did have a great effect in lending sales appeal to the bonds. 69

Perhaps it was as one of the Commercial Attaches abroad stated, in a protest letter regarding the unwarranted sale of bonds, that fundamentally the fault lies in the innocence of the buyer. However, it would appear that if the buyer was indeed innocent, the sellers were not. Even in common law, there would have been some remedial action, if buyers had but realized it. 70

The United States investor and the foreign-dollar bond defaults

The U.S. bond market collapse in May, 1928, was followed by the stock market crash in October, 1929. Following these severe financial changes came a series of defaults on U.S. foreign-dollar bonds. The first foreign-dollar defaults were from the Latin American countries who were hardest hit by weakened commodity prices in the world markets. Starting with Bolivia in December, 1930, other Latin American countries, including Chile, Brazil, Peru, Colombia, and Uruguay, followed in default. By the end of 1933, practically all Latin American foreign-dollar loans were in default, except for the Argentine and Haiti government dollar

69 Lawrence Dennis, op. cit., pp. 203-204.
70 Ibid., pp. 62-63.
bonds, and one Argentine province and two Argentine municipalities.

European dollar bond defaults were at their peak in 1933, when some 116
German issues were placed in partial default. By the end of 1935 approxi­
mately $2.8 billion of some estimated $7.4 billion of U.S. foreign-dollar
bonds were in default. Latin American issues were highest with 80 per
cent of their outstanding bonds in default. European countries were next
with 51 per cent of their outstanding dollar bonds in default; the Far
East was lowest, as less than 1 per cent of its outstanding dollar bonds
were in default. North American defaults amounted to only 3.1 per cent
of their total dollar obligations outstanding.71

There was some improvement in the default status of foreign-dollar
bonds during the latter 1930's. By 1937 some resumption of payment was
made, and some renegotiations of issues had taken place. However, in
this relatively good year of the depression period, 35 per cent of all
issues outstanding were still in default, and the current market prices
for these defaulted issues averaged about 25 per cent of their par
values.72 This gradual improvement abated with the coming of World War II,
and by the end of 1940 some 31 per cent of outstanding dollar bonds were
in default. It was only through the use of funds from the frozen accounts
of European countries in this country that the default percentage was not
higher.73

71 Cleona Lewis, op. cit., pp. 398-400; John T. Madden and associ­


Although many nations who were in default on their foreign-dollar-bond obligations openly denied being able to make payments on their obligations, many of these countries allowed their nationals to purchase large amounts of these obligations at bargain prices. In some cases countries actually encouraged their nationals to buy up these obligations. Germany and Chile were notable in this regard. Other countries where large amounts of defaulted dollar bonds were repatriated were Bulgaria and Costa Rica. Mr. Hal Lary, formerly with the Department of Commerce, estimated that a conservative estimate of U.S. foreign-dollar bonds thus repatriated would involve about $2 billion to $3 billion par value. 74

In addition to losses due to repatriation at depressed defaulted prices, in the process of the renegotiations of many of the defaulted issues, the original contractual interest rates have been greatly lowered. In the case of most Latin American nations, the new coupon rates were roughly one third to one half of the former rates. German renegotiations took place on fairly equitable terms to bondholders, being at three fourths the old contractual rates for the Dawes and Young obligations, and two thirds the old contractual rates for municipalities, provinces, and corporations. The Japanese renegotiation took place following the Peace Treaty of September 8, 1951, and as a result of the renegotiation, Japan, in 1952, resumed interest and sinking fund payments at the original contractual rates. 75

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The author has not attempted to make a complete study of the extent and amount of the renegotiations. This would be beyond the compass of the present work. It is possible, however, to give some tentative estimates of the return to date (1961) on foreign-dollar bonds floated during the 1920's. Taking losses on the estimated repatriations into account, reductions on substantial proportions of obligations whose contractual coupon rates were reduced by nearly 50 per cent and calculating as possibly irretrievably lost some $267 million estimated dollar bonds issued by some ten iron curtain countries, it is possible to estimate that Americans probably netted some 3% on their original investment in the form of interest, and got their original capital back. Compared with a return of about 6½% on our direct investments, this is a rather poor return, not to mention a precarious medium for the investment of funds. On December 31, 1961, of some $7.395 billion of foreign-dollar bonds issued by the governments or political subdivisions thereof in the period 1919-1961, there remained $4.645 billion outstanding, of which $3.580 billion or 77 per cent are receiving full service and sinking fund payments. The remaining $429 million represent some 114 countries, all but four being behind the iron curtain.  

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76 See Cleona Lewis, op. cit., pp. 430-432, and John T. Madden and associates, op. cit., pp. 139-141, for their respective estimates.

TABLE 5
FOREIGN-DOLLAR BONDS PUBLICLY ISSUED OR GUARANTEED BY GOVERNMENTS
OR SUBDIVISIONS THEREOF, WHOSE ISSUES WERE IN DEFAULT
AS TO INTEREST AND SINKING FUND ON DECEMBER 31, 1961
(in dollars)

<table>
<thead>
<tr>
<th>Country</th>
<th>Amount of default on interest and sinking fund</th>
<th>Country</th>
<th>Amount of default on interest and sinking fund</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bolivia</td>
<td>60,342,600</td>
<td>Germany (East)</td>
<td>21,762,000</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>16,634,500</td>
<td>Greece</td>
<td>36,371,000</td>
</tr>
<tr>
<td>China</td>
<td>5,500,000</td>
<td>Hungary</td>
<td>17,685,600</td>
</tr>
<tr>
<td>Cuba</td>
<td>52,460,800</td>
<td>Mexico</td>
<td>3,252,000</td>
</tr>
<tr>
<td>Czechoslovakia</td>
<td>2,734,300</td>
<td>Poland</td>
<td>41,075,410</td>
</tr>
<tr>
<td>Danzig</td>
<td>3,422,000</td>
<td>Rumania</td>
<td>89,875,650</td>
</tr>
<tr>
<td>Estonia</td>
<td>3,271,500</td>
<td>U.S.S.R.</td>
<td>75,000,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Total</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>429,387,360</td>
</tr>
</tbody>
</table>


Legal and governmental protection of the investor

One of the letters in the unpublished group in the Senate Banking and Currency Committee's attic cage concluded with the following remark, "It seems to me that some kind of a law ought to give us [investors'] protection." What degree of protection was afforded the investor?

The investor, of course, did have some basic resort against fraudulent practice. He could, under common and statutory laws of his
state, seek and obtain, if proven, legal redress. However, this kind of protection has to have the proper kind of evidence to support such claims, and quite frequently buyers were unaware of the intent and were not prepared to validate claims of wrongdoing.

During the 1920's there were several attempts to pass bills through Congress to seek federal law and to create agencies to administer security transactions. However, these did not obtain sufficient support, either in Congress or from the administration. The administration was particularly opposed to any regulation of securities; indeed, Mr. Coolidge stated that the only reason he allowed the State, Commerce, and Treasury departments to review the foreign-bond lending was that he was anxious to prevent an attempt by Congress to pass a law on securities. The State Department, and the administration, did not, after March, 1922, review loans for "investment purposes." It is interesting to note that in at least one state, that of Ohio, the Securities Commission took the position relative to the interpretation of the "blue sky" laws of that state, that since the "State Department was supervising the matter of the flotation of foreign loans, that when the State Department indicated that there was no objection to the loan, that this constituted approval of the loan for purposes of investment merit, and according to the Commission, this action suspended the operation of the 'blue sky' laws as far as this issue was.

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79 Interview with Mr. Kiraly and Mr. Johnson of The Ohio Division of Securities, Columbus, Ohio, August 29, 1950; also see Supplement to the Ohio State Bar Association Report, Vol. I, January 15, 1929, No. 42.
redressal was opened. How many other states interpreted their "blue sky" laws in the manner of Ohio is not known.

The Securities and Exchange Laws, passed largely as a result of the Pecora Committee Hearings, have dealt mainly with the problems disclosed in the Hearings. The passage of The Johnson Act in 1934 precluded loans to countries in default on their war debts and, to a large extent, since many countries' issues were in default, actually shut off foreign-dollar-lending during the 1930's. The Export-Import Act as amended in 1945 and The Bretton-Woods Agreement in the same year, however, did suspend the effect of The Johnson Act in so far as it affects transactions related to countries under The Export-Import Act, and those signatory countries to The International Monetary Fund. 80

Conclusions

A few concluding statements are now in order regarding the role of the private investor in the flotation and defaults of U.S. foreign-dollar bonds.

1. U.S. investors did not become significantly interested in foreign-dollar bonds until after World War I. The experience of holding Liberty and Victory bonds was a unique experience and many people became investors in bonds through the war bond drives.

2. During the 1920's, with administration sponsorship and investment banking salesmanship, many investors and others who became investors,

purchased foreign-dollar bonds. While it is difficult to estimate the correct number of these bondholders, it may reasonably be concluded that there were a little under a million holders of foreign-dollar bonds by the end of the period of the 1920's holding perhaps a little over $3,000 each in foreign-dollar bonds.

3. Factors influencing U.S. investors in buying foreign-dollar bonds were many and varied. A principle factor was the growing yield differentials which were favorable to the purchase of foreign-dollar bonds as opposed to the purchase of high grade bonds. Another factor was the interest of Americans in "helping" with world recovery. Still another factor was the development of a selling program by investment bankers which attracted growing interest by investors. After 1925, an increasing number of investors were attracted to foreign-dollar bonds as a means of speculation.

4. Investors in foreign-dollar bonds favored European issues with 40 per cent of their purchases. Latin American countries issued some 23 per cent of the total, while Canadian issues were a close third with 22.6 per cent. Other issuers, those in Asia and elsewhere, issued 14.3 per cent. An interesting note is that when the risk premium on foreign-dollar bonds began to go down after 1927, investors turned increasingly to those bond issuers in which the risk was the greatest.

5. When the defaults came, the emphasis placed by investors, and bankers alike, in Latin American issuers, proved to be a bad experience as this area of the world had the largest number of defaults. It was also in Latin America where the lowest recoveries were made in renegotiations.
6. While investment bankers may have contributed to the defaults by their selection of poorer quality obligations, investors themselves were apparently quite anxious to partake of these risks. Information made available by bankers and salesmen was not exemplary of best practice, but investors, too, were especially gullible.

7. U.S. investors of foreign-dollar bonds appeared to be either dazed or extremely angry at the defaults of these issues during the 1930's. Apparently their experiences with the defaults have influenced the foreign-dollar-bond market to this day.
in trade was already underway in world markets. America's stake in these issues was largely due to her loans to the Allies; however, a larger stake was indirectly involved due to America's replacement of the European belligerent nations in the role of supplier of goods to Latin American countries and in the Orient during the war. In the month of May, 1920, commodity prices began to collapse, and during the summer and autumn, foreign trade fell off rapidly. Exchange rates became very erratic and eventually the exchange markets were completely demoralized. Under these conditions, American exporters had extreme difficulty in realizing their claims. Interest rates rose and credit availability was greatly restricted. Finally, Germany's financial and economic collapse in 1923, which followed, complicated and prolonged world-wide recovery.  

Domestically, the chief economic problems were those connected with the depression. Agricultural surpluses and low commodity prices were a source of great concern to the farm-belt states. High interest rates made these surpluses more burdensome and costly. Manufacturers, wholesalers, and retailers were likewise placed in peril by falling prices, higher interest rates, and lowered availability of credit. In addition, there was a considerable amount of unemployment in many places throughout the nation. During this period, the government

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11 Ibid.
CHAPTER VI

PRIVATE CAPITAL IMPLEMENTATION OF TECHNICAL ASSISTANCE

Introduction—post-World War II adjustment

World War II left a plethora of international economic problems which were clearly beyond the capacity of private long-term foreign capital to solve alone. Fortunately, the nations of the Atlantic Community decided on a broad basis of cooperation involving the creation of a major international institution—The United Nations. Also, in the specific area of international lending the International Bank and the International Monetary Fund were created. Other agencies designed to deal with various aspects of the international post-war economic problems were developed. In addition, the United States made the largest single unilateral contribution with Marshall aid, the $3.75 billion loan to England, credits to France, and more recently, the Technical Assistance programs and Military aid and grants. By the end of fiscal 1961, the United States has made available in one form or another nearly $85 billion in net foreign aid as its contribution to world recovery.

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The place of private foreign investment in the immediate post-war adjustment

The private investment market played a very modest part in the recovery effort. The principal reasons for this were that the dollar needs of foreign countries, especially in Europe, were too great, and the risks associated with private foreign investment such as exchange convertibility, service requirement on debt, fear of exchange depreciation, and the like, were also too great. Furthermore, the U.S. domestic capital markets offered greater returns with comparative safety of funds due to the huge backlog of civilian needs following the war. United States private capital investment abroad increased from about $13,658 billion at the end of 1945 to $16,762 billion at the end of 1948, or by $3,104 billion. Practically all of this net increase was in direct investment $2,949 billion. Foreign-dollar bonds actually were reduced by about $75 million, largely because of interest reduction and amortization. On the other hand, U.S. Government long-term investment abroad, during the same period, increased to $12,903 billion, or by $11,223 billion. Thus, it is readily seen that the magnitude of the adjustment in the immediate post-war years was too great for the capacity of private capital to respond to it, and government investment and grants were required to fulfill the need. Combined government and private long-term investments provided about 20 per cent of the exchange required for financing the export of U.S. goods and services during the

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1946-1948 period. Private long-term funds alone financed about 3 per cent of the total.\(^3\)

Not only were private capital funds inadequate in size for post-war reconstruction and development needs, but the distribution of these funds by both use and geographical classification, left much to be desired. During 1947, for example, 666 million dollars, or 90 per cent, of U.S. private long-term foreign investment was direct investment, and 70 per cent of it was invested in the petroleum industry. Over 75 per cent of the net out-flow of direct investment was accounted for by ten of approximately 2,500 American companies.\(^4\) Although the American Republics were the recipients of over 50 per cent of the direct investments for this year, the investments went into established industries and plants, rather than new developmental enterprise.\(^5\)

Thus, in the immediate post-World War II period, the nature of the response to the needs of adjustment were quite different from that of the corresponding World War I period of adjustment. During the 1920's, foreign-dollar bonds provided about 60 per cent of the private capital funds; whereas, in the World War II period, direct investment accounted for approximately 90 per cent. Furthermore, whereas private capital funds provided virtually all of the adjustment in the World War I period, in the World War II period, government investment provided about 88 per cent.\(^6\)

\(^3\)Ibid., p. 129.


\(^5\)Ibid., p. 129.

\(^6\)Ibid.
Foreign-dollar bonds, in the post-World War II period, did not have the confidence of investors which was due largely to the extent of the defaults. Few countries enjoyed a high credit standing and thus, the number of potential borrowers was far less than after World War I. Thus, in the post-World War II period, 1946-1948, only Canada, Norway, the Netherlands, and the International Bank were able to raise capital by selling dollar bonds. The total of these issues was $.411 billion, which compares with $1,438 billion sold during the three years following World War I. Among the principal reasons for the lack of confidence by investors in foreign-dollar bonds as an investment, other than the previous record of default, were political and economic uncertainties, and the shortage of dollar exchange. Perhaps the unwillingness of certain debtors to make more adequate renegotiations of their outstanding dollar obligations was an important factor as well.

It was fortunate that the "World Bank" and the Export-Import Bank functioned as well as they did during this period, even considering the limited experience and capital of the bank, and certain restrictions concerning the "Ex-Im." However, without "Marshall Aid," post-war adjustments could not have been made in the European international accounts without drastically reducing their imports and thus delaying their ultimate recovery. By the end of 1948, however, certain U.S. government officials, if not foreign government officials, were wondering what might take up the slack, if and when Marshall Aid was ended. In President Truman's June 24, 1949 message to Congress, came the answer to

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this question. America was to assist the underdeveloped nations of the world to help themselves, by providing technical assistance with some modest grants-in-aid. While the idea was not new, certainly the timing and emphasis of the program made its reception abroad quite electrifying. Later, the United Nations set up its own technical assistance program, and the U.S. contributed the lion's share to the cost of this program as well.8

It was thought in 1950, that with the international institutions providing stability and cooperation, and with progress along treaty lines with respect to treatment of the investments of foreign countries, that the private capital markets would soon implement the technical assistance program.9 However, the Korean War upset these expectations, and the technical assistance program became submerged in the program for military aid under Mutual Security.10

The capital requirements for sustained growth for underdeveloped countries

During 1951, a distinguished group of economists from United Nations countries were appointed to act as experts on an Economic and Social Council project to study "the problem of reducing unemployment and

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9 U.S. Department of State, Point Four, ibid., p. 4.

10 See Gordon Gray and Staff, op. cit., pp. 6-8.
underemployment in underdeveloped countries. . . ."\(^{11}\) This group of experts found that the capital requirement to raise National Income of underdeveloped countries by 2 per cent per annum would be about nineteen billion dollars annually. Assuming the countries, themselves, could possibly marshall some estimated five billion dollars for domestic investment, this would leave a total of about fourteen billion dollars annually. Even with an assumption for further savings from the increased income which might be derived from the investment flow, a basic ten billion dollars was considered to be the absolute minimum for raising total incomes by the desired 2 per cent. These experts furthermore pointed out that these targets, while high, are not beyond attainment, since a 2 per cent transfer of national incomes of the countries of Western Europe, Australasia, the United States, and Canada would yield some $350 billion of income and $7 billion per year for underdeveloped countries.\(^{12}\) However, neither the Gordon Report or the Rockefeller Report on foreign economic aid envisioned any program of such magnitude.

The Rockefeller Report said in part:

> The prevailing economic pattern of these regions could be revolutionized through a consistent investment flow from the Western industrialized world of several billions of dollars a year, if combined with local capital and channelled into genuinely productive enterprise.\(^{13}\)


The Rockefeller Report added one significant additional point, well worth considering, when it stated, "Miracles are not accomplished overnight." This report emphasizes that the developmental program was, indeed, a slow, gradual process—eventually utilizing a number of billions of dollars annually—but hardly likely to be able, without adverse economic repercussions, to utilize a multi-billion dollar capital program. Moreover, the Rockefeller Board saw "economic development as a people-to-people program." 14

Most professional economists, either in the service of the U.S. Government or attached to universities throughout the country, adhere generally to the thesis of a gradual, balanced, process of foreign economic development. 15

During most of the period of the last ten years, technical assistance aid has remained substantially less than a billion dollars per annum. The government lending program, however, through the Export-Import Bank and under the loan provisions of the various development acts, has been substantially increased. This reflects the fact that private investment has not yet regained sufficient strength to take over the major responsibility for development. 16

15 This researcher has had numerous appointments, consultations, and other communications with government economists concerning the above thesis; even in the United Nations there are a large number of foreign economists who also adhere to this position.
Conditions in the private capital market for long-term foreign investment

Conditions of stability, so vital for long-term foreign investment, were disrupted by the Korean War. The power play between East and West, sometimes hot, sometimes cold, has kept the private investment markets in a turmoil during most of the time since 1950. Despite this, as noted above, the unilateral action of the United States and the international institutions did help very measurably in achieving growth and development particularly in the Western European nations. Great progress has been noted, too, in Japan and in India.

The total of all U.S. Government grants, loans, military and technical assistance and contributions to international agencies amounted, during the period 1946-1960, to about eighty billion dollars. Private long-term foreign investment for the same period increased by about 33.1 billion dollars; from 12.3 billion dollars in 1946, to 45.4 billion dollars by 1960. Of the 33.1 billion dollar increase in private long-term foreign investments, direct investments accounted for the largest portion, about 25.5 billion dollars; while portfolio investment increased about 7.5 billion dollars. By 1960, total private direct investments were approximately 32.7 billion dollars, and portfolio investment amounted to 12.6 billion dollars.

18 See Table 6, p. 192 of this dissertation.
19 See Table 6, p. 192 of this dissertation.
### TABLE 6
INTERNATIONAL INVESTMENT POSITION OF THE UNITED STATES
FOR SELECTED YEARS, 1914-1960
(in billions of dollars)

<table>
<thead>
<tr>
<th>Type of Investment</th>
<th>1914</th>
<th>1919</th>
<th>1930</th>
<th>1939</th>
<th>1946</th>
<th>1955</th>
<th>1960</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. Investment Abroad</td>
<td>3.5</td>
<td>7.0</td>
<td>17.2</td>
<td>11.4</td>
<td>18.7</td>
<td>44.9</td>
<td>71.5</td>
</tr>
<tr>
<td>Private</td>
<td>3.5</td>
<td>7.0</td>
<td>17.2</td>
<td>11.4</td>
<td>13.5</td>
<td>29.1</td>
<td>50.4</td>
</tr>
<tr>
<td>Long-term</td>
<td>3.5</td>
<td>6.5</td>
<td>15.2</td>
<td>10.8</td>
<td>12.3</td>
<td>26.7</td>
<td>45.4</td>
</tr>
<tr>
<td>Direct</td>
<td>2.6</td>
<td>3.9</td>
<td>8.0</td>
<td>7.0</td>
<td>7.2</td>
<td>19.3</td>
<td>32.8</td>
</tr>
<tr>
<td>Portfolio</td>
<td>.9</td>
<td>2.6</td>
<td>7.2</td>
<td>3.8</td>
<td>5.1</td>
<td>7.4</td>
<td>12.6</td>
</tr>
<tr>
<td>Short-term</td>
<td>N.A. a</td>
<td>.5</td>
<td>2.0</td>
<td>.6</td>
<td>1.3</td>
<td>2.4</td>
<td>5.0</td>
</tr>
<tr>
<td>U.S. Government Investment</td>
<td>a</td>
<td>a</td>
<td>a</td>
<td>a</td>
<td>5.2</td>
<td>15.9</td>
<td>21.1</td>
</tr>
<tr>
<td>Long-term</td>
<td>a</td>
<td>a</td>
<td>a</td>
<td>a</td>
<td>5.0</td>
<td>15.2</td>
<td>18.2</td>
</tr>
<tr>
<td>Short-term</td>
<td>a</td>
<td>a</td>
<td>a</td>
<td>a</td>
<td>.2</td>
<td>.7</td>
<td>2.9</td>
</tr>
<tr>
<td>Foreign Investment in U.S.</td>
<td>7.2</td>
<td>4.0</td>
<td>8.4</td>
<td>9.6</td>
<td>15.9</td>
<td>29.6</td>
<td>44.7</td>
</tr>
<tr>
<td>Long-term</td>
<td>6.7</td>
<td>3.2</td>
<td>5.7</td>
<td>6.3</td>
<td>7.0</td>
<td>12.6</td>
<td>18.4</td>
</tr>
<tr>
<td>Direct</td>
<td>1.3</td>
<td>.9</td>
<td>1.4</td>
<td>2.0</td>
<td>2.5</td>
<td>4.3</td>
<td>6.9</td>
</tr>
<tr>
<td>Portfolio</td>
<td>5.4</td>
<td>2.3</td>
<td>4.3</td>
<td>4.3</td>
<td>4.5</td>
<td>8.3</td>
<td>11.5</td>
</tr>
<tr>
<td>Short-term asset</td>
<td>.5</td>
<td>.8</td>
<td>2.7</td>
<td>3.3</td>
<td>8.9</td>
<td>17.0</td>
<td>26.3</td>
</tr>
<tr>
<td>U.S. Net Credit Position</td>
<td>-3.7</td>
<td>+3.0</td>
<td>+8.8</td>
<td>+1.8</td>
<td>+2.8</td>
<td>+15.3</td>
<td>+26.8</td>
</tr>
<tr>
<td>Net long-term position</td>
<td>-3.2</td>
<td>+3.3</td>
<td>+9.5</td>
<td>+4.5</td>
<td>+10.3</td>
<td>+29.2</td>
<td>+45.2</td>
</tr>
<tr>
<td>Net short-term position</td>
<td>-.5</td>
<td>-3</td>
<td>-7</td>
<td>-2.7</td>
<td>-7.4</td>
<td>-13.9</td>
<td>-18.4</td>
</tr>
</tbody>
</table>

*Not available.*

Foreign-dollar bonds increased from 1.7 billion dollars outstanding in 1945, to 4.9 billion dollars in 1960.20 A portion of this increase took place after the German and Japanese bonds were adjusted and represents increases in the market valuation of these obligations. However, it is noteworthy that about 2.4 billion dollars of new issues of foreign-dollar bonds were purchased by U.S. citizens between 1946 and 1955, although redemptions and amortizations totaled 1.4 billion dollars. Of these new issues, about 1.4 billion dollars were new Canadian issues, six hundred million dollars were bonds of the World Bank, and about two hundred million dollars were bonds issued by Israel. In addition, since 1953, Belgium, Cuba, Norway, Australia, The Union of South Africa, and a few private corporate borrowers have issued securities in the U.S. market.21

In 1957, portfolio investment increased significantly again, and new issues of foreign-dollar bonds amounted to six hundred million dollars, of which two hundred million dollars was for bonds of the World Bank. New countries borrowing were The Netherlands, The Belgian Congo, Northern Rhodesia, and The European Coal and Steel Community. Many of the previous borrowers, such as Norway, Canada, Israel and others, were also in the market.22 In 1958, new foreign-dollar bonds amounted to

20 See Table 7, p. 194 of this dissertation.
received a large number of requests to assist in alleviating the situation.\textsuperscript{12}

The U.S. made clear very quickly that it wished no further foreign entanglement. A prime factor in determining this position was the apprehensiveness of the administration that the Allies might expect America to provide further financial assistance for world recovery.

The Harding Administration approach to these problems\textsuperscript{13} was from the standpoint of a business oriented government.\textsuperscript{13} Most of the important cabinet officers were either businessmen, or were known to be very sympathetic and responsive to business interests. It was natural that they wanted to avoid the stigma of being unsympathetic to business, as the Wilson Administration had come to be known.\textsuperscript{14}

It is also natural that a weak executive, fairly inexperienced in matters of international diplomacy and high finance, should be dominated by such men as Hughes, the Secretary of State; Mellon, the Secretary of the Treasury; and Hoover, the Secretary of Commerce.\textsuperscript{15} Furthermore, it is not surprising that when the President wished to reinforce cabinet information relative to urgent domestic and international problems of a financial nature, he called into secret session at the White House a group of the top financiers of the country to help advise him.\textsuperscript{16}

\textsuperscript{12}See, for example, "Decry Parsimony toward Consuls," \textit{New York Times} (February 7, 1921), p. 10.


\textsuperscript{14}Beard, \textit{op. cit.}, p. 121.

\textsuperscript{15}\textit{Ibid.}, p. 420.

## TABLE 7

U.S. PRIVATE LONG-TERM FOREIGN INVESTMENT FOR SELECTED YEARS, 1945-1960

(in billions of dollars)

<table>
<thead>
<tr>
<th>Type of Investment</th>
<th>1945</th>
<th>1948</th>
<th>1954</th>
<th>1958</th>
<th>1960</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private Long-term Foreign Investment Total</td>
<td>13.7</td>
<td>16.8</td>
<td>24.4</td>
<td>37.5</td>
<td>45.4</td>
</tr>
<tr>
<td>Direct Investment</td>
<td>8.4</td>
<td>11.3</td>
<td>17.6</td>
<td>27.3</td>
<td>32.8</td>
</tr>
<tr>
<td>Portfolio Investment</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>5.3</td>
<td>5.4</td>
<td>6.7</td>
<td>10.3</td>
<td>12.6</td>
</tr>
<tr>
<td>Foreign-Dollar Bonds</td>
<td>1.7</td>
<td>1.7</td>
<td>2.7</td>
<td>3.9</td>
<td>4.9</td>
</tr>
<tr>
<td>Other Foreign Securities</td>
<td>2.1</td>
<td>2.2</td>
<td>2.4</td>
<td>3.7</td>
<td>4.6</td>
</tr>
<tr>
<td>Other Investment</td>
<td>1.5</td>
<td>1.5</td>
<td>1.6</td>
<td>2.6</td>
<td>3.1</td>
</tr>
</tbody>
</table>

Note: All figures are rounded and may not equal totals.


Nine hundred million dollars; however, Canada and the International Bank accounted for 350 million dollars each. Despite this, eleven different countries were in the market, although for small amounts each.23

During 1959 the U.S. bond market declined somewhat as the International Bank borrowed abroad in Europe. At the same time, because of a

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change in interest rates, Canada borrowed at home, rather than in New York. One significant loan was made, however, to Mexico for one hundred million dollars.24

Americans, after 1956, began to purchase significantly larger amounts of foreign stocks and bonds, stated in foreign currencies. This accelerated as Britain and other countries established more liberal conditions with respect to convertibility. Large sales of European and more modest sales of Canadian securities were made in the United States market in 1958. Sales of securities of South African countries took place via the sale of shares in an investment fund in the same year.25 Other securities, in the portfolio investment category, including foreign equities and bonds stated in foreign currencies, increased from 2.4 billion dollars in 1954, to about 4.6 billion dollars in 1960.26 Probably an additional factor causing this large percentage increase is the recovery made in the earnings of European corporations and the declining yield on comparable American securities.

In accounting for the relatively smaller proportion of foreign-dollar bonds, compared to direct investment in the post-war period, a number of significant deterrents can be noted. Probably most important, as noted above, has been the lack of a genuine condition of peace among

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26 See Table 7, p. 194 of this dissertation.
nations. After World War I, despite some delay on the part of the French, conditions of peace were completed. The United States took the lead in the disarmament discussions culminating in the Kellogg-Briand Pact. There has been no such interval of genuine peace in this post-World War II period. None the less, there is the impression that both investors and borrowers are beginning to accept a condition of political uncertainty as a built-in factor of the loan market. Certainly the number of countries borrowing, if not the magnitude, of dollar lending, especially since 1955, bears out this conclusion.

A major factor, also contributing to the relative weakness of foreign-dollar lending, in the post-World War II period, has been the tremendous attraction of the United States domestic equities markets. Earnings of corporations during the early portion of the period, particularly between 1947 and 1957, were unusually high. This was a major factor in the rapid rise of the so-called "Eisenhower market," particularly in industrial equities. This proclivity to invest in a booming stock market, also attracted foreign funds and gave the debt management officials in the U.S. Treasury frequent unpleasant moments. Investors in the stock market increased during this period from about six and a half million single name, non-institutional individuals to about 16½ million by the end of 1961.


28 Personal interviews with dealers in securities, government economists and others. (See Appendix for a list of such appointments.)

29 See special surveys by the New York Stock Exchange for this information.
A principal factor in keeping foreign-dollar-bond financing modest in magnitude has been the default status of the issues floated during the 1920's. The experience of these investors has been dealt with elsewhere, however, a few relevant remarks are essential here. In the post-war period, a number of countries, previously in default, resumed the service on their obligations. Some renegotiations took place on a basis which many experts felt were quite unfair; but at least some effort was made to resume payment. Many of the renegotiations took place on a basis of one third to one half of the previous rate. Other issues were renegotiated on a much more favorable basis. The German and Japanese issues treated investors very fairly. The principal defaulted issues, outside of the Bolivian and Greek issues, lie behind the Iron Curtain and the Bamboo Curtain. It may be assumed that unless a major realignment of power takes place, most of the remaining issues will not be renegotiated and must be presumed lost. Furthermore, as indicated in Chapters IV and V, the author believes that most of the original bondholders who purchased these bonds are deceased. The present holders of these obligations have purchased them at much lower prices than they were issued, and, in the main, they represent dealers, wealthy investors, and others who are holding large inventories for appreciation. What is being said here is, not that losses have not been taken in the past by the original investors, but that the present group of holders are largely those who have purchased these instruments at very low prices and who have substantial potential capital gains showing. In other words, while the

30 See Chapter V of this dissertation.
31 See Chapter V.
memory of losses may still linger, the present group of bondholders have not experienced them. The significance of this statement is that since World War II, a whole new group of investors have come upon the scene who do not have quite the abhorrence of hearing the term "foreign-dollar bond." And, if the proper incentives are presented, it is certainly not impossible to envision investor interest.

This brings up another issue. Some borrowers were somewhat calloused concerning their responsibility of completely honoring their debts. During the past decade or more, these borrowers have not had the advantage of private credit. In some cases, it may be expected that they have learned their lesson. Furthermore, those countries having access to the World Bank and the Export-Import Bank have experienced lending terms and conditions which have acquainted them with standards of borrowing, making ultimately for much better lending conditions via private-dollar lending.

Exchange controls and lack of convertibility were a factor of great importance during the post-war period, especially the first decade following the war. Countries have, however, gradually removed these controls, once normal trade conditions returned to most countries.

Associated with the general removal of exchange controls and reestablishment of convertibility has been the great recrudescence of the European market under the stimulus of the Common Market. It is difficult for Americans, who have become accustomed to seeing annually in the various foreign aid appropriation bills, measures for the assistance of many of the countries of Europe, to realize that these very same countries are now very healthy and well protected competitors
of the United States with large foreign reserves. Indeed, the Common Market has stimulated a direct investment out-flow from the United States, along with significant portfolio amounts which have, along with our responsibility for development elsewhere, given the U.S. some significant balance of payments problems.

One additional factor is important. The domestic relationship of yields on high grade stocks vs. bonds had, for a long time, favored that of stocks; especially so when the investor psychology was so much geared to the fear of inflation. In the past four or five years, yield differentials have favored non-equities, and the inflation factor is not, perhaps, a serious contender.

Since the 1930's, a number of protective measures have been taken to assure the new investor in foreign-dollar bonds that the information provided in the prospectus for new foreign-dollar-bond issues was warranted to be free from deception. The "Truth in Securities" Act--the Securities Act of 1933--and the Securities Exchange Act of 1934, have placed under the jurisdiction of the Securities and Exchange Commission, the responsibility of requiring foreign governments, political subdivisions, and foreign corporations who wish to sell foreign-dollar bonds in the U.S. market, to comply with certain specific requirements of information. This information is somewhat similar to the requirements

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32 See Seymour H. Harris, op. cit.
33 Ibid.
of domestic corporations, and the like. In addition, information, particularly relevant to foreign exchange problems and related items, is required.  

Although the Johnson Act of 1934, forbidding nations owing the United States Government on their debts the right to use the markets of the United States for foreign capital needs, has been partially suspended by the Export-Import Act and the Bretton-Woods Agreement, so far as signatory powers are concerned, it is still effective for those nations not associated with these institutions. While this group is not large, it acts as a constant reminder to nations who might have ideas of wavering. Finally, the Foreign Bondholders Protective Council, Inc. was organized on December 18, 1933, as a non-profit, membership corporation, without capital stock, in the state of Maryland, for the protection of the interests of U.S. foreign bondholders. It was set up in lieu of the organization of the Corporation of Foreign Security holders provided for in Title 2 of The Securities Act of 1933. The Council has been successful since it has been organized in negotiating some $1.2 billion of foreign-dollar bonds in default. It exists to serve

34 See Form 18 for Foreign Governments and Political Subdivisions thereof, Securities and Exchange Commission, Washington, D. C.


bondholders and to serve notice to borrowers that a quasi-governmental organization exists to undertake responsibility if it is needed. 38

Some notations concerning direct and portfolio investment

As one reviews the statistics of the post-World War II period concerning private long-term capital movements, the predominance of direct investment is impressive. 39 Perhaps it may be said with some reasonableness that the period of the 1920's had too much portfolio investment, and the period of the forties and fifties had too much direct investment. Some writers have extolled the use of direct investment as making for more flexibility in the balance of payments. 40 However, recently there has been reason to fear the associated effects of a heavy dosage of direct investment. During the last four years, there has been on the Latin American continent a number of cases of expropriation of direct investment.

Some economists have tried to expose "Direct Investments" as islands which generate exchange for itself and do not assist the local process in growth, nor in the development of skills. 41 It would appear that the Singer argument is somewhat overworked. According to Ragnar Nurkse, "This pattern was not . . . a result of deliberate planning . . .


39 See Tables 6 and 7, this Chapter, pp. 192 and 194.

40 Hal B. Lary and associates, op. cit.

but a natural result of the free play of private market motives. The lack of a domestic market causes direct investment, where it is isolated, to seek offshore markets and thus appear to be unconcerned with the local economy. Even here, the relatively slow growth rate of direct investment appears to be due to the fact that the export market for raw materials and foodstuffs are not enjoying the same rate of secular expansion as during the nineteenth century. This may be due to the destructive powers of wars, and perhaps to the development of synthetic substitutes.

Foreign loans, in the first instance, are more adaptable for use by public authority in a developmental program. Furthermore, it is not subject to the criticism of control so frequently identified with direct investment. From a sequence of development point of view, Nurkse points out that in most of the development of the eighteenth and nineteenth century foreign loans for the development of social overhead capital took place first, with attending development of the home market. Then came direct investments with entrepreneurial skills which were related to the home markets.

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45 Note: By "social overhead capital" we mean investment in roads, communications facilities, public utilities and the like, which are basically needed to support a major program of direct investment.
46 Ragnar Nurkse, *op. cit.*, p. 91.
It may well be that U.S. efforts to expand direct investment, especially in the early days of technical assistance, may be somewhat ill advised. Perhaps a more judicious blending of foreign loans and direct investment might bring about more balanced growth.

It may be also noted that with the ending of the war has come a surge of nationalism with many new nations being formed, and many colonial nations assuming complete sovereign responsibility. This nationalism, which, while understandable, is not without its hazards with respect to expropriation. Many new countries find it quite difficult to tolerate large economic areas which are under partial economic control of foreigners. Some leaders of underdeveloped areas find it politically expedient to blame foreign direct investment for many of the local problems. It is incredible, however, that where investment is associated with the development of social overhead capital, that local governments would find it expedient to expropriate.

The investment company may prove to be a useful medium for American private investment abroad. It can obtain diversification by country, as well as by company and industry. Furthermore, the foreign investment company, organized to hold foreign securities, by application under Section 7(d) of the Investment Company Act, if approved, may sell their securities in the United States. This allows the company freedom from the capital gains tax, if domiciled in a country such as Canada. Thus foreign investment companies have the advantage of reinvesting proceeds of sales of securities without being compelled to distribute capital gains. A company staffed by experts, including talent from several foreign countries, could in combination with U.S. capital become a highly successful organization. Since yield differentials have favored foreign
Mr. Harding quickly established the general lines of his foreign policy in a number of major speeches during the first several months of his administration. In his inaugural address on March 4, 1921, he stated, "We will accept no responsibility except as our conscience and judgement in each instance dictates." This was taken to mean a rejection of the League of Nations. It furthermore indicated the Harding position on government assistance for international reconstruction and development.

Another cornerstone of the Harding Administration's foreign policy is revealed in the President's address to Congress:

The urgency for an instant tariff enactment, emergency in character and understood by our people that it is for the emergency only, cannot be too much emphasized. I believe in the protection of American Industry and it is our purpose to prosper America first. The privileges of the American market to the foreign producer are offered too cheaply today, and the effect on much of our own productivity is the destruction of our self reliance. ... Today American agriculture is menaced. ...  

The Emergency Tariff Act of 1921 was eventually made quite permanent by the Fordney-McCumber Act of 1922 which raised the average rates to the highest level ever experienced, save for the Hawley-Smoot Bill of 1930.  

Another problem faced by the Administration was the position to be taken on foreign-dollar loans. A number of loans of some magnitude,

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commitments for some time, eventually the investment company may receive greater interest from investors. Since foreign governments have become more critical of direct investments, the investment company device may reduce political risks where American control is in disfavor.

Conclusions

Foreign private-dollar lending has increased significantly, especially in the last five years. Whether it will again resume the dimensions of the 1920's is somewhat doubtful. Many new public institutions have appeared on the scene which helps provide funds at a rate of interest which is not attractive for private investors. So long as these institutions continue to lend at these rates, it is doubtful whether foreign private-dollar lending will regain its former scope of operations. If governmental agencies begin to tighten up, because of a lack of lending authority or other restrictions, then dollar lending could indeed be much more important. The international investment company may be a better vehicle for use in the area of foreign-dollar lending. It would provide a greater degree of diversification against the risks of this form of investment. Certainly one can say that with still two thirds of the world considerably underdeveloped, the need especially for social overhead capital is immense. And as we compare the proportions of U.S. foreign private direct investment to that of U.S. portfolio investment, there may be some need to be concerned.

47Lawrence M. Greene, op. cit., p. 493-503.
CHAPTER VII

CONCLUSIONS

Introduction

This dissertation has been an inquiry as to whether U.S. portfolio investment, and specifically U.S. foreign-dollar lending, is likely to make a more significant contribution in the pattern of capital flows for development abroad. This question has been raised because there have been some significant changes taking place, institutionally, in the capital markets, and also, there appears to be some reluctance, legislatively, to continue large governmental foreign-dollar aid for such purposes, particularly in view of increasing balance of payments difficulties of the U.S. If U.S. private foreign-dollar lending were to resume on a large scale abroad, what are the chances that U.S. investors might once again experience a sad experience of defaults in subsequent years?

It appeared relevant, in seeking answers to this question, to explore again the nature and experience of U.S. foreign-dollar lending during the period of the 1920's. It was believed that there was considerable bias and indeed, animus, involved in some of the previous attempts to record and assess this experience. Furthermore, since the 1930's, there has been an opportunity to review the data in the context of a larger historical perspective, and, at the same time, make further inquiries into significant aspects of this episode. These areas of
further investigation are (1) the relationship of the government and its supervision to the flotation of these obligations, (2) the reassessment of the role of the banker in the flotations, and (3) the assessment of the role of the investor.

The major issues and questions

Some of the more specific questions that were raised, in terms of the relationship of the government to the flotation and defaults of the U.S. foreign-dollar lending of the twenties, were the following:

1. To what extent did the U.S. Government stimulate and foster the excessive foreign-dollar lending during the twenties?

2. What was the specific role of the State and Commerce departments in the supervision of this lending?

3. What was the relationship of the government to U.S. bondholders? How well did they protect their interests? These questions and many others are dealt with in Chapters II and III.

Since several authors have previously presented conflicting evidence of the role of the banker in the flotation and defaults of U.S. foreign-dollar bonds, this phase of the operation was carefully reexamined. Some of the questions dealt with in Chapter IV on the role of the Investment Banker in the flotation and defaults of foreign-dollar bonds are the following:

1. To what extent did bankers, if at all, knowingly misrepresent the facts concerning the obligations they sold to investors?

2. To what extent did bankers overlook or knowingly disregard the hazards in lending to countries having poor reputations or conditions as debtors?
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1. To what extent did bankers, if at all, knowingly misrepresent the facts concerning the obligations they sold to investors?

2. To what extent did bankers overlook or knowingly disregard the hazards in lending to countries having poor reputations or conditions as debtors?
3. What, specifically, were the standards of lending of bankers and what ethical considerations influenced these standards?

Furthermore, it was important to examine the role of the investor in the flotation and defaults of U.S. foreign-dollar bonds. The investor is the subject of Chapter V. Some of the important questions under consideration in this chapter are the following:

1. Who was the investor in U.S. foreign-dollar bonds? Was he a predominantly wealthy individual, perhaps seeking capital gains; on the other hand, was he a simple individual of modest means?

2. What were the informational facilities available to the investor? How much, and how good was the investment information available? Did the investor avail himself of this information?

3. How did the investor become interested in U.S. foreign-dollar bonds? What means were used to interest him and sell him securities?

4. What remedial measures did the U.S. investor have to protect himself against fraud?

5. What were the motivations of the U.S. investor?

It was also considered important to examine the institutional arrangements of the international capital markets. If there is a possibility of a reappearance of U.S. foreign-dollar bonds in the American market, is there a possibility that bondholders may again be badly hurt by defaults? What protection, if any, does the potential bondholder have against this possibility?

Finally, what has been the nature of U.S. private long-term foreign capital movements in the post-World War II period? What
comparisons can be made of this period with the lending during the 1920's? What are the conditions and the capital combination considered to be prerequisite for sustained growth and development in this period? Last but not least, if there is continued expansion in the private markets for U.S. foreign-dollar bonds, what assurance do we have that debtors will respect the integrity of their debts?

These are a few of the more important questions and issues raised and treated in Chapter VI. It now remains to indicate the conclusions concerning the above inquiries.

Conclusions

1. The role of the U.S. Government in the flotations and defaults of foreign-dollar bonds was largely one of ineptitude.

   a. It was found that both the Commerce and State departments were involved in stimulating the U.S. foreign-dollar lending during the 1920's. The Department of Commerce, however, was mostly responsible for actively encouraging U.S. bankers to undertake the leadership in lending. The major motivation behind this was the reluctance of Congress and the government to assist in world recovery with public funds during the 1920's. Domestic conditions of underemployment during the 1920's also was a prime factor. Americans were, perhaps, overcome by their conviction that "the dollar can heal the wounds of the world," and U.S. top government officials were of one mind in this belief. When the government had succeeded in unleashing the full forces of free enterprise, it found it difficult to control them, and finally almost gave up the attempt.
b. The general role of supervision by the government was on a voluntary basis of compliance, based upon a simple press release by the President. This was not even an executive order. The government half-heartedly entered into surveillance or supervision of loans because of its concern in being paid the debts owed it by the Allies abroad. Furthermore, it was fearful that if there was not some control over foreign-dollar lending, Congress might enact a stringent law and create an agency to deal with foreign-dollar loans and securities. But, the control over the lenders was imperfect; there was a power struggle over who would exercise the controls. When authority was given to the State Department, there was disagreement on the extent of the control. Later on, when business interests placed pressure on the use of these controls, the controls were further weakened by executive interpretation. Finally, when they were badly needed, they were virtually non-existent, and the great debacle occurred.

c. The government did not interpret its responsibility to inform bondholders of facts affecting their investment, as it did conceive their responsibility to leave no stone unturned abroad on behalf of business. Investors who inquired at the State Department generally received a brief reply that it was not in a position to comment upon the investment merits of loans. The Department of Commerce, which did disseminate information to investors, did not have appreciable use made of its information by those investors who really needed it. Furthermore, the information presented was fairly general, not particularly designed for investor usage. In addition, the information was frequently late, or was held up by diplomatic intervention, so that its
usefulness to investors was of little real consequence. Investors, in most cases, did not receive specific answers to their inquiries. When the defaults took place, the U.S. Government appeared dazed by its own ineptitude, and did very little to act on behalf of bondholders; although, when a private debt settlement of one of the New York banks needed adjustment, the Secretary of State and a large retinue of experts traveled to New York to see what could be done. Those experts, in the service of the government, who knew the facts concerning the inadequacy of the U.S. foreign loan policy, were too insecure in their positions to be able to make their superiors understand the gravity of the situation.

2. The role of the investment banker in the flotation and defaults of U.S. foreign-dollar bonds was characterized largely by low standards which in many instances were fraudulent or nearly so.

   a. Lending practices of bankers during the period 1920-1924 were generally more satisfactory than were the practices in the period 1925-1929. Competition among bankers after 1925 became increasingly active, and lending practices began to deteriorate. After this date, a deluge of small firms, without experience, entered the business and actively sought out foreign borrowers. In some cases, these small investment bankers bribed foreign officials in order to procure loans. Since these obligations were for sale and not to keep as investments by the bankers, an active campaign to "educate" the public was usually undertaken. Prospectuses, quite frequently, were made to look palatable by leaving out most of the unfavorable material while including irrelevant but interesting items of information. In some cases, underwriters would cable the desired information to the borrowing authority
and then the borrowing authority would re-cable the information back as official data to be placed in the prospectus. Salesmen of distributing firms were equipped with "sales pitches" and all sorts of descriptive brochures with which to entice their clients. The "nationality angle" was frequently employed to allow emotionalism to influence the sale, where perhaps logical analysis might not have succeeded. There was a sharp difference in ethics and business practices between some of the large investment affiliates as well as some of the small, new bankers and the ethics and practices of some of the old line firms, following the English system. Some of these firms, particularly J. P. Morgan, actually refused most loans after 1926 and did not enter into the fray for business.

b. Under the extremely active conditions of competition for business, indicated in (a), it is not surprising that bankers did, especially after 1926, undertake very doubtful loan transactions. The record is loaded with many such cases where firms deliberately sacrificed the factor of quality of loans, knowing full well that there was a good probability of default ahead. The large old reputable firms, which stayed aloof from this kind of business, did not, in the main, handle this kind of business and the record of the fewness of defaults of their bonds is adequate testimony.

c. The old English type of underwriter generally did not solicit business but required it to come to him. He examined carefully all relevant statistical information, and if the borrower's record was good and his desire to pay high, he would undertake the business. In this manner he protected his clients, the bondholders. In fact, the
banker who followed this practice also believed that he had a continuing obligation to his client to oversee that the conditions as represented continued to exist. Bankers who followed these practices always made sure that their associates in various aspects of the underwriting business followed the same high standards. The emergence of the huge banking affiliates helped to break down this kind of ethical relationship. If loans were accepted with too great a risk, they were given additional "points" for salesmen in contests competing to sell obligations. Volume was a prerequisite of the large-bank-security affiliate. And management incentive plans were evidently one of the means by which these standards were finally broken down. Perhaps the "New Era Doctrine," too, was influential but something else reinforced the New Era Doctrine.

3. The role of the investor in the flotation and defaults of foreign-dollar bonds was characterized frequently by sentimentality, gullibility, ignorance, and greediness. He was usually exposed to pervasive sales promotion, substantial misrepresentation, and a lack of remedial and protective measures.

a. It is probable that there were slightly less than one million foreign-dollar-bond investors in the U.S. during the period. Perhaps there were at least 142,000 large investors, and over eight hundred thousand small investors. Foreign-dollar-bond investors were located in every state in the nation. The states of New York, Massachusetts, Pennsylvania, and California represented the states of the largest number of foreign-dollar-bond investors, and the largest dollar amounts held of these bonds. The foreign-dollar-bond investor was quite likely to be a person who had previously held Liberty bonds during the war.
such as the $100 million French Government loan, were being scheduled for flotation in the American market. The cabinet met and discussed the issue on May 20, 1921. Information released by the Administration stated:

The Cabinet discussed the problem of favoring exports and the desireability of the application of the proceeds of foreign loans made in the financial markets for the purpose of exporting our commodities and the refunding of outstanding liabilities.20

In other words, the Administration was anxious that the banking resources of the U.S. be conserved for itself. All loans to foreign governments were to be scrutinized with great care. Bankers were to make sure that all foreign-dollar loans were either "tied" loans, or were for refunding purposes.21

The administration also stressed that while the war-power control of the sale of foreign-dollar bonds exercised during the war to assure maximum marketing success for Liberty, Victory, and other U.S. obligations was now ended, that the administration hoped to be able to control the situation by moral influence. It was hinted that bankers ought to avail themselves of the advice of the government prior to floating a loan.22

On May 23, 1921, President Harding disclosed another element of his foreign loan policy when he stated:

Our position in the world has been greatly changed as a result of the war. We have become a creditor rather than a debtor. It is doubtless unfortunate that the change has

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21 Ibid.
22 Ibid.
Frequently he was a person who was a first descendant of or an immigrant from a foreign country, whose obligations he was purchasing largely on the basis of sentiment.

b. Frequently he knew little or nothing about investments, except what the salesman told him. Small investors, particularly, relied exclusively on salesmen's information. There were a number of investment services available, but small investors were not likely to know about them. They did not even realize that some information was available from the Department of Commerce. Although there was incredible ignorance concerning investment facts, there was also laziness or unwillingness on the part of investors to ascertain facts. However, it is true that the facts that were presented and available to investors were "colored" and "doctored." None the less, some of the more sophisticated investors were able, on further investigation, to assess the probabilities concerning the securities and either not purchase them, or sell them quickly if they possessed them, with a smaller loss than their less fortunate but more naive fellow investors.

c. In the first instance, many investors became interested in foreign-dollar bonds through their experiences with Liberty or Victory bonds in World War I. As a member of a "nationality group," he may have purchased his first bond. Some investors were attracted because of the high coupon and high yield rates, overlooking the extensive risk they were assuming. Others became interested in these bonds through direct contact by salesmen. Lastly, some investors were induced to become bondholders through advertisements and articles in newspapers.
investments was a matter of social prestige, and those who did were held in great esteem. Americans, then, as now, were great materialists; and when reinforced with the belief that they were "helping the old country," these investors were willing buyers of foreign-dollar bonds.

d. The investor, however, did not have much in the way of remedial measures to protect himself against defaults, or misrepresentation, or even fraud. Some state laws exempted foreign-dollar bonds from the "blue sky" provisions. Fraud is difficult to prove if the plaintiff does not suspect that it is taking place, and gathers evidence later to buttress his case in court. Furthermore, the U.S. Government did little or nothing to protect him on the matter of the defaults. It was not surprising that in the disillusionment which followed in the 1930's one investor wrote to the Pecora Committee, "There ought to be a law to protect us investors."

e. And yet, investors themselves were not devoid of blame. They undertook large risks, partly because of greediness for yields and capital gains. Some of them were aware, perhaps vaguely, that they were playing investment roulette. Very few, if any, however, realized the full gravity of the situation.

Conclusions concerning foreign-dollar lending in the post-war years

1. While some American investors remember the defaults of the 1930's, most of the original investors are deceased; present investors are holding renegotiated issues with large amounts of capital gains. In
other words, the investment climate for investors is distinctly more favorable now than it has been for many years.

2. The present investor is much better informed; and even if he is somewhat inexperienced, he has many protective institutions seeking to create better standards of lending, even though there may be substantial risk. More specifically, fraud and misrepresentation are much less likely and are remedied through the Securities and Exchange Commission, the Foreign Bondholders Protective Council, Inc., and state "blue sky" laws, etc.

3. There is today a tremendous need for large amounts of "social overhead capital" in the development program throughout the world. Most of the capital formation has been "direct" rather than "portfolio." Balanced growth requires both "direct" and "portfolio" investment. Too heavy dosages of direct investment may, in a "Nationalism"-conscious world, evoke expropriation.

4. Yield structures between domestic U.S. investments and potential yields on investments abroad are distinctly favorable to, not only direct investments abroad, but also portfolio investments, including much greater amounts of dollar bonds.

5. Although it is true that political and economic instability are still present throughout the world, sufficient economic stability, as measured by exchange rates, convertibility, and the like, is obtainable to warrant further increases in lending. Investors are, it is thought, beginning to accept a modest amount of political instability as a "built-in" dimension to mid-twentieth century existence.
6. Although its present use is still small, the International Investment Company as the future vehicle for large, diversified investment in dollar obligations as well as other portfolio investment is a probability worth watching and examining.

7. The international institutions and the Export-Import Bank have created conditions and practices of lending in the post-war period which may be used for better results with private lending.

8. Investment bankers have reestablished themselves, not only in the eyes of investors and supervising governmental agencies as being much more capable and conservative, but they have gradually built up an excellent reputation dealing with nations and companies throughout the world. They have acquired great respect in these countries, and it is expected that, barring unforeseen circumstances, it will continue to develop.

9. Perhaps, eventually, in the next several years, state authorities may modify their investment requirements for banks, insurance companies, and other fiduciary types of investors to allow some proportion of their tremendous buying power to be used in foreign-dollar investments.

While foreign-dollar lending may never again achieve the status that it once did during the 1920's on the American investment scene, it is not improbable that it will grow much more rapidly in the near future.
APPENDIX

LETTERS AND SELECTIONS

217
October 4, 1933

Hon. James Cousens
United States Senate
Washington, D. C.

Dear Sir:

If not too late, may I suggest that (deleted) be questioned about the Bolivian 7% bonds which this firm sold to the public back about 1928 or 1929.

Here is what his firm did. They sent around circulars stating in substance that Bolivia had never defaulted on its external debts. That was a favorable argument in favor of the issue they were then trying to sell. I fell for it and bought two $1,000 Bolivian 7% bonds for somewhere near par. Then I investigated, fortunately, and learned that the statement, although true was misleading, for the reason that until (deleted) commenced to sell Bolivian bonds, that country never had had any external debts worth mentioning, only a few million dollars. I was not badly burned, only about 10 pts. loss per bond. But the misleading statement was so crooked in view of the fact that although it told the truth, it distorted that truth to the great danger of ultimate loss to investors, that I should like to see the matter brought out publicly. Unfortunately, I have thrown away the circulars, but the facts can be obtained from Moody's bond books, as to the small external debt that Bolivia used to have.

(passage deleted)

Respectfully,

(name deleted)

Copy
New York, April 22, 1933

In January 1927, I was planning to go abroad for an indefinite time, and was leaving my few securities, which I had purchased over a period of some twenty years, (all of which were bought through (deleted), from the time I first had a dollar to invest) with the (deleted) to be taken care of during my absence.

About a month or so before I was to leave New York, I called at the office of (deleted), with regard to the exchange of some one of my holdings but the salesman with whom I had always dealt was out, and another man came forward and asked me what I wanted. Then in talking with him and he found that I was going away and was going to leave my securities in so-called "Safe Keeping" he immediately jumped at the idea of making some huge profits for his firm by getting me to make a large loan at my bank and turning over the whole sum to (deleted), to put into their Foreign bonds which they were bringing out at that time. He figured out on paper how I could borrow on my securities up to the limit of their value, getting the loan from my bank at 5&, as he said, and that they could invest the whole amount in their foreign issues at 8% and that I would thereby increase my income at least $600.00 per year, by getting for them a loan of $20,000 and pledging everything that I possessed to get it.

I had always been a self-supporting woman all my life, working both night and day, over a period of more than twenty years, and these securities which I now had were bought one at a time whenever I had saved up a little money to invest. They represented all my life's earnings and savings, and I did not feel that it was a wise or safe thing for me to jeopardize them in the way this salesman suggested. I therefore told him that his scheme was "too much high finance for me" and that "It made me frightened to even think of it" and that I did not want it.

He however, with his high powered salesmanship, would not take "No" for an answer, but pursued me vigorously for at least a month, calling me up at my apt., and coming to see me, etc. there was scarcely a day passed that I did not hear from him, nagging at me continually to get me to make this huge loan, saying that this $600 per year was just going begging.

I finally went to my bank (deleted) to talk it over with them and they did not make any objection, but were quite willing and anxious to aid and abet in the scheme, not having my interests at all in mind. The loan, therefore was made by my signing away all my hard earned savings and securities as collateral to the (deleted) Bank, and that huge sum of $20,000 was sent right down to (deleted) office, and they put the entire sum into their foreign bonds which they were financing and on which they were, of course, making huge profits, and the salesman also got his fat commission. This was done in spite of the fact that I had
distinctly told them that I did not wish to have any foreign issues. I did not consider them safe. These foreign bonds which were bought with the loan were also sent up the (deleted) Bank as further collateral to the loan, and were held there with all my original securities. I never even saw a penny of this loan, nor the bonds which were purchased with it. It was solely and entirely (deleted) loan, not mine. They made about fifty percent profits out of it, to add to their millions, while I have made about two hundred percent losses, being sold out by the (deleted) Bank a month ago, with a very small balance, and all my earnings and savings of a life time gone.

I am a woman alone, without relatives or anyone to assist me, and now at my age, I cannot start all over again to accumulate an income, and in fact it is not possible to get work of any kind in these days, so I am entirely destitute, through no fault of my own. Those human vultures who get rich by robbing self-supporting women of their savings and earnings should be forced to reimburse me with the amount they have taken from me, as it was all done by lies, fraud and misrepresentations. I never needed or wanted any loan from anyone and never thought of such a thing at all, until this high powered salesman pestered me to death and coerced me into it.

After the loan was made, it developed that the (deleted) Bank was charging me 6% interest on the loan, instead of the 5% I was told it would be, but I did not know this until after I had left the country, nor for two months after, as I got no mail for two months, nor any statements from my Bank until that time, as I was traveling. Furthermore, the money of the loan was all put into (deleted) foreign issues, in spite of my orders to contrary, and at only an interest rate of 7% instead of the 8% which had been promised by them, and the consequence was that I only made a bare one percent out of the whole transaction, and this only for two years, when the Market crash came, and all these holdings began to go down to nothing. So that the net result of my making this huge loan for the benefit of (deleted), was that I received only two hundred dollars a year more income for just two years, while they made all their large profits out of me, and now I have lost everything that I possessed and that I worked all my life to earn, because it was all pledged as collateral to loan, which I was induced to take through the lies and misrepresentations of their salesman, and for which the firm is distinctly responsible, as they send out their salesmen to bring in the money, by fair means or foul, out of which they make their huge profits. It is a perfect outrage.

I, therefore, claim that they owe me at least the $20,000 amount of the loan which they got from me, and should be forced to reimburse me without delay. And this does not cover the other securities which I previously bought from them over many years of work, and which I also lost entirely on their account. Such creatures think that women alone are legitimate prey for their nefarious doings. My total loss through them amounts to $40,000, so that they really owe me this amount. The
bonds of South America and Poland which were bought with this loan, were all bought about par, so that they could not go up, and only went continuously down in value, so that I did not even have a gambler's chance on this fraudulent transaction.

I also claim that the (deleted) Bank had no right to sell out my collateral without notifying me, as I was in Paris at the time, and only learned of the Bank's closure through the newspapers. And immediately upon learning of it, I cabled (deleted), the Conservator, and begged him to withhold all action on my loan until my return, stating that I was returning at once to New York, and giving the exact dates of my sailing and arrival here. But he sold me out just four days after I cabled him not to do so, and at the very bottom prices on the Market, which has since gone up. There was no hot haste about selling me out, as my margin was about the amount required, of 20% and I never knew it had been done until my arrival here on April 15th. They had sold me out on March 28th, when the Market was at the low peak; I was so amazed on hearing this from (deleted) himself, that my heart just stopped beating, I was so stunned. There was no reason for this very hasty action, and I have not been able to get any explanation from them as to why it was done. It wiped me out completely of all that I possessed, and I consider it an abominable way to treat a customer whose family and self had been clients of the Bank for about twenty years. They wrote a letter on March 26th and sold me out on March 28th and I never received the letter until April 18th here in New York, as of course it reached Paris after I had left there. It could not get across the ocean in two days, and they knew well that I was living over there, but would not give me even time to reach here, but sold me out ruthlessly at the very low market. They should make good to me the loss thereby incurred, between the price they sold my securities at, and the present market.

From time to time during the past three years I had been reducing my loan at the (deleted) Bank by selling some of the securities they held as collateral, but of course, in each case it meant that I was obliged to sell them at about one-third the amount I had paid for them, because the bonds had defaulted in interest and greatly depreciated in value. In this way I had paid off half of the original amount so that last month it stood at $10,000 against about $13,000 collateral, which should have been sufficient for them to refrain from selling me out, at least until I could return to New York.

Last October (deleted), the "Executive Vice President" asked me to put up more collateral for my loan, sending me "Irrevocable Stock Powers" to sign and send them on three thousand dollars worth of stocks which were not pledged as collateral for the loan. He did this knowing very well that the Bank was insolvent and had been since last July (1932) and that by so doing I was perfectly certain to lose this additional three thousand which he asked me to put up. Of course I signed the powers and sent them to him, knowing nothing of the Bank's Condition
thus throwing another $3,000 in the sewer, out of my hard earned savings, in fact it was the very last dollar I had in the world, of securities, which fact I told him at that time. This was another piece of their trickery and dishonesty, and they were 1st pfd. stocks which had not at all depreciated in value, in fact one was being called at 110 per share.

On another previous occasion, when I was anxious to make a payment on the loan out of collateral, in October 1931, I wrote this man (deleted) to sell for my account and credit the loan with the proceeds of sixty shares of Utah Power & Light First Preferred stock, which was then selling at 103 per share, which would have yielded me over $6,000 to be credited to the reduction of the loan, but he wrote back that he considered that stock some of my best collateral, ranking with New York Telephone C. Pfd and advised me not to sell it, which advice I followed, with the result that it had depreciated to a low of 20 per share last month when they sold me out, thus making me lose another $5,000, almost. Though when I put up the additional $3,000 in October 1932, he wrote me that the Bank would continue to carry my loan through the Market fluctuations.

(Name deleted)

Copy
been brought about under conditions which the war imposed. We would have become a great creditor nation in the near future had there been no war. The exigencies of war compelled the government to take by taxation much wealth from our people to be loaned to our allies. This is the basis of their obligation to us, and it is not a good form in which to hold the obligations of our people to another people.

... It is altogether to be hoped that in a reasonable period we may change the form of these obligations and distribute them among all the people.

... Our strength in the industrial, financial, and commercial world, our capacity to produce, our ability to extend credits which others cannot give and which brave but unfortunate people sorely need, all of these make it necessary that we shall adopt new commercial methods, whereby to ensure the fullest possible service to civilization.

... I speak for the least possible measure of government interference with business...[and] for the largest cooperation with properly conducted business...

In the above speech, President Harding reveals some of the anxiety of his administration concerning the ultimate solvency of the World War government-to-government loans. It became quite apparent to the administration that, although it was committed to an essentially laissez-faire position vis-à-vis loan policy and the U.S. underwriters, it could not completely remove itself from this sphere of influence. The U.S. Government was concerned that European nations who owed it on World War I government-to-government loans might not honor these debts without pressure by the U.S. It was decided that the U.S. Government would not allow those nations, which had not funded their government-to-government war debts to the United States, the right to use the private capital markets of the U.S. for their needs. In fact, the increasing propaganda at home and abroad for cancellation or modification of these debts were

TELEGRAM

(NAME DELETED) JANUARY 10, 1929

PRESIDENT (DELETED) BANK, (DELETED), SOUTH CAROLINA

SUGGEST YOU CAREFULLY STUDY MY LETTER OF EIGHTH AND CIRCULAR ON (DELETED) WITH VIEW TO PURCHASING STOCK FOR YOUR PERSONAL ACCOUNT STOP CONSIDER THIS MOST ATTRACTION INVESTMENT FROM STANDPOINT OF PROFIT I KNOW OF SUPPLY VERY LIMITED AM HOLDING TWENTY FIVE UNITS FOR YOU OR OTHER OFFICERS AND DIRECTORS YOUR BANK THE INITIAL PAYMENT IS SIX HUNDRED AND TWENTY FIVE DOLLARS WIRE COLLECT WHETHER OR NOT YOU ACCEPT WILL TELEPHONE YOU GIVING COMPLETE DETAILS IF AT ALL INTERESTED CONSIDER OPPORTUNITY TOO GOOD TO LET PASS

(NAME DELETED)
ATLANTA

Copy
January 10, 1929

(name deleted)
------, South Carolina

Dear Mr. (deleted)

Today, I wired you calling your attention to my previous letter and urging you to purchase for your personal account. (passage deleted).

I am particularly anxious that you accept my recommendation and buy this stock and for that reason I want to leave nothing undone to make you a stockholder in the Corporation. This holds the best possibility for appreciation of any stock which has come to my attention in several years.

The Board of Directors are: Walter P. Chrysler, Clarence Dillon, Charles Hayden of Hayden-Stone Company, New York, Matthews Sloan, President of Consolidated Gas of New York, George Moffett, Executive Vice-President of Corn Products, Inc., Dean Mathey of Dillon, Read & Company, and Ernest Tracey, President of the parent company--(deleted)--S. Z. Mitchell, President of Electric Bond & Share Company.

I have a limited amount of stock and if you are interested it is necessary that I hear from you immediately. The units are payable in quarterly installments of $25.00 each, and I suggest that you telephone me immediately at (deleted), collect, to discuss the matter in detail, as it will be well worth your while.

Sincerely yours,

(name deleted)

Copy
January 15, 1929

(name deleted)
______, South Carolina

Dear [deleted],

You have recently purchased from us (deleted). We note this first transaction through Mr. Keady with much pleasure.

It has occurred to us that you might be interested in a brief description of the facilities which we have available for investors.

Our Statistical Department is constantly at your service. On request we shall be glad to submit to you available information with regard to any investments which you now own or which you contemplate purchasing. In addition to this general information, we are constantly advising clients, whose securities we have a record of, as to redemption notices, convertible features, issuance of rights and other matters pertaining to their holdings. We invite you to make use of these facilities.

In addition to calling the attention of our customers from time to time to securities which we regard as attractive, we are always ready to make analyses of lists of investments and offer suggestions as to desirable readjustments.

Again assuring you of our personal interest and of our desire to demonstrate our usefulness to you, we are

Very truly yours,

(name deleted)

Copy
The American Senatorial committee named to investigate the manner in which loans were granted to this nation from abroad proceeds in its work; and according to cablegrams received, it is clarifying the manner in which American bankers floated South American bonds.

It is of great interest, therefore, to follow this legislative investigation, because it is revealing details of the political aspects of loans received by many countries in the past years and which has affected the pattern of international finance. On the onset of a depression, the majority of nations were overwhelmed by the loss of their principal sources of income, as well as by the heavy public debts. Faced by the impossibility of meeting their commitments, they have been forced to declare a moratorium on their obligations, and have meanwhile been putting in practice the indispensable measures for avoiding bankruptcy. The importance of this is inarguable, since it comes from the legislative of the most powerful (economically) nation, which of late has been the regulator of international credit. Unfortunately this political aspect of the loans has been most harmful and one which the U.S. may be considered mistakenly as an element which favored the relations between this country and those which asked for the loans, the effects which today are manifestly in error. Some of the witnesses have indicated that officials from the Department of Commerce yielded to the exigencies of the diplomatics and which, in spite of knowing in full the precarious actual situation and the poor future of the nations which solicited the loans, they took the steps toward these operations. That which was revealed cannot be more eloquently in evidence as that they did not have sufficient knowledge and honesty to contain the wave of (sic) inflation. With the money from the loans it was easy for governments to sustain themselves in power and to deprive the people of all civil rights (expression). The same technicians encharged with studying economic conditions of the countries of South America reported that they were abnormal; but in spite of all they facilitated the concession of the loans.

These acts are coming to light now, and no one now doubts that the loans were floated under shady circumstances. Hence Senator Glass speaks of "moral responsibility" in the Department of State for each dollar lost by American citizens in the acquisition of foreign bonds. Since then each nation enjoyed the widest right of contacting obligations; but it is also necessary to state that the persons who acquired the bonds have at least means of making investigation as to the solvency of the borrowers. This inquiry was avoided, because the say-so of the Department of Commerce sufficed to support the offer of the securities. It is known that the U.S. Government supports a vast service of observers and commercial technicians and that they were in charge of formulating studies relative to the flotation of the loans. It appears that the facts submitted by them did not influence the criteria by which they were expedited, but that they were measured in accordance with other suggestions.
EL DIA (contd.)

If the U.S. Government, upon promoting the loans, desired to give health to relations between itself and other nations, it has made a deep mistake. Mistake more condemnable, because rarely has the debtor to be grateful to the creditor. Parting from a false position, the money granted with such largesse and such liberality, only served to lengthen the period of regimes whose immoral procedures are obvious. It is for that very significant the statement of Sen. Glass and it purports to recognize an erroneous policy which we hope will be rectified, so that in the future situations so deliterious and anger-provoking will be avoided. The "moral responsibility" which falls on the Dept. of State upon consenting to these negotiations of credit should serve for the management or bringing into order the loans, reductions and cancellations can be obtained.

The money of the loans arrived to the borrower considerably reduced in buying power, because these operations were generally contracted for most onerous conditions. Then the governments continued to squander the funds, seldom investing in real works, and frequently in imaginary ones. It is also necessary to take into account the fact that a good part of those loans were absorbed for the purpose of maintaining funds for stabilizing. All these factors should be seriously considered as the revision of the loans is effected.

It will be very interesting to follow the investigation and hope that it produces more information, regarding the unfortunate policies followed. With regard to Peru the investigations have had definite results. Strauss & Breck, representatives of Seligman & Co., bankers who placed the loans in our country, has confessed that there was a gain to J. Leguia. . . .

This is clearly proves the existence of bribery in the contracting of loans by the dictatorship. It is very difficult for this country that the national interest was defrauded by the same friends of the president of the republic and that the imputation of speculation was definitely confirmed today. . . . The lack of honesty in the flotation of loans . . . favors the cause of Peru, strengthening its moral position to the creditor to come to an equitable arrangement and to minimize the harm suffered by ourselves by operations which were not honestly made.
Memo from (deleted)

To (deleted)

Re: Sante Fe External 7% Gold Bonds 1924-1942

The advertisement as published in the newspapers relative to the above issue makes no mention whatever of the past fiscal record, admittedly one of the most dependable criteria in evaluation of foreign loans. The prospectus, on the other hand, seemingly goes into detail regarding the attitude in the past on the part of the Province towards foreign creditors. It is significant to observe in the prospectus the following reference to the financial record.

"The Government states that during each of the last 25 years all payments of interest on all bonds of the Province in the hands of the public have been promptly met when due."

According to information available the Province was in default on obligations at the very time the above issue was sold in the American market. The Buenos Aires Stock Exchange, in fact, stated publicly, that the Province was in default and that nothing was known officially as to whether payment would be resumed. This information was also contained in an issue of the Review of the River Plate, one of South America's most reputable Journals.

No mention is made of the suit brought against the Province of Sante Fe by holders of the 5% External Gold Loan of 1910, and nothing is said about the defaults and irregularities of payment in connection with the 4% External Loan of the City of Rosario, which bonds are unconditionally guaranteed by the Province of Sante Fe.

No mention is made of the irregularity of payments in connection with the City of Sante Fe External 6% Loan of 1889 which is also unconditionally guaranteed by the Province.

It is worth calling attention to the fact that at the time the Provincial issue was offered for public subscription on the American market, the City of Santa Fe loan, unconditionally guaranteed by the Province, was paying interest only at the reduced rate, so that one would have been justified at the time the bonds were sold to question whether the Province would be able and willing to continue to pay on a 7% loan when it was unable to meet the service in full on the already existing 6% issue.

Copy
Mr. Ferdinand Pecora, Special Counsel,
United States Senate,
Washington, D. C.

Dear Sir:

Please inform me if you desire to obtain documentary evidence and list of witnesses to assist you in exposing the incompetence, inefficiency and dishonesty on public works in the Republic of Colombia which were financed by bond issues sold to the investing public in the United States.

It is my opinion, based on actual construction work under my direction in Colombia, that investigation will reveal that 75% of all funds expended on railroads and highways have been improperly expended. It is not my desire to see anyone condemned without a fair and open hearing but I do not doubt that the investigation which you are conducting will reveal that in some cases the bankers who floated Colombian bonds were criminally negligent in not supervising expenditures in a manner sufficient to prevent racketeering from replacing engineering on the public works for which the loans were specifically contracted.

Yours very truly,

(name deleted)

Copy
Los Angeles, California, June 27, 1933

Mr. Pecora and Senate Committee
Washington, D. C.

Gentlemen:

The country is reading with interest your investigation of the N.Y. Bankers.

I write in reference to the Foreign bonds. I invested my life's savings in these bonds—some twenty issues. I purchased them because I had confidence in the great N. Y. banks that sponsored them. I thought the security was good. I borrowed money from the banks on them and made investments and when the bonds began to decline the banks, as is their custom, demanded more security. I cashed in on Life Insurance and when the depression came with full force I lost bonds, property and fifteen thousand in Life Insurance.

I still have two of the Brazilian, two Bogoto and one Caddas, Columbia, one of the Bolivian, one of the Hungarian Municipal, several Chinese Huyang RR - twelve in all.

I wrote to all the Banks that issued the bonds that I purchased and received prompt replies. I asked what they were doing to stabilize these bonds, etc. when interest would be paid on the defaulted bonds etc. I asked as to the viewpoint of the public on the banks that floated such securities etc. I know of many hard working people who invested their all in such bonds and have lost all. I wrote to some of the foreign representatives inquiring about these securities and invariably received a reply similar to the one enclosed. They pass the buck to the banks.

I hope you will keep the ball rolling until something worthwhile will issue from the investigation.

(deleted) who issued the Bogotos 8's and some of the Brazilian ought to be called for an explanation. I was told recently by a man from Columbia that that nation would not pay unless forced to do so.

(deleted) issued those bonds on The Municipality of Tucuman, Argentine; (deleted) those on the State of Caldas, Colombo; Chase National those on Parana (state of Brazil) also the Bolivian 7's.

I understand Hungarian interest coupons are being paid by (deleted) on the Chinese Railroad on the European Issues but not the American. Why the preference? Now, it seems to me that Banks that issued bonds ought in some way to be held responsible for the value and interest, at least to half or more of the par value of the bonds.
Mr. Pecora and Senate Committee (contd.)

And banks that make loans on bonds ought to share in the loss when they decline. Some kind of laws at least that will give us protection. I am only a small "Fry" though my name has gotten into "Who's Who in North America," but thought I would write you a line in commendation of the work you are doing and say "go ahead" the whole country says "Amen" The Lord bless you.

Yours sincerely,

(name deleted)

Copy
Dr. Willy Feuerlein  
International Investment Section  
2631 C United Nations Secretariat Bldg.  
New York, N. Y.

Dear Dr. Feuerlein:

I want to thank you for your kindness in seeing me, last December, to discuss International investment problems of the "Point Four" program. This was, you will recall, in connection with this university sponsored project "U.S. Private Long Term, Foreign Investment and Point Four." Our mutual friend, Kenneth Spang, arranged for the appointment.

I very much appreciated being able to talk to you about this project and benefit from your observations. Of course, I still don't quite agree on your point that it would be just as easy for a foreign country to default on its dollar bonds as it would be to expropriate direct investment, if this country was becoming more nationalistic minded. My main reason for disagreeing is that basically the reasons for default and expropriation are quite separate and distinct; default of dollar loans, were and are primarily, an exchange problem; whereas expropriation of direct investment, so far as I have been able to gather, has been largely due to failure of direct investment to agree to some kind of national policy restricting its control. This was part of my reason for thinking that wherever adaptable, some increase in dollar lending might be very desirable; whereas the complete emphasis at present being on direct investment expansion might very well lead us to trouble in the years to come as the spirit of nationalism of many of the underdeveloped countries accelerates.

I trust that all is going well in your division and that you thoroughly enjoyed the holidays.

With highest personal regards, I am

Sincerely yours,

John R. Nichols  
Research Fellow

P.S. Would it be too presumptuous on my part if I were to communicate with you occasionally relative to literature being turned out by your and other divisions on the subject in which I am interested?
becoming increasingly popular in view of the difficulty with German Reparations and exchange conditions in general.²⁴

On May 26, 1921, Mr. Harding invited seven prominent Eastern bankers, two cabinet members, Mellon and Hoover, and Governor Strong of the New York Federal Reserve Bank to a White House dinner for the purpose of discussing the administration's plans regarding the flotation of foreign-dollar loans and the revival of industry and trade.²⁵ Among the most important matters discussed was the promotion of American investment abroad as a means of promoting our exports and reviving industry. A scheme was disclosed to fund the debts of the former Allies to the U.S. Government into issues to replace the Liberty bonds held by the American public. Although bankers expressed interest in the scheme, they were generally sceptical as to its practicality.²⁶ Certainly, it can be said that the administration had altered its position on foreign lending, perhaps due in part to the declining condition in exports and mounting inventories and unemployment perhaps in part, due to the realization that if world recovery was to take place, America could not isolate itself from its responsibilities. During the following summer, the elements of the loan policy took shape and were put into effect.

²⁴ New York Times, May 24, 1921, p. 1, and ibid., May 27, 1921, p. 1; also see John Maynard Keynes, The Economic Consequences of the Peace (New York: Harcourt, Brace and Howe, 1920), Chaps. 4 and 7 especially.


²⁶ Ibid., p. 2.
Mr. John R. Nichols  
Department of Economics  
The Ohio State University  
Columbus 10, Ohio  

Dear Mr. Nichols:

Thank you for your letter of 6 February 1951 following up our discussion in January. I should like to add that in my opinion the defaults on dollar loans were caused by exchange and fiscal problems. With respect to direct investments the reasons for expropriations may also be a little broader than you state. However, I agree with you that the emphasis on direct investments may lead into trouble in future years, particularly if an over-expansion should now occur in extractive industries causing thereby imbalance in the economic development program of many countries. Over-expansion of direct investments can be just as dangerous as operating too much in the foreign securities markets. With respect to borrowings it will be interesting to watch whether default on inter-governmental loans will in a long run occur as frequently as default of private obligations. The lending government may wield a big stick or on the other hand, close its eyes to the problem!

So far the United Nations has not issued any new books or reports on the subject you are interested in. If you write me again in a month or two something new may have come out.

Wishing you success with your study.

Very truly yours,

W. Feuerlein  
Department of Economic Affairs  

Copy
Mr. Ferdinand Pecora  
Committee Council  
Washington, D. C.

Dear Mr. Pecora:

I have read with a great deal of interest of the investigation taking place in Washington and the splendid work you have been doing on checking up the New York Bankers, and judging from the proceedings I can readily see the reason I lost approximately $200,000.

In 1928 I sold out a good laundry business for which my share was approximately $4 million dollars in cash and $125,000 of Baxter 7% preferred Stock. When I received the money, at the time I was advised to make my investments with some of the best and biggest Banks in the Country, and I naturally decided that was the proper course to pursue.

The Preferred Stock, which I received from the Baxter Laundries as part payment, was not worth very much, nevertheless, the Internal Revenue Office compelled me to pay, in 1930, an additional $15,000 in income taxes on the worthless Preferred Stock, although I could not sell it at the time for the amount involved in the tax payment, and naturally I had to pay it, for I was not crooked enough to make out my income tax returns along the same lines as was done by some of the New York Bankers whom you are investigating at this time.

On or about October 15, 1929 the representative of the (deleted) Bank called on the writer with the suggestion that the (name deleted) Company check up on some of the Bonds I had at the time. They recommended that I dispose of some of the Bonds my wife and I had and purchase 200 shares of (name deleted) Bank Stock at $250 per share, and since this recommendation came from one of the largest Banks in the Country, I did so with the result that I paid $50,000 for the 200 Shares of Stock and its present value is only $4000.00.

I can readily see that this is the Stock that (name deleted) was selling short on the market.

In November 1929 when this Bank Stock dropped down to about $200 a share, I went direct to New York and had a talk with (name deleted) telling him that I intended to go again into the Laundry Business and felt like disposing of the Stock, but since there was a loss of $10,000 at the time, I wanted to get his advice.

To use his exact words, "Why, it would be perfectly ridiculous for you to dispose of this Bank Stock at this time. All the officers of the Bank, including (name deleted), are buying Stock now and it is not the time to sell," --but I could readily see that it was just the contrary.
Pecora Committee (contd.)

I, likewise, noticed a report that (name deleted)'s income for 1932 was over $1 million dollars, while as far as I am concerned, I did not earn enough money last year to pay my living expenses and take care of my wife and five small children.

(Name deleted) sold me $10,000 worth of Fulton Flat Bush Corporation - 6% Bonds March 2, 1928, for which I paid at par, and now they offer me for the entire $10,000 just $100.00. At the time the purchase was made, the circular read that it was a Gold Bond. After making an investigation of same it was disclosed that these Bonds were illegally sold in the State of Wisconsin. I have corresponded with them on several occasions, but they just ignore me.

(Name deleted) sold me the following securities with their earnest recommendation that was the best list they ever submitted to any conservative investor:

<table>
<thead>
<tr>
<th>Description</th>
<th>Paid</th>
</tr>
</thead>
<tbody>
<tr>
<td>100 Shares of National City Bank Stock</td>
<td>$30,000.00</td>
</tr>
<tr>
<td>10,000 Chicago Milwaukee &amp; St. Paul Adjustment Bonds 5%</td>
<td>7,782.50 9/11/29</td>
</tr>
<tr>
<td>5,000 Republic of Peru 6% of 1946</td>
<td>95.00 10/24/29</td>
</tr>
<tr>
<td>10,000 Chicago Rapid Transit 6%</td>
<td>91.00</td>
</tr>
<tr>
<td>5,000 Lautoro Nitrate Co. - First Mortgage 6%</td>
<td>99.00</td>
</tr>
</tbody>
</table>

All of the above mentioned securities are in default at this time.

The (name deleted) of New York sold me $5000.00 worth of F & W Grand 6's in 1929, which are in default and that I still have.

Living in the Village of Shorewood, near the City of Milwaukee, all of my five children were compelled to save a certain amount of money every week at the school and monthly it was turned over to the Shorewood Bank. My wife had a small checking account at this Bank. They accumulated several hundred dollars—the Bank failed and closed last year on account of the President of the Bank being dishonest as per findings of a local court. Up to this time, all my family received from this Bank was 5¢ for every dollar they had in it.

The New York Bankers are crooked, and some of the Milwaukee Bankers are crooked, and I pray that our worthy President Roosevelt, with the assistance of as capable a man as you, and with the Senate, that something could be done whereby the life savings of a man could be preserved.

Wishing you lots of success in your investigation and hoping you will weed out all of the crooks we have in this Country, I am

Very truly yours,

(name deleted)

Copy
Mr. Ferdinand Pecora (contd.)

The New York Bankers are crooked, and some of the Milwaukee Bankers are crooked, and I pray that our worthy President Roosevelt, with the assistance of as capable a man as you, and with the Senate, that something could be done whereby the life savings of a man could be preserved.

Wishing you lots of success in your investigation and hoping you will weed out all of the crooks we have in this Country, I am

Very truly yours,

(name deleted)

Copy
April 26

Senator George W. Norris
The Capitol
Washington, D. C.

Dear Sir:

The Committee might also inquire into a big loan by the same firm to Brazil in 1921-22, likewise peddled out to the public. It was a loan for public works or largely for that purpose. The banker's terms, commissions and so forth might be inquired into, but they would not disclose that a side agreement required that the works be executed by the same firm (Kennedy and Co.) upon a basis of cost plus 10 per cent profit.

A similar situation might be uncovered in the big loan by the same firm to Bolivia for the building of railways--the construction contract however to be given to contractors named by the bankers (i.e. Kennedy).

These practices are perhaps not illegal but explain the great incentive to bankers to take on often doubtful foreign loans and distribute them to the investing public.

Very truly yours,

(excerpt from letter only)

Copy
Morristown, N. J.

May 20, 1933

Hon. Ferdinand Pecora
Washington, D. C.

Sir:

The issues of Argentine dollar loans by the (deleted) amazed me at the time—being personally familiar with the country I believed that the Argentine Republic had profited extraordinarily during the war and that there could be no possible necessity for the export of American capital to that country for productive purposes.

It would be interesting to know what steps if any were taken by the (deleted) to watch the uses to which the vast sums they were loaning were put.

As to the (deleted) issue of Bolivian dollar Bonds, anyone familiar with that country knows well that of all the South American Republics, Bolivia is the least worthy of credit—the men are frankly immoral and generally untrustworthy; I would say that there would be no willingness to pay if evasion were possible.

You need no suggestions from me of course, but as an old timer in this business, I kept carefully away from the sale of South American bonds and from most of the other foreign loans; my conviction was and is that the Houses responsible for them deliberately went out competitively and used dubious means to get the sanctions.

Although these investigations are like locking the stable door after the horse has gone, nevertheless complete publicity of the methods and reasons for the gigantic totals of the foreign loans will do a lot of good—the plain fact is that these large private banking firms were consumed with greed for banking profits.

Prior to the war, all the financing for the Argentine was done from River Plate House in London—I never heard of a single instance of any trouble with any of the loans made over a long period of years.

Respectfully yours,

(name deleted)

Copy
Mr. Oliver C. Townsend
American Commercial Attache, Lima, Peru

Dear Townsend:

I feel that I understand exactly how you look upon reporting at
length upon every question put up to you by the Bureau or by business
houses. As an engineer you believe in economy of words. You told me
after you had plowed through the files or reports from some offices that
you thought a large part of the work was wasted effort and that you
could say the same things in much less space, or perhaps leave them
altogether unsaid.

I have some sympathy with your viewpoint for it is easy to agree
that there is much duplication, unnecessary expansion of ideas, and
unimportant reporting; but I don't know that I agree with your corrective
measure. I'm sure you won't mind if I make some observations which are
partly my own and partly those of commodity chiefs. I feel such a keen
personal interest in you that I want to pass them on even though such
action is outside my regular line of duties.

In the first place, I don't believe you fully realized when you
left here the basic importance of the written word in the work of the
bureau. The field man can pass on his ideas or knowledge verbally to
only a comparatively few persons; the majority must be reached through
written reports. Moreover, it is more important to reach the stay-at-
home effectively than it is the traveler who already is fairly well
informed. We in Washington and the export managers in Podunk and Oshkosh
cannot get a true picture of Peru and its trade possibilities unless the
Commercial Attache gives it to us fully in written form.

In the second place, it would appear to me that you, in the
desire to be brief, give an impression of impatience or curtness, or
even discourtesy, which is far from your real nature or intent. When a
man writes down to Peru and waits three months for a reply he expects
something big, and therefore, the reply, especially a negative reply,
should be couched in friendly and sympathetic terms.

Thirdly, it is my impression and that of some commodity chiefs,
that you are over alarmed about a temporary trade condition that has
slowed business but should not preclude all consideration of American
sales to Peru. In several trade letters you have taken the view that
the inquirer should not even try to investigate Peruvian trade possibil-
ities for months or even years. Aside from the fact that such an answer
rarely satisfies because the inquirer is interested in potential as well as present possibilities, there is the more important consideration that the trade situation may not be warranted even by the time the reply reaches its destination.

Right in this connection, I should like to emphasise that the spirit of the bureau follows the spirit of American business, which is to make sales in spite of difficulties, or to find ways of doing seemingly impossible things. As officials we should be encouraging whenever possible and discouraging only in the last extremity. We are builders, promoters—even propagandists, although never to such an extent that we fail to recognize and point out difficulties.

Finally, I think that you may be tempted to overlook the small things or those that you personally are more or less uninterested in. It is surprising how many big pieces of export business have developed out of almost nothing by attention to details; how a casual observation by some commercial attache has opened up a market for some American specialty or a close study of costs and prices has put American goods in a hitherto closed territory.

I know you will take these observations in the friendly spirit in which they are made. I am so much interested in our Latin American work and in you personally that I want to do anything I can to be helpful. I do hope you are interested rather than impatient when you lay this letter down.

Thomas R. Taylor
Assistant Director

Copy
PERUVIAN NOTES—OFFICIAL NEGOTIATIONS

Tuesday night's dinner, given at the Hotel Bolivar by S. A. MacGinniss to fifty-odd guests, was a fair sample of what the local society folk are treated to at rather close intervals, namely, entertainment by promoters seeking favors of one sort or another from the Government.

Our host, who was Minister to Bolivia during the Wilson administration, is here with a big entertainment fund in the interest of J. W. Seligman, a New York banking firm, to bid on the securities shortly to be issued as a part of a big refunding loan.

The ex-minister is a big chap of about 50—ex-newspaper man—probably a lawyer by present profession—loud voiced, glad handed—just a little short of being offensive in his jovial familiarity. One wonders how and why such a person is selected as a representative of important Latin American interests. A reasonable guess is that the bankers are led to believe that a person having intimate knowledge of what is represented to them as a delicate but well organized graft system, of which the President and high officials of the local government form a part—is the only agency through which they can accomplish their objective. It would be—I suspect—a revelation of gullibility to listen in on the confidential talks between the bankers and MacGinniss as he outlined to them his particularly unique fitness for the game of getting the best of all competitors on this job of securing the coveted securities to be resold to American investors.

"Being an ex-minister," I can hear him say, "I naturally have an already established entree to the President. This game of fixing presidents and officials of South American Republics is one in which I am expert. Sure, they all take graft—but it must be handed over in just the right way so that no evidence is left upon which a future scandal can be built—and it must be done with delicacy to avoid hurting the peculiar type of sensibility common to Latin American Presidents."

The bankers swallow it—line the promoters pocket with expense money—agree to pay him a commission if he succeeds and pass unquestioned what sums he says he paid out to state officials who are of the system. If he brings home the contract he's a great negotiator—if he doesn't, he manufacturers an alibi as specious and untrue as was his original representation. It's a great life—the promoters. However, this dinner was picturesque.
Peruvian Notes (contd.)

The puzzle suggested to my mind is: Why has all this undignified scramble and promotion atmosphere become an accepted feature of the program for disposing of an issue of Government bonds? There is something about such scrambling that is highly appealing to Latin American officials—who encourage the intrigue and delays accompanying them—as a coy maiden flirts with a group of suitors—not in any spirit of indecision but for the long drawn out pleasure afforded by the game.

One would think that more satisfactory results might be achieved by the Government if it were itself to first fix the terms of its loan in accord with international usage, and call for bids for the issues of which it desired to dispose. Not only would it secure all of the advantages of competitive bidding—but it would conceivably save itself something of the time and annoyance which its representatives must suffer at the hands of the importunate salesmen—promoters by whom it is beset, under the system now followed and the dignity of the proceedings would be vastly greater.

South American officials must realize that their methods of procedure in negotiating public contracts give color to the suspicion prevalent amongst foreigners—that graft really is an inherent factor in all official negotiations.

James Brown, a senior partner of Brown Bros. & Co.—New York and London—passing through on the "Laconis tour" Thursday, talked about bond buying in South America—in which he has had a large experience. His attitude is that the antiquated methods of negotiation take so much time and effort that his policy has become one of "Let George Do It." On occasions his firm participates in such loans after they have been negotiated by other bankers—but he regards the actual negotiations as undignified and the "cost" which intertwine themselves into them as unnecessary burdens upon the borrowing peoples.

Mr. Brown further explained that in his opinion bankers should avoid the practice of offering such bonds to the general public because of the uncertainties of interest and principal payments. As investments they belong in the safe deposit boxes of the rich who make yearly investments in diversified lists of securities from excess incomes. On the theory that even South American States do not go permanently bankrupt, such investors are secure in the ultimate recovery of both principal and interest, but the small investor who buys for income and is forced to take a loss when interest is defaulted should not be advised by bankers to buy such issues. The experience of English investors in Argentine bonds sponsored by Baring Bros. in 1890, was cited to illustrate the uncertainties from which investors for income should be protected by bankers.

Copy
In general, the position taken on foreign-dollar loans by the Harding Administration was shared by the Coolidge and Hoover administrations, with some exceptions. As Dr. Feis states:

A vague sense of obligation existed to respond to the deep need and desire of other countries for our aid.

... The prevailing view was that the American citizen should not be taxed and the American Government should not borrow in order to lend abroad, that foreign seekers of capital should go to the private American investor for it; that he could make his decisions and arrange his deals on a paying business basis while the government could not; that if the government began to make loans it would soon find itself entangled in international quarrels and intrigues against its wishes.

... The chief officials of all three administrations that were in office ... were of this mind. They were in favor of our foreign financial activity. They believed in the benefits to themselves and others of the loans and the investments that were being made. ... 27

The appointment of Hughes as Secretary of State

The announcement that President Harding had appointed Charles E. Hughes as Secretary of State was finally made on February 19, 1921, at St. Augustine, Florida. 28 The appointment of Hughes lent considerable prestige to the Harding Administration for Mr. Hughes had had a distinguished and varied career as Governor of New York, Associate Justice of the United States Supreme Court, and as the Republican Presidential candidate during the 1916 campaign. 29


Mr. Brown. I do.
Mr. Pecora. Your full name, Mr. Brown?
Mr. Pecora. And where do you live?
Mr. Pecora. What is your business or occupation?
Mr. Brown. I have none. Oh, yes; I am clerking for the poor board.
Mr. Pecora. What was your business or occupation?
Mr. Brown. I was a theatrical manager, owner, and producer.
Mr. Pecora. In the early part of the year 1928 were you a resident of Pottsville, Pa.?
Mr. Brown. Yes, sir.
Mr. Pecora. And at that time were you contemplating making a trip for your health to the State of California?
Mr. Brown. I was.
Mr. Pecora. About the time that you had arranged to leave your home for California did you have any business transactions with the National City Co.?
Mr. Brown. Yes, sir.
Mr. Pecora. How did the transactions originate?
Mr. Brown. I saw an ad in a national magazine that fitted my particular dilemma.
Mr. Pecora. What was the substance of this ad, as you recall it?
Mr. Brown. It said—I cannot quote verbatim.
Mr. Pecora. No; the substance of it.
Mr. Brown. (reading) Are you thinking of a lengthy trip? If you are, it will pay you to get in touch with our institution, because you will be leaving the advice of your local banker and we will be able to keep you closely guided as regards your investments.
Mr. Pecora. Whose name was signed to that advertisement? Was it the National City Bank or the National City Co.?
Mr. Pecora. What did you do, if anything, when you read that advertisement?
Mr. Brown. Why, it struck me, Mr. Pecora, as suitting my needs, and I answered the advertisement.
Mr. Pecora. Did you receive a reply?
Mr. Brown. A man called that I had never seen before.
Mr. Pecora. Do you know his name?
Mr. Brown. Yes.
Mr. Pecora. What was his name?
Mr. Brown. Fred Rummel.
Mr. Pecora. Did he tell you whom he represented?
Mr. Brown. He told me he represented the National City Co. and that they had received a letter from me.
Mr. Pecora. Your letter was addressed to the National City Bank?
Mr. Brown. I think so.
Mr. Pecora. And a Mr. Rummel of the National City Co. called to see you in response to your letter?
Mr. Brown. Yes, sir.
Mr. Pecora. Now tell the committee briefly the substance of the conversation you had at that time with Mr. Rummel.
Mr. Brown. I told Mr. Rummel that I had just sold my chain of theaters to different individuals and that the proceeds were becoming due and that I would need to invest them and that I was contemplating leaving for the West Coast and that I was glad he had called in response to my letter. I wanted his guidance in investing those funds, Mr. Pecora.
Mr. Pecora. Did you tell him how much money you had available for investment at that time?
Mr. Brown. Yes, sir.
Mr. Pecora. What did you say to him about that?
Mr. Brown. I told him that I would have approximately $100,000 to invest.
Mr. Pecora. What did Mr. Rummel say to you about that?
Mr. Brown. He told me that he would make—I had some bonds as well as some cash. The cash was becoming due, Mr. Pecora.
Mr. Pecora. That is, the cash from the proceeds of the sale of your theaters?
Mr. Brown. Yes, sir.
Mr. Pecora. It was about to be paid by the purchasers?
Mr. Brown. Yes, sir.
Mr. Pecora. And you told that to Mr. Rummel?
Mr. Brown. Yes, sir.
Mr. Pecora. You said that cash would amount to about $100,000?
Mr. Brown. Together with bonds that I had at the time.
Mr. Pecora. What kind of bonds had you at the time?
Mr. Brown. I had Government bonds.
Mr. Pecora. United States Government bonds?
Mr. Brown. Yes, sir; and some Italian Government bonds. About $25,000 all told.
Mr. Pecora. Yes. Now, did Mr. Rummel give you any advice concerning the investment you should make with your resources?
Mr. Brown. He said that he would take that up with his company and would advise me.
Mr. Pecora. What happened thereafter?
Mr. Brown. He came back with certain recommendations for the sale of all of the securities I had.
Mr. Pecora. That included the United States Government bonds?
Mr. Brown. Yes, sir.
Mr. Pecora. Yes. Go ahead.
Mr. Brown. And the purchase of other bonds through his company.
Mr. Pecora. Were there any specific issues that he recommended
you to buy with the proceeds of the sale of the Government bonds?
Mr. Brown. I don't remember.
Mr. Pecora. Tell the committee from that point on in your own
way—
Mr. Brown (interposing). Oh, I can remember some, Mr. Pecora.
One was that issue of Peru that we spoke about.
Mr. Pecora. You mean the Peruvian bonds that were the subject of
testimony here yesterday?
Mr. Brown. Yes, sir.
Mr. Pecora. Tell the committee in your own way, Mr. Brown, if
you will, just what transactions and negotiations led to the making of
investments by you with representatives of the National City Co. from
that point on. Just tell the committee in your own narrative.
Mr. Brown. My attention was called to the fact that all the
securities which I then held were all wrong, and certain recommendations
were made for the purpose of replacing those securities, and loans were
made at banks which I had never been in. The first loan was made at
the National City Bank of New York of $75,000.
Mr. Pecora. Who arranged that loan?
Mr. Brown. Mr. Rummel.
Mr. Pecora. Had you ever before had any dealings or transactions
with the National City Bank or the National City Co.?
Mr. Brown. I had never been in them; no, sir.
Mr. Pecora. Give the committee, please, the general circumstances
surrounding the making of the loan, what induced it, what the purpose
was, and what you did with the proceeds of the loan.
Mr. Brown. My attention was called by Mr. Rummel that if I could
buy bonds below par that were paying 7\% netting 7\% percent, and borrow
the money at 5 or 5\% percent, that I could make the difference on the
borrowed money and pay off those loans when the bonds came back, as he
expected they would go to par.
Mr. Pecora. Did you also invest at that time upon his recommenda-
tion any part of the $100,000 approximately, which you had in cash or
obtained as a result of the sale of your Government bonds? Did you make
any investments through Mr. Rummel of that money?
Mr. Brown. Yes, sir.
Mr. Pecora. Tell the committee about those investments.
Mr. Brown. They are substantially the same, Mr. Pecora, as the
loan at the National City Bank.
Mr. Pecora. Tell us about that.
Mr. Brown. We would buy Greek Government 6's and have them sent
to a bank in Reading that I had never been in, the Northeastern Trust
Co., and a loan approximately 2 or 3 times that amount, the amount of
the value of the bonds, would be placed and other bonds equal to that
sum would be purchased.
Mr. Pecora. Upon whose judgment were the investments made?
Mr. Brown. I am presuming upon that of the National City Bank
and National City Co. because he was their representative.
Mr. Pecora. You mean Mr. Rummel?
Mr. Brown. Yes, sir.
Mr. Pecora. Had you made any suggestions to him concerning the specific securities that you wanted to invest your moneys in—
Mr. Brown (interposing). Only that I did not want stock.
Mr. Pecora. — or did you leave that entirely to his judgment?
Mr. Brown. I left it entirely to his judgment, except that I specified I did not want stocks.
Mr. Pecora. You wanted fixed interest security?
Mr. Brown. Yes, sir.
Mr. Pecora. Fixed income security?
Mr. Brown. Yes, sir.
Mr. Pecora. Such as bonds?
Mr. Brown. Yes, sir.
Mr. Pecora. What investments were made for you by Mr. Rummel?
Mr. Brown. I would have to consult my records.
Mr. Pecora. Please do that, will you, if you have your records with you?
(The witness left the witness chair for a few moments and returned with documents.)
Mr. Brown (handing document to Mr. Pecora). That will give you an idea, Mr. Pecora. It is entirely too lengthy to read. They were bought and sold and traded in to such an extent that I could not follow it.
Mr. Pecora. What was the aggregate amount of investments in dollars and cents that you made under Mr. Rummel's advice and guidance?
Mr. Brown. I should say $200,000 to $250,000.
Mr. Pecora. You had approximately $100,000 of capital to start with in the early part of 1928 when you first met Mr. Rummel?
Mr. Brown. Yes, sir. I want to correct that. That is December or November, 1927, instead of the early part of 1928.
Mr. Pecora. All right. Where did you get the funds above that amount—
Mr. Brown (interposing). They were borrowed.
Mr. Pecora. — that you invested to the aggregate to $200,000 to $250,000?
Mr. Brown. They were borrowed at various banks.
Mr. Pecora. Through whose instrumentality were those loans effected?
Mr. Brown. Only through Mr. Rummel's.
Mr. Pecora. And at what banks were those loans placed?
Mr. Brown. The Northeastern Trust Co. of Reading, Pa.
Mr. Pecora. Had you ever had any business transactions with that bank before?
Mr. Brown. No sir.
Mr. Pecora. Go ahead.
(There was a pause.)

Mr. Pecora. May I read into the record the list produced by the witness as being a list of the securities in which investments were made for him in the manner that he has indicated?

Mr. Brown (handing other documents to Mr. Pecora). That is the bank in Philadelphia, sir.
### National Bank (Securities)

#### MUNICIPALS

<table>
<thead>
<tr>
<th>Description</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Bay Biscayne Bridge Company 6½-41 1st Mtge SFGB Certificate of Deposit #734/6</td>
<td>$2,742.00</td>
</tr>
<tr>
<td>2. Cape Girardeau Bridge Co. 7-47 1st Mtge SFGB #329 327/8</td>
<td>2,742.00</td>
</tr>
<tr>
<td>3. City of Coral Gables, Fla. 6-35 Man. Imp. Bonds Certificate of Deposit #1605 1604 1606/8</td>
<td>5,000.00</td>
</tr>
<tr>
<td>4. Mount Hope Bridge Co. 6½-57 1st Mtge SFGB #445 407/10</td>
<td>4,987.50</td>
</tr>
</tbody>
</table>

Total: $15,471.50

#### TOWNSHIP OF BLAIRSTOWN--LOCAL

<table>
<thead>
<tr>
<th>Description</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Blairstown Township Improvement 6-31</td>
<td>$1,599.92</td>
</tr>
<tr>
<td>2. Blairstown Township Improvement 6-31</td>
<td>1,825.11</td>
</tr>
<tr>
<td>3. Blairstown Township Improvement 6-31</td>
<td>166.66</td>
</tr>
<tr>
<td>4. Township of Blairstown 6-31 Temporary Improvement Bond No. 1</td>
<td>1,599.92</td>
</tr>
<tr>
<td>5. Township of Blairstown 6-31 Temporary Improvement Bond No. 1</td>
<td>1,825.11</td>
</tr>
<tr>
<td>6. Township of Blairstown 6-31 Temporary Improvement Bond No. 1</td>
<td>166.66</td>
</tr>
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Total: $7,183.38

#### FOREIGN

<table>
<thead>
<tr>
<th>Description</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Bank of Columbia 7-47 20 yr. SFGB 409/11</td>
<td>$2,887.50</td>
</tr>
<tr>
<td>2. Bolivia Republic of 7-58 Ext. Sec. GB #1780/84</td>
<td>4,662.50</td>
</tr>
<tr>
<td>3. Buenos Aires, Arg. 6½-61 Ext. SFGB #7475 7473/4</td>
<td>$2,857.50</td>
</tr>
</tbody>
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Total: $10,207.50

**copy**
National Bank Securities (contd.)

**UTILITIES**

<table>
<thead>
<tr>
<th>Description</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. American Natural Gas Corp. 6½-42 SFGB #5089/91</td>
<td>$2,917.50</td>
</tr>
<tr>
<td>2. Atlanta Gas Light Co. 4½-33 2 yr. GN #2236/2240</td>
<td>4,925.00</td>
</tr>
<tr>
<td>3. Canadian Railway &amp; Harbour Term. 7-45 SFGB #909 908</td>
<td>2,000.00</td>
</tr>
<tr>
<td>4. Central Railway Term'l &amp; Cold Storage 6½-52 1st Mtge. SFGB Certificate of Deposit #904</td>
<td>4,987.50</td>
</tr>
<tr>
<td>5. Central Power &amp; Light Co. 5-56 1st Mtge. GB #26115 30826 14559 3074</td>
<td>3,162.50</td>
</tr>
<tr>
<td>6. Cities Service Power &amp; Light 5½-49 Gold Deb. #3905/7</td>
<td>3,050.00</td>
</tr>
<tr>
<td>7. Consolidated Gas Utilities 6-43 1st Mtge. &amp; Coll. GB &quot;A&quot; #672/76</td>
<td>4,925.00</td>
</tr>
<tr>
<td>8. East Coast Utilities Co. 6-33 Conv. GB Ser. A #269/71 274/5</td>
<td>4,937.50</td>
</tr>
<tr>
<td>9. Eastern Utilities Investing Corp. 5-54 Golf Deb. (Warr. att) #4354 4350/3</td>
<td>4,850.00</td>
</tr>
<tr>
<td>10. Gary Electric &amp; Gas Co. 5-34 1st lien Coll. GB &quot;A&quot; 6901/3</td>
<td>1,932.50</td>
</tr>
<tr>
<td>11. Gatineau Power Co. 5-56 1st Mtge. GB #64796/800</td>
<td>4,612.50</td>
</tr>
<tr>
<td>12. Houston Light &amp; Power Co. (Temp) 4½-81 1st lien &amp; Ref. GB &quot;E&quot; 1291/6</td>
<td>3,895.00</td>
</tr>
<tr>
<td>13. Insull Utilities Investments Inc. 5-49 Gold Deb. Ser. A. #4150/54 #777 3613/5 5025</td>
<td>9,275.99</td>
</tr>
<tr>
<td>14. Jersey Central Power &amp; Light 4½-61 30 yr. 1st Mtge. GB &quot;C&quot; #25876 26391 #25570/1 25569</td>
<td>4,937.50</td>
</tr>
<tr>
<td>15. Lexington Water Power Co. 5½-53 Conv. SFGB #3944/48</td>
<td>4,675.00</td>
</tr>
<tr>
<td>16. Midland United Co. 4½-32 Ser. G Notes #9571</td>
<td>998.09</td>
</tr>
<tr>
<td>17. North Continental Utilities Corp. 5½-48 1st lien &amp; Ref. GB #1017/21</td>
<td>4,837.50</td>
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*copy*
### National Bank Securities (contd.)

<table>
<thead>
<tr>
<th>Description</th>
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<tbody>
<tr>
<td>18. Public Service Co. of Oklahoma 5-57 1st Mtge. Ser. D</td>
<td>$1,515.00</td>
</tr>
<tr>
<td>#13825/7</td>
<td></td>
</tr>
<tr>
<td>19. Seaboard All Fla. Ry. 6-35 1st Mtge. GB Ser. A. Certificate of Deposit</td>
<td>2,697.50</td>
</tr>
<tr>
<td>#4787/9</td>
<td></td>
</tr>
<tr>
<td>20. Southern Ohio Gas Co. 6 1/2-38 1st &amp; Ref. SF Mtge. (Warr. Att.) #59/60</td>
<td>2,940.00</td>
</tr>
<tr>
<td>43/4 30/9</td>
<td></td>
</tr>
<tr>
<td>21. Texas Electric Railway 5-47 40 yr. GB 1st &amp; Ref. Certificate of Deposit</td>
<td>3,100.00</td>
</tr>
<tr>
<td>#132</td>
<td></td>
</tr>
<tr>
<td>22. Twin States Natural Gas Co. 6-35 Conv. Gold Deb. Certificate of Deposit</td>
<td>980.00</td>
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Total $82,150.59

### INDUSTRIALS

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<tbody>
<tr>
<td>1. American Bolt Corp. 7-37 Certificate of Deposit</td>
<td>$240.00</td>
</tr>
<tr>
<td>2. Butler Bros. 5-33 Gold Deb. #600/4</td>
<td>4,885.50</td>
</tr>
<tr>
<td>3. Hearst Magazines, Inc. 6-34 Ser. Gold Deb. #882</td>
<td>977.90</td>
</tr>
<tr>
<td>4. Maher Colleries Co. 6 1/2-27 1st Mtge. SFGB Certificate of Deposit #56</td>
<td>1,933.40</td>
</tr>
<tr>
<td>5. National Theatres Corp. 6 1/2-42 1st &amp; Ref. Mtge. GB &quot;A&quot; #1199 1195/8</td>
<td>4,887.50</td>
</tr>
<tr>
<td>6. Peabody Coal Co. 5-53 1st Mtge. SFGB Ser. A. #8623 2211 7561 1124 1584</td>
<td>4,337.50</td>
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<tr>
<td></td>
<td>$17,261.40</td>
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<tr>
<td>7. United Porto Rican Sugar Co. 6 1/2-37 Sec. SFGB Ser. A #1005/7</td>
<td>2,992.50</td>
</tr>
<tr>
<td>8. United Steel Works Corp. 6 1/2-51 25 yr. SFGB Ser. C #8225 8227</td>
<td>1,945.00</td>
</tr>
<tr>
<td></td>
<td>$4,937.50</td>
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<td></td>
<td>17,261.40</td>
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<td>$22,198.90</td>
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### REAL ESTATE

<table>
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<th>Description</th>
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<tbody>
<tr>
<td>1. Beneficial Industrial Loan Corp. 6-46 Conv. Deb. #M5411/2</td>
<td>$1,965.00</td>
</tr>
<tr>
<td>3. Madison Ave. &amp; 57th St. - 6-34 Leasehold Mtge. GB #445 443/4</td>
<td>2,979.60</td>
</tr>
<tr>
<td>4. Montague Court &amp; Office Bldg. 6½-38 1st Mtge. #636 635</td>
<td>2,992.50</td>
</tr>
<tr>
<td>5. Realty Foundation Inc. 6-38 Part SFGB #216/18</td>
<td>3,000.00</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$12,795.30</strong></td>
</tr>
<tr>
<td><strong>Grand Total</strong></td>
<td><strong>$140,007.17</strong></td>
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</tbody>
</table>
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In making the most important appointment—that of Secretary of State—Mr. Harding gave Mr. Hughes a free hand in the direction and decision-making in the department. When asked about the details of his consultation with Mr. Hughes about diplomatic and departmental affairs, the President-elect stated:

You must ask Mr. Hughes that. This is going to be another policy of the next administration. From the beginning the Secretary of State will speak for the State Department.30

Very few, if any, secretaries of the State ever served with as free a hand in shaping policy and guiding affairs as did Mr. Hughes.31 Mr. Hughes was clearly the dominant force in the cabinet, and in almost all instances his judgment was followed by President Harding. Indeed, as Mr. Hoover states in his Memoirs, "He seemed a little afraid of his stiff Secretary of State."32

Mr. Hughes tackled the job of Secretary of State with a zest which belied his age. His approach was that of a jurist. As Mr. Charles Hyde, Solicitor in the Department from 1923, stated: "Law was the language that Secretary Hughes spoke..."33 but on the contrary, "He never failed to distinguish between what was and what was not entitled to his time."34 He was a man dedicated to securing peace and stability in world affairs, and he helped lead America to the conclusion that if

33 Samuel Flagg Bemis, op. cit., p. 233.
34 Ibid., p. 395.


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U.S. Congress, House of Representatives Committee on Foreign Affairs.  
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1950.  

U.S. Congress, House of Representatives Supplemental Report of the  
Committee on Foreign Affairs. Foreign Economic Assistance. 81st  

U.S. Congress, House of Representatives Supplemental Report of the  
Committee on Foreign Affairs. Foreign Economic Assistance. 81st  

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American Countries. 83rd Cong., 2nd Sess. Pursuant to S. Res. 25,  
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permanent peace was to come, America must take an active role in creating the proper condition for it.\textsuperscript{35}

The kind of diplomacy exercised by Mr. Hughes was "Open diplomacy." He believed that treaties must be arranged under conditions of negotiation in which all parties act in good faith and honesty, devoid of deception or hidden purposes. If nations act by giving justice and security, then they can require it from others. The welfare of mankind was associated in this pursuit of justice on an international scale. Repeatedly, he identified American interests with the peace, prosperity, and well-being of peoples in other parts of the world.\textsuperscript{36}

In general, the economic orientation of Mr. Hughes was similar to that of the President and the Cabinet. He considered Mr. Hoover and Mr. Mellon the best minds in the Cabinet.\textsuperscript{37} He was eager to see American capital and American experts honestly at work developing the resources of neighboring countries:

This sort of 'economic penetration' may be regarded as the highest expression, from the material standpoint, of international confidence and good will.\textsuperscript{38}

But it also stemmed from the national interest, as Mr. Hughes states:

Ability on our part to sell our surplus production, and thus to maintain a high degree of production activity, is the

\textsuperscript{35}Charles E. Hughes, \textit{The Pathway of Peace} (New York: Harper and Brothers, 1925); see selection entitled "Some Aspects of Our Foreign Policy," pp. 32-58 especially.

\textsuperscript{36}\textit{Ibid.}, see selection entitled "Some Aspects of the Department of State," pp. 250-266. Also Pusey, \textit{op. cit.}, pp. 421-422.

\textsuperscript{37}Pusey, \textit{op. cit.}, p. 426.


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Sara Biellous, June 30, July 24, and August 21, 1950.

Fred Cutler, August, 1950.

Hillary Houston, July 18, 1950.

Grosvenor Jones (formerly of Department of Commerce), telephone conversation, November 29, 1950.

Charles A. McQueen (formerly of Department of Commerce), November 22, 1950.
Robert L. Sammons, August 1, 1950, and August 21, 1952.
John Walsh, September 8, 1952.

Department of State

Charles Bevans, August 16, 1950.
George Gazzera (formerly with Redmond & Co.), August, 1951.
Fred Livesey, July 31, 1950, and August 28, 1952.
Dr. Carl Lokke, September, 1951.
E. Taylor Parks, September, 1951.
Hamlin Robinson, August 6, 1950.
Mr. Rosa, July 31, 1950.
Mr. Sullivan, July 31, 1950.
Mr. Sullivan and Vernon G. Setser, August 21, 1952.

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Henry Bitterman (correspondence), May 18, 1950.
Dr. Paul Dickens, July 21, 1950, and September, 1951.
Mr. Hirschtritt, August, 1952.
Robert J. Swartz, November 18, 1952.
Henry Bauer, Secretary, Schroder Trust Co., December 13, 1950.
Benjamin H. Beckhart, Professor, Columbia University, December 5, 1950.
Dr. Benjamin Caplan, Council of Economic Advisors, June 29, and July 5, 1950.
Henry Davis, Sutro Brothers, December 4, 1950.

Willy Feuerlein, Department of Economic Affairs, United Nations, December 15, 1950.


William Johnson and Mr. Kiraly, Ohio Division of Securities, Department of Commerce, State of Ohio, August 29, 1950.

Leo Kane, Vice President, National City Bank, December 13, 1950.


August Maffery, Vice President, Irving Trust Co., December 7, and 8, 1950.

Benjamin Makela, Assistant to the U.S. Chamber of Commerce, August 2, 1950.

Carl Marks, Dealer in Foreign Dollar Bonds, December 10, 1950.


Dr. Ray Moulton, Brookings Institute, August 1, 1950.

Judge Ferdinand Pecora (telephone conversation), December 19, 1950.

Albert J. Redway, Export-Import Bank, September 9, 1951.

Dr. James Grafton Rogers, President, Foreign Bondholders Protective Council, December 5, 1950.


George Ross, Investment Section, Technical Cooperation Administration, September 3, 1952.

Dr. R. H. Rowntree, Export-Import Bank, July 31, 1950.

Dr. Kenneth Spang, Foreign Bondholders Protective Council, July 25, and December 11, 1950.

Dr. Kenneth Spang and Dr. James Grafton Rogers, Foreign Bondholders Protective Council, December 6, 1950.

Amos Taylor, Pan American Union, August 1, 1950.

John M. Vorys, Representative, 12th District, Ohio, July 23, 1950.

Herbert Willet, Technical Cooperation Administration, September, 1951.

Brooks Willis, Department of Research, Chase National Bank, December 13, 1950.


Harding Woodall, Partner, Harriman-Ripley & Co., December 14, 1950.

Dr. Ralph A. Young, Federal Reserve System, August 3, 1950.

Addendum


Samuel Pizer, Department of Commerce, August, 1950.
I, John Raymond Nichols, Jr., was born in Lorain, Ohio, November 5, 1917. I received my secondary school education in the public schools of Rocky River, Ohio, and my undergraduate training at Western Reserve University and Baldwin-Wallace College. I received the Bachelor of Arts degree in 1942 from Baldwin-Wallace College. From Ohio State University I received the Master of Arts degree in 1946. From 1947 to 1956 I held various assistantships and teaching assignments in the Department of Economics while completing requirements for the Doctor of Philosophy degree.

In 1957 I accepted a position as Assistant Professor of Economics at Coe College, which position I presently hold.
key to our prosperity and the maintenance and extension of our foreign trade is a matter of concern primarily to our wage earners, who depend upon opportunities for employment, and secondarily to those engaged in the multitude of transactions incident to commercial exchanges.\textsuperscript{39}

Shortly after Mr. Hughes assumed his tenure of office, he began a comprehensive reorganization of his department. Even before he took office, he requested that a number of reassignments being contemplated by Mr. Colby in the foreign service be deferred for his consideration. Henry P. Fletcher, a career diplomat, was selected as his first undersecretary and placed in charge of the reorganization.\textsuperscript{40}

In the reorganization which followed, the secretary recast the Department's Foreign Service with special emphasis on regional divisions devoted to distinct geographical areas. The office of the Foreign Trade advisor virtually ceased and the experts in foreign trade were incorporated into the regional divisions, so that each division had its own foreign trade expert.\textsuperscript{41} Career Diplomats with foreign experience were returned to home posts to enrich the Department with their first-hand knowledge. Mr. Hughes was finally successful in getting promotions based on the merit system and a more adequate basis of compensation for service officers; however, he was not completely successful in preventing political appointees to ambassadorial posts abroad.\textsuperscript{42}

\textsuperscript{39}\textit{Ibid.}, p. 54.
\textsuperscript{40}\textit{Pusey, op. cit.}, p. 412.
\textsuperscript{41}\textit{New York Times}, May 1, 1921, p. 3.
\textsuperscript{42}\textit{Pusey, op. cit.}, pp. 417-420.
The evolution of the Department's foreign loan policy

When the Harding Administration assumed office and began to establish its foreign loan policy, it did not have the use of the war powers of the President to implement this policy, as did the Wilson Administration. Nor did the new administration consider it advisable to seek any special kinds of control or legislation to implement its policy. The chief architects of foreign loan policy—Hughes, Hoover, and Mellon, in addition to President Harding—were all committed, essentially, to a laissez-faire approach to government administration and regulation. This was not only consonant with the general philosophy of these individuals, their party, and constituents, but it represented a reaction to the more positive kind of control employed by the Wilson Administration.

Shortly afterward Mr. Hughes began his duties as Secretary of State and became involved in the role of peacemaker to a number of Latin American countries. It also became apparent to the department that a number of our former allies were seeking to obtain substantial loans in the U.S. market for refunding, currency, stabilization, and a number of other purposes generally associated with reconstruction. At the time,


UNITED STATES FOREIGN-DOLLAR BONDS AND PRIVATE INVESTMENT;
THE 1920'S AND THE 1950'S

DISSERTATION

Presented in Partial Fulfillment of the Requirements for
the Degree Doctor of Philosophy in the Graduate
School of The Ohio State University

By

John Raymond Nichols, Jr., A. B., M. A.

******

The Ohio State University
1962

Approved by

Clifford L. James
Adviser
Department of Economics
Interest rates were high in the U.S. market and the availability of capital was limited, even for domestic use. It appeared to Mr. Hoover that these funds might better be used for U.S. domestic purposes to assist business and agricultural interests preserve their working capital. Mr. Hoover was also concerned about lending funds abroad without tying the proceeds of the loan to the export of U.S. goods and services, particularly U.S. agricultural products, which were glutting our markets. 46

Mr. Mellon had a more serious objection to allowing our former Allies, who had not refunded their government-to-government debts to the U.S. Government, to borrow in the private capital markets of the United States. He was concerned that if we allow them to borrow extensively here without first funding the war-time government-to-government debts, that the interest to honor them might wane and the debts prove to be uncollectable. It was the great desire of Mr. Mellon to put the U.S. financial house in order. As the Treasury was paying out over a billion dollars interest annually on the debt, Mr. Mellon saw that if we could get the Allies to make arrangement to settle their debts to us, the Treasury could reduce its own debt, reduce the budget, and lower taxes. 47 Furthermore, it was the expressed desire of Congress that the administration obtain a settlement as soon as practical.

46 U.S. State Department, Decimal Files, 835.51/326, Memo from Assistant Secretary Dearing to Mr. Fletcher, dated July 29, 1921; New York Times, May 21, 1921, p. 23; New York Times, May 31, 1921, p. 15.

So, the Harding Administration, which most certainly did not wish to intervene in the area of control over our private foreign lending, found that it could not for many reasons of national policy leave this area of policy without some measure of governmental influence. Mr. Hughes found that it was desirable to have the right to deny unrecognized governments the right to borrow here. Later, he found it expedient in terms of his role as a peacemaker to Latin American nations to deny the use of loan proceeds for armament where it tended to foster aggression. 48 Mr. Hoover introduced the policy of preventing loans which tended to strengthen monopolistic foreign producers who could then exploit American business firms and consumers with reduced production and higher prices. 49 These policies and others will be discussed in greater detail below.

By and large, the foreign loan policy of the administration, at least during the early part of the Harding Administration, was pragmatically determined and highly flexible in organization and application. As problems developed, the administration dealt with them; indeed, in some cases, it almost appears that some of the cases showed some inconsistency in treatment. Gradually, as loan policy emerged from Cabinet meetings, or from separate conferences with the President, the lines of executive authority were drawn more distinctly and a committee was set up from the State, Commerce, and Treasury departments to implement the

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49 Hoover, op. cit., pp. 81-84.
policy established. In general, it must be said that the slowness of the emergence of policy with respect to foreign loans was due in part to a general hesitancy on the part of the policy makers to invade what was conceded to be a private business matter. In part, it reflected the absence of statutory laws dealing with security flotations. Perhaps, too, it reflects the fact that the administrators, themselves, were somewhat inexperienced, particularly in the understanding of the subtle details of international capital movements.

Presidential authority for the determination and execution of our foreign loan policy, while resting fundamentally on the executive powers of his office, was unfortunately not buttressed by specific statutory law or by executive order. When President Harding and the chief cabinet executives began to inquire into the nature of our foreign loan policy and other related problems, they sought the assistance and counsel of a group of top Eastern and Western bankers. As a result of the first conference with Eastern bankers, Mr. Harding informally asked these bankers to cooperate with the administration by submitting to the State Department, prior to consumation, the details of any foreign loans they might be contemplating. This informal request was apparently

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50 U.S. State Department, Decimal Files, 832.51/289, Memo from Mr. Carrel to Mr. Wells, dated October 28, 1921.

51 Personal interview with Mr. Frederick Livesey, July 31, 1950; also see New York Times, March 25, 1923 for criticisms of Hughes and Harding on Foreign Loan Supervision by Frank Vanderlip, former President of the National City Bank of New York.


misunderstood or not received by bankers, because by the autumn of 1921 a number of instances of non-compliance of the request had already occurred. The administration felt it necessary on March 3, 1922, to make more specific by a Presidential press release, a request to bankers to comply with the wish of the government. However, even this press release of March 3, 1922 was not an executive order of the President.

The locus of power in the administration of the government's foreign loan policy was vested in the State Department. This was, of course, as it had been historically, particularly in the Wilson and Taft administrations. Nonetheless, Mr. Hoover, who enjoyed considerable prestige when he undertook the Secretaryship of Commerce, made a strong bid to obtain the stewardship for foreign loan policy in his department. While Mr. Hoover failed in this endeavor, he did succeed in obtaining for the Department of Commerce a bigger role than it had previously enjoyed. According to both Mr. Hoover and Mr. Hughes, the relationship between the State and Commerce departments during the early part of the Harding Administration was quite cordial and cooperative.

During the spring of 1922, Governor Strong of the New York Federal Reserve Bank wrote a letter to the Secretary of State protesting against the supervision of foreign loans. Specific objection was made

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54 U.S. State Department, Decimal Files, 832.51/268, Memo from Mr. Carrel to Mr. Dearing, February 16, 1922.


56 Hoover, op. cit., pp. 86-88 for Hoover's own account; for a slightly different version see Feis, op. cit., p. 8.
to the supervision of "investment merits" of loans. Secretary of the Treasury Mellon agreed that it was impractical, if not impossible, for the government to determine the worthwhileness of obligations. When President Harding agreed with Mr. Mellon, Mr. Hoover was forced to abandon his interest in the issue. Mr. Hughes was also quite opposed to this element of policy and the Department of Commerce scheme for supervision. However, his grounds were that he thought the government's legal right to review this portion of foreign loan policy was doubtful. He furthermore questioned that it was wise to engage his limited staff in matters of this kind. Finally, it should be added that by this time the administration was committed to a policy of stimulating our foreign lending program in an effort to help our economy gain recovery.

Later on, after Mr. Coolidge succeeded to the Presidency, our foreign loan policy began to wane. Mr. Coolidge gradually chipped away at certain portions, particularly our policy of not lending to foreign monopolies controlling raw materials purchased by the United States. Eventually, the role of Commerce and Treasury in formulating and executing foreign loan policy was substantially reduced, and to all intent and purpose, the Department of State exercised a more exclusive role. Under the guidance of Secretary Kellogg and Secretary Stimson, our foreign loan

57 Ibid.


59 Hoover, op. cit., p. 88.
policy became not only more limited in scope, but rather inflexible in application.

**Elements and supervision of U.S. foreign loan policy**

War debt settlement

The Harding Administration had not been in power for long when it began to run into problems which altered its ideas of controlling private foreign loans. In May, 1921, came the first intimations that some of the former Allies of the United States were seeking to borrow substantial funds in the U.S. market. Since there had been considerable agitation for cancellation of the U.S. war loans to foreign governments, the Treasury and the State Department, not to mention the Congress, became exercised lest we lose all power to influence the settlement of these debts.

The feasibility of denying access to the U.S. market for private capital issues to those reluctant Allies, not willing to consent to a funding of the war obligations, was a matter of interest and concern to the Cabinet in a meeting on May 10, 1921. A French Government loan for $100 million was approved by the Harding Cabinet for flotation in the U.S. private capital market. The reason for the approval of this loan

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60 *New York Times*, May 21, 1921, p. 23, and May 22, 1921, p. 5, Sec. II.

61 For a good summary account of the many and varied problems associated with the negotiation of the funding of the war debts, see Mr. Gerrard Winston's article, *New York Times*, July 29, 1928. Also for a good account of Mr. Hughes' place in these negotiations, see Merlo J. Fasey, *op. cit.* Chap. 56, pp. 579-593.

was that it was not completely a loan for new money, as a large portion was for refunding a previous loan. It was decided that a policy should be made concerning loans to those former European Allies who had not funded their debts to the U.S. Government. It was suggested that a committee composed of those departments interested in foreign loans be set up to apply this policy. It was also decided that the advice of our bankers on these issues would be desirable. President Harding had a scheme which contemplated the refunding of our outstanding Liberty bonds with obligations of our foreign governmental debtors. As it turned out, this scheme proved to be impractical. At this same meeting, bankers were asked informally to notify the State Department about foreign issues being contemplated, so that the Department might have the opportunity to suggest if any issue countervened State Department policy. By the fall of 1921, a tentative set of policy considerations guiding the interest of the government in our foreign lending had been agreed upon. The State Department was selected as the logical clearing house for this information and advice, with Commerce and the Treasury to share in the formulation and execution of policy and to be consulted in turn. Later, when the Federal Reserve learned that it was to be excluded from having a part, it objected to the whole procedure,

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63 U.S. State Department, Decimal Files, 832.51/289, Memo from Mr. Carrel to Mr. Wells, October 28, 1921.


65 U.S. State Department, Decimal Files, 832.51/289, Memo from Mr. Carrel to Mr. Wells, October 28, 1921.
and some changes were made in policy and procedure in consultation. 66

During the early part of the winter, it became quite evident that the Allies were still balking at arranging debt settlements for the war debts. Congress independently had decided to set up a Debt Commission to assist in securing the settlement. On February 22, 1922, Mr. Harding nominated Secretary Mellon, Secretary Hughes, Secretary Hoover, Senator Reed Smoot and Representative Theodore Burton to serve on the Foreign Debt Commission. The Commission under the chairmanship of Mr. Mellon conducted most of its negotiations through the ordinary diplomatic channels of the State Department. It commenced its negotiations with Great Britain. 67

However, the situation in Europe grew worse, and diplomatic efforts did not avail. American hints that if armament were cut, Europe's debts to us could be met, were received coolly. 68 Even the Allied Reparations Committee's request that J. P. Morgan and Company consider an international loan to Germany and accept membership on the financial subcommittee, did not, at least then, break the deadlock. 69 Although Mr. Morgan and assistants sailed for Europe anxious to help, with the blessings of President Harding, 70 it was soon reported back by observers


69 New York Times, April 19, 1922, p. 3.

that Europe was not making much effort to create the conditions for
satisfactory international lending. Most European countries were not
curtailing expenditures, and military costs were excessive when judged
by peacetime standards. Thus, in October, the Department of State again
sought to increase the pressure on foreign governments for settlement of
the war debts. The Department of State divulged to newspapers, unoffici­
ally, its intention to prevent those nations which had not funded their
wartime government-to-government loans from borrowing privately in the
U.S. market. It was also divulged that diplomatic pressure had been
applied on Rumania, which was seeking to negotiate an international loan
of $175 million.

On November 11, 1922, came the information that the policy of the
government in preventing non-funding-war-debt countries from partic­
ipating in the U.S. market, had met with some modest success in that the
Rumanian debt commission had arrived in this country for discussion of
its debt to the U.S. Government. But the real start on negotiations
began when the British Debt Commission came to Washington in January,
1923, and finally made a settlement.

Negotiations with France proved to be most difficult. As Mr.
Gerrard Winston, former Undersecretary of the Treasury and secretary to

74 Pusey, op. cit., pp. 584-586 for an interesting behind the
scenes account of this settlement.
the War Debt Commission stated, "Washington undertook positive methods to bring settlement." The Congress of the United States adjusted its formula for settlement of war debts due the U.S. Government by considering "what can the debtor pay." On December 31, 1924, the U.S. Congress, fearing that France was considering repudiation of its debt to the United States, threatened to pass a resolution that the U.S. not undertake any new private loans to France. Later, in May, 1925, nine foreign governments, including France, received a suggestion from the State Department that debt adjustments were in order. By October, 1925, negotiations had arrived at a stage where the solution seemed possible. But it proved a long wait, and in the meantime, the French evaded the ban by borrowing elsewhere. Finally, in anticipation of French ratification, Mr. Coolidge in January, 1928, raised the ban on French industrial loans.

As Mr. Winston has stated, the policy of banning countries not having renegotiated their war debts with the U.S. Government the right to have resort to borrowing in the U.S. market had but limited success. "This pressure alone did not bring about the debt settlement. . . .

But, I think the restrictions accelerated negotiations."

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80 Winston, op. cit.
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The author wishes to express his appreciation to his reading committee, consisting of Dr. Clifford L. James, Dr. Mikhail Condoide, and Dr. Alva Tuttle, for their helpful suggestions and constructive criticisms. Many others on the Ohio State University Faculty made useful suggestions, and among those to be especially thanked are Dr. Viva Boothe, Director, Bureau of Business Research, and Dr. Edison L. Bowers, Chairman of the Department of Economics. Dr. Mikhail Condoide of the Bureau of Business Research and the Department of Economics was particularly helpful with many phases of this dissertation.

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To my adviser, Dr. Clifford L. James, goes my sincere expression of appreciation for his tolerance, patience, and valuable suggestions.

Lastly, especial thanks are extended to two individuals who contributed money and ideas to help in the early phases of this research, Mr. W. B. Calkins and Mr. Willard Kiplinger.
Unfortunately, a few years later, in the depression, a complete breakdown of payments occurred which brought virtually all the efforts to naught.

Non-use of loan proceeds for war purposes

A second item in the U.S. Government's foreign loan policy was the objective of preventing, if possible and where practical, the use of foreign loan proceeds for armament purposes. This principle was broadly conceived in the President's authority to conduct foreign relations and had many previous precedents in application. As Mr. Hughes interpreted it:

The President is empowered in case he finds that in any American country conditions of domestic violence exist, which are promoted by the addition of arms or munitions of war procured in the United States, to put an embargo upon the exportation of such arms or munitions of war from the United States to such country with such limitations as the President may prescribe.81

It was also the manifest desire of the people of the United States that our government use its influence to bring about conditions of peace. When Mr. Hughes assumed his duties, he was immediately thrust into the role of peacemaker between Panama and Costa Rica. These incidents and others probably convinced Mr. Hughes that what the Americas needed, if not the world, was someone to help adjudicate its snarled affairs.82

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82 Pusey, op. cit., Chaps. 39, 44, and 51; also see Charles E. Hughes, The Pathway of Peace (New York: Harper and Brothers, 1925).
The opportunity to help positively to preserve the world peace came out of the competitive arms race following World War I. The United States, Great Britain, and Japan were engaged in a massive naval expansion. Soon, protests began to be heard from all quarters, including the U.S. Congress, that something should be done to alleviate this state of affairs. Finally, on July 8, 1921, Mr. Hughes had the U.S. Ambassadors in Great Britain, Japan, France, and Italy inquire whether they would agree to participate in a conference on limitation of armament to be held in Washington. While there were many problems which had to be worked out, this conference ultimately was successful, as well as lending considerable prestige to Mr. Hughes, its progenitor.83

During the autumn of 1921, while the planning for the Washington Naval Conference was taking place, the Federal Reserve was involved in a study on the relative costs for armament in the budgets of the major foreign powers. This study concluded that a limitation on armaments is the "necessary first approach toward the restoration of banking soundness and economic stability . . . and, . . . the stabilization of foreign exchange. . . ."84

Other Cabinet members, particularly Mr. Hoover, demonstrated their interest in arms limitation. Mr. Hoover, speaking as chairman of the U.S. section of the Inter-American Commission, stated that two major problems had to be solved before permanent economic rehabilitation of the world could be hoped for: (1) the readjustment of German reparations

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83 Pusey, op. cit., Chap. 44.
84 New York Times, December 8, 1921, p. 4.
payments based on the power of the German people to pay; (2) reduction of the armed forces of countries, eliminating inflation and balancing budgets. In this manner, capital investments could accomplish the job where the proper stability had been achieved. 85

On October 10, 1922, an administration spokesman stated with reference to an announcement, the U.S. would place an embargo on loans to non-funding European Allies, that the U.S. was also concerned that certain European nations were not reducing their military expenditures and balancing their budgets.

It is now inferred that the Government will not look with favor on loans with American bankers to foreign governments or foreign business interests which are to be utilized in keeping certain nations on a war footing. 86

Confirmation that the administration had, indeed, made the use of loan proceeds for war purposes another element of the foreign loan policy is obtained from the official memos of members of the department. Mr. Young, in a memo to Assistant Secretary White, stated in part, "it may be pointed out that in general it is the policy of this government to discourage loans for military purposes." 87

Mr. Coolidge retained the essential features of the foreign loan policy developed by the Harding Administration. Although there was considerable speculation, from time to time during Mr. Coolidge's Administration as to whether he might abandon it, this never actually


87 U.S. State Department, Decimal Files, 824.51/153, Memo Mr. Young to Mr. White, July 17, 1922.
occurred. On April 8, 1925, in response to a press inquiry, Mr. Coolidge stated that the loan policy was the same as it had been in the Harding Administration. On April 4, 1925, Mr. Coolidge had occasion to warn foreign countries seeking funds in the United States that the U.S. Government was not in favor of loans for the purpose of enlarging armaments. Later in December, 1925, Secretary Kellogg, discussing U.S. loan policy and other issues at a dinner meeting of the Council on Foreign Relations in New York City, stated that our foreign loan policy consisted of positions against (1) countries which have not settled their debts to the U.S.A., (2) loans for the purpose of armament, and (3) lending to foreign companies who exercise substantial control over raw materials sold to the United States.

During the later portion of Mr. Coolidge's Administration he received a number of criticisms of the State Department's administration of our foreign loan policy. Many of these criticisms came from Congress, but some came from professional groups, bankers, and from abroad. Most of these attacks were stimulated by the U.S. intervention in Nicaragua. Mr. Coolidge stoutly defended his stewardship of foreign loan policy. Legally, he stated that it was well within the "proper conduct of foreign relations . . . and . . . within the powers of the President under the Constitution." While Mr. Coolidge admitted that there had

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88 *New York Times*, April 9, 1925, p. 5.
been some difference of opinion within the State Department on administration of loan policy, the Secretary of State was the authority charged with its execution.92

The Hoover Administration made some changes in the method of handling foreign loan policy. Some of the delay in studying loan issues relevant to policy consideration was eliminated. According to a departmental spokesman, while departmental policy on foreign loans would continue, fewer exceptions to loans would be made.93 Perhaps the implication was that subsequently our loan policy would be to deal directly with the bankers and keep the decisions secret.94

Despite the explicit specification that it was the policy of the government to be opposed to foreign loans for the purpose of procuring armament, the record of departmental treatment of cases shows a wide gulf between statement and practice. Excepting the fact that quite early in the Harding Administration a number of loans were made involving military expenditure before the loan policy on armaments was clearly defined, it is hard to explain the number of exceptions afterward. These instances of violation of the armament policy range from the ABC nations of Latin America to China in the orient, and the weaker powers of Latin American such as Bolivia, and some of the Caribbean powers.

During the summer of 1922 it was called to the attention of the department that Bolivia was diverting some of the funds it had just

94 Feis, op. cit., p. 8, for an interpretation of Mr. Hoover's policy.
received from the 1922 Equitable loan for the purpose of building a cartridge factory. The point was made by the economic advisor that this was "undesirable" and "against the policy of the government." However, a position against this was taken by the Assistant Secretary that "a cartridge factory seems entirely reasonable. Especially if it \[Bolivia\] should have a war with either Chile or Peru. . . ." Meanwhile, a "wait and see" policy was adopted ad interim. Finally, on October 22, 1922, the Assistant Secretary of State for Latin American affairs stated, "nothing seems to have been received . . . since the dispatch. It is to be presumed that the fiscal commission would block any attempt to divert funds." 95

In 1925 a large loan of $100 million was made to Argentina despite the fact that dispatches previously had disclosed that much of the proceeds were to be spent on military items. Apparently a key factor in the approval of this loan was the fact that the military portion of the loan was already contracted for. Secretary Kellogg personally approved this loan. 96 Apparently, it became known that if military contracts were consummated prior to the loan designed for their payment, that approval would most likely be had. The American Ambassador in a dispatch from Santiago, Chile, wrote, "I understand the policy of the American Government is generally unfavorable to military loans, but,

95 U.S. State Department, Decimal Files, 824.51/153, July 17, 1922, with appended memos of departmental officials.

96 U.S. State Department, Decimal Files, 835.51/524, letter dated July 17, 1925, J. P. Morgan to Secretary of State and accompanying memos attached.
if an indebtedness for that purpose has already been incurred, the loan
will be approved."

A similar situation occurred with respect to a loan to Bolivia in
1928. Bolivia ordered armament from Great Britain prior to the signing
of the loan contract. At first, the firm making the loan did not
disclose this fact to the department; later, when it was called in on
this matter, it protested the "right" of the department to interfere in
private matters. The department, prior to this time, had received
persistent reports from its Ambassador in Paraguay that arms were being
purchased by Bolivia. Although there were some questions concerning
other matters on this loan, the armament factor was approved by the
State Department, and the loan consummated. On December 9, 1928,
while President-elect Hoover sat on the deck of the battleship bearing
him on his good-will trip to Latin America, which was then off the
coast adjacent to Bolivia, and while he was receiving the officials
from that country, it was announced that Bolivia had severed diplomatic
relations with Paraguay over the "Chaco Territory."

97 U.S. State Department, Decimal Files, 825.51/205 Dispatch,
Ambassador, to Secretary of State, October 2, 1925.

98 U.S. State Department, Decimal Files, 824.51/D58/11 Memo of Con-
versation dated September 15, 1926.

99 U.S. State Department, Decimal Files, 824.51 Dispatch November
23, 1926, again February 9, 1927; also U.S. Ambassadors dispatch from
Paraguay, October 14, 1927.

100 U.S. State Department, Decimal Files, 824.51/D58/34 dated
October 4, 1927.

In some cases, the government received much criticism, in addition to fostering future wars, by not strictly enforcing the loan policy on armaments. In the case of the South Manchurian Railroad loan, the department avoided diplomatic protests by the Japanese Government, only to have the Chinese Government state, "it makes the United States an accomplice . . . in promoting war." Years later, the lack of wisdom of this single action was to plague President Hoover.

A few notations can be made at this juncture concerning an evaluation of the policy and practice on armament. Admittedly, there is no way of knowing how effective the enunciation of the policy may have been, especially during the Hughes Administration. It may have, indeed, helped prevent some of the grass fires which occasionally take place between small nations. However, there is doubt, with many cases illustrating lack of application of the policy, during the Kellogg and Stimson administrations, that any real good was accomplished by the policy. Undoubtedly, many nations were aware of the fact that the armament policy was not being strictly enforced. Bankers appeared to be aware that this was the case, and attempted to utilize all methods to avoid the application of the policy to their loans.

Loans to unrecognized powers

The U.S. Government's position on no loans to unrecognized powers was an outgrowth of its general policy of non-recognition to unestablished, coup d'etat types of powers having interests clearly incompatible with

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Note: The State Department did not approve the loan to the railroad directly; however, when the bankers resubmitted the loan as a loan to the Oriental Development Co., it received approval.
that of the U.S. Government. Other administrations prior to the Harding Administration had applied it previously. As Secretary Hughes stated, the policy in connection with recognition of the Soviet Regime in Russia:

Recognition is an invitation to intercourse. It is accompanied on the part of the new government by the clearly implied or express promise to fulfill the obligations of intercourse. These obligations include, among other things, the protection of the persons and property of the citizens of one country lawfully pursuing their business in the territory of the other and abstention from hostile propaganda by one country in the territory of the other. Recognition by our government of the Soviet regime in Russia was refused on the ground that the international obligations of the Russian State had been repudiated, that American property held in Russia under valid titles had been confiscated without prospect of indemnification. . .

During the 1920's, the policy of non-recognition was applied to a number of countries and correspondingly the U.S. loan market was effectively denied to them. The application of non-recognition and denial of the privilege of the U.S. loan market had the effect of helping settle U.S.-Mexican claims after May, 1923. However, in the case of Russia, it had another effect. Late in 1927 Russian officials approached Mr. Charles E. Mitchell, President of the National City Bank to attempt to secure his cooperation for a loan. When Mr. Mitchell informed the Russian authorities that the U.S. Government would not approve any loan prior to adjustment of previous claims, they dropped the inquiry. Later, next year, the State Department became aware that the Soviet

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104 Ibid., pp. 42-46.
Government was attempting to evade the U.S. policy by a scheme to sell U.S. investors bonds through the mails from Europe. Apparently, two London banks were to handle the service. Shortly afterward, the State Department drafted a letter to the Chase National Bank which was to cooperate with the London institutions in the deal for a flotation of thirty million dollars of railroad bonds by Russia. Finally, on February 5, 1928, the Chase National Bank stated that it "would not lend its facilities to any policy inconsistent with that of the State Department" and "gladly" refrained from further action (with Russia).

Thus, it may be stated that the denial of privilege of the U.S. loan market to non-recognized nations was effective in causing some nations to adjust their contracts with us; while the denial of recognition, in other cases, did not bring about contractual adjustment on the old debts, it did preclude the non-recognized country from making additional debts in the U.S. market.

Use of loan proceeds by foreign monopolies

This element of our foreign loan policy was the last one to be developed. The progenitor of this element of policy was Mr. Herbert Hoover, the Secretary of Commerce. Since this element of policy was contributed and to some extent administered by the Department of Commerce, the full discussion of it appears in Chapter III.

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108 See pages 90-93, Chapter III of this dissertation.
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treatment of it here is to discuss how the State Department helped to administer it, and to evaluate its effectiveness.

After a period of investigation in which Congress supported an inquiry into the effects of foreign monopolies upon the prices and supply of raw materials to American manufacturers and consumers, the Cabinet put into effect a policy which sought to deny the benefits of the U.S. loan market to foster the growth of foreign monopolies. ¹⁰⁹

Two significant cases of the administration of this policy occurred in 1925. The Department of Commerce made exception to the proposed flotation of a German Potash loan. ¹¹⁰ Again, one week later, in connection with a Brazilian coffee loan, Commerce again objected to the State Department. ¹¹¹ In both cases, the Commerce Department was sustained in its objection. Both of these loans were shortly floated abroad, and some interest in the foreign syndicate was taken by American firms who proceeded to sell the securities to American buyers.

Once it was apparent that the government had adopted its policy of refusing to allow foreign monopolies to be benefited by American loans, it was only a matter of time before American bankers and foreign borrowers began to seek and find methods of avoiding the impact of this policy. As noted above, one of the practices of bankers was to participate in foreign syndicates and sell large portions of foreign


currency loans here to American clients. Another means of avoiding the application of the U.S. loan policy on lending to foreign monopolies was for a foreign borrower seeking funds for this purpose to switch loans. If he had a loan outstanding which was floated in London, he might refund that sterling loan in the New York market. He could then float the new loan for valorization purposes, which the State Department would not approve, in the London market and have his funds. The nominal effect in this case is as if the U.S. accepted the original valorization loan. Still another practice to avoid the impact of the State Department policy was to word the loan contract in such a way that it could not be interpreted as a valorization type loan.113

In 1926 difficulties concerning the interpretation and execution of the monopoly issue began developing. The Department of Commerce objected to a projected loan to the Chile Nitrate producers association. However, Mr. Kellogg demurred on the grounds that the issue under consideration concerned itself only with ordinary current financing of production, and not of valorization. After some minor memos of rebuttal, Commerce decided to back down on this issue.114 Finally, in 1927 came a

112 The term "valorization" refers to the practice of some basic commodity producer countries in buying portions of the commodity in order to withhold supplies that might otherwise be placed upon the market, and thus weaken market prices. The ultimate objective is to raise prices of the commodity. Examples of commodities withheld from the market in this fashion have been rubber, coffee, nitrates, tin, and other similar items.

113 See Chapter III, pp. 90-93.

114 U.S. State Department, Decimal Files, 825.51/237, October 22, 1926.
further capitulation on the monopoly issue. Commerce had objected to a loan to the Rio de Janeiro Agricultural Institute. In the discussion and interplay of memos which followed, two points were raised by the State Department. The first point concerned the legal issue of whether this was a valorization loan, since the State Department noted that there was no legal authorization to purchase coffee. Lastly, a departmental issue was raised on the relative significance of the State of Rio de Janeiro's coffee production, which was "scarcely ten per cent of Brazil's total coffee production." 115

It should be noted that the development of controversy over the interpretation and execution of the monopoly issue came at a time when the government was under pressure at home and abroad regarding our Caribbean policy. In fact, as President Coolidge noted, at one point he had considered abandoning the loan policy entirely. 116

All in all, this element of loan policy fared about the same as the other elements of policy. As time developed, the cooperative sharing of policy ceased and the Department of State became more completely the sole executive. As Mr. Coolidge stated, "there is only one person responsible for our foreign policy, and that is the Secretary of State." 117

Thus, under these circumstances, it became a policy structured by loopholes, and quite difficult to enforce. Finally, it should be noted that

115 U.S. State Department, Decimal Files, 832.51/466, February 4, 1927.


commodity prices generally were beginning to weaken after 1926, so that quite possibly the raison d'être of the policy had ceased.\textsuperscript{118}

The investment merits of loans

During the first year of the Harding Administration, prior to a basic consideration and formulation of what later became known as our foreign loan policy, decisions and consultations by the several departments regarding foreign loans were quite irregular or unformalized. It was during this first year that supervision of foreign loans by the administration was most flexible and the relationship between the departments was most cooperative.\textsuperscript{119}

During the first year of the Harding Administration, the departments interested in foreign loans reviewed loans for their "investment merits." According to Mr. Hoover, he had asked for, and received, when he expressed the conditions under which he would consider the position of Secretary of Commerce, the right for his department to have a part in, among other things, the economic aspects of foreign trade.\textsuperscript{120} Thus, when the record of the first year of foreign loan policy is examined, we find Mr. Hoover and the Department of Commerce playing a very important and active role in this policy.\textsuperscript{121}

\textsuperscript{118} New York Times, June 20, 1927 for a similar position taken by Dr. Max Winkler at the Foreign Policy Association in New York City.

\textsuperscript{119} See Chapter II, pp. 23-27.

\textsuperscript{120} Hoover, op. cit., p. 36.

\textsuperscript{121} See Chapter III for a more complete development.
Specifically, although there never was any attempt at codification of the loan policies, the term "investment merits of loans" meant the worthwhileness of the obligation to the potential investor. These obligations were, of course, rated by the investment rating authorities and graded accordingly. Some issues of prime borrowers, where interest coverage was good and debt history unimpeachable, had very favorable rates to the borrowers and had no difficulty in finding willing underwriters and investors. Other issues having a less attractive record had to be "sold." There were other economic aspects of foreign lending which could have been considered, such as availability of exchange and the exchange adjustments incidental to lending, changes in the composition of the balance of payments, income effects abroad, and so forth. However, these were kinds of things that only the experts knew, and quite frequently it required a fairly masterful job of exposition to demonstrate fairly simple things—such as triangular trade—to the chief decision makers of the administration. Mr. Hoover used a fairly homey term, "reproductive nature" of loans, to refer to what he meant by the investment merits of loans. He was concerned by virtue of his engineering background that loan proceeds be expended primarily for real goods, primarily capital equipment which would have the ultimate effect of

122 See Chapter IV for a fuller analysis of this point.

123 Personal interview with Mr. Frederick Livesey, former acting Economic Advisor, State Department, at his office, State Department, Washington, D. C., August 28, 1952.
increasing output and providing employment. He was opposed to loans for balancing budgets, or profligate spending. ¹²⁴

Mr. Hoover assumed, however, that if the loan was for "reproductive purposes" it should prove to have investment merit. Unfortunately, as it turned out, many loans for so-called "reproductive purposes" did not provide for their exchange service and their investment merit suffered the consequences. ¹²⁵ At this juncture, however, with the problems of reconstruction, home employment and the like, Mr. Hoover, and others were less concerned about the merits of investments to investors, per se.

The State Department, in its interpretation, called the matter investment merits, and quite possibly this is how the policy became known. However, from time to time, Secretary Hughes and Secretary Kellogg used the term "details" in a somewhat analogous sense. ¹²⁶

During the first year of the Harding Administration, the State Department cooperated with Commerce and Treasury fully. Indeed, in a number of cases, it appears that the State Department permitted Commerce to take the lead. Perhaps this was due to the economic necessities of the depression. Perhaps too, it was because of the somewhat "activistic" nature of Commerce and Secretary Hoover in "attempting to help." ¹²⁷

¹²⁴ U.S. Department of State, Decimal Files, 835.51/268, August 12, 1921.


¹²⁶ For Hughes see U.S. Department of Commerce, Balance of Payments Division, Letter of Secretary Hughes to Secretary Hoover, March 10, 1922.

¹²⁷ See Chapter III.
A review of the documents available for this period discloses an interesting, if somewhat unsystematic handling of loans. Loans in some cases were turned down because the exchange conditions were uncertain. In other cases, loans were encouraged because exchange conditions were difficult. These and other inconsistencies did occasionally disturb a "consistency oriented" State Department. Later, another serious matter developed, when the Commerce Department involved the State Department in a solicitation of a loan for an American underwriting firm to the Argentine Government.

Consequently, when the Cabinet was called together in February, 1922, to deal with loan policy and other matters, it seemed like a good opportunity for the State Department to make a change. Mr. Mellon and Mr. Hughes convinced the President that the matter of the investment merits of loans was not the proper kind of activity for the government to be engaged in. The President supported these two Cabinet members and Mr. Hoover was forced to vacate his activity in this area. Thus, after the Presidential Press Release on March 3, 1922, investment merits of loans are no longer an acceptable policy.

Nonetheless, the Commerce Department found that later on after 1927, when the quality of loans began to decline, they could not leave this area alone. On a number of occasions they pressed for the State

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128 U.S. State Department, Decimal Files, 835.51/257, July 25, 1921; also 835.51/326, July 29, 1921.

129 U.S. State Department, Decimal Files, 835.51/268, August 12, 1921.

130 Supra, pp. 23-28.
Department to take a stand. In these cases, they were in possession of documentary evidence to show that bondholders would surely be the ultimate losers. In all cases, the State Department held firm, and finally Commerce resorted to attempting to publish the facts. It was, as it proved to be, too late to have much effect.\footnote{See Chapter III, pp. 87-89.} In reviewing several long memoranda, which State Department officials wrote on this issue, there are many references which indicate that many of the experts wanted to take a position on the basis of the investment merits of loans, but were precluded by official policy.\footnote{U.S. State Department, Decimal Files, 832.51/475, April 30, 1927 and U.S. State Department, Decimal Files, 824.51/D581/26, June 23, 1928.} As Mr. Frederick Livesey stated, "Many of the experts who knew the facts were too insecure in their positions to risk protesting."\footnote{Personal interview with Mr. Frederick Livesey, former acting Economic Advisor, State Department, at his office, Washington, D. C., July 31, 1950 and August 28, 1952.}

Miscellaneous aspects of loan policy

In addition to the above items of U.S. foreign loan policy, there were a number of aspects of this policy which deserve brief mention. The State Department believed that in the cases of certain Caribbean powers where the State Department had, under the Monroe Doctrine, negotiated treaties which involved loans and/or customs receivership, that the relationship was so confidential as to preclude the interest of both Commerce and the Treasury. When the State Department attempted to include Bolivia in this category and exclude the Commerce and the Treasury...
departments from participation, Commerce objected informally. Actually a good share of the criticism regarding foreign loan policy was directed at those relationships with Caribbean countries.

Another aspect of policy concerned loans to the defeated powers such as Germany and Austria. These loans were deemed by the Secretary of State to involve treaties and the Department of State exercised its prerogative to specially handle loans to these powers. Indeed, on at least one occasion, the Secretary of State took it upon himself to warn bankers about their excessive lending to German states and municipalities.135

State Department relations with underwriters

The State Department became involved informally with U.S. underwriters when the President first called a group of prominent Eastern bankers into conference at the White House on May 27, 1921. Bankers were asked to submit voluntarily their plans for loans prior to their consummation to the State Department in order for that department to ascertain if they were contrary to established policy.136

For awhile it appeared that this informal notification would be sufficient; however, by mid-summer of 1921 it became increasingly

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134 U.S. State Department, Decimal Files, 821.00/500, April 24, 1922. Also see 821.51/196.

135 U.S. Congress, Senate, Hearings before the Committee on Finance, 72nd Cong., S. Res. 19, December 18, 1931 to February 10, 1932, Four Parts, Part II, pp. 951-955. Hereafter these hearings will be referred to as the Johnson Committee Hearings.

apparent that some underwriters were either purposely evading the request, or were uninformed about it. Finally, this problem and other considerations of loan policy were discussed at a February, 1922 meeting of the Cabinet. On March 3, 1922, the President issued a Press Release requesting underwriters to clear their loans with the State Department prior to consummation.

The general policy of the State Department, in their dealings with underwriters, was similar in respect to the "Open Diplomacy" practiced by Mr. Hughes. Each firm was normally treated alike in so far as consultation and information. Each firm was expected to respect the request of the department for information.

There were, of course, some difficulties. Some bankers were the recipients of the department's displeasure, which under a forceful secretary could be of some import. Some bankers were not truthful and had to be dealt with somewhat summarily. In a number of cases, especially after 1925, the State Department actively discouraged bankers of little repute from negotiating foreign-dollar loans. Finally, it must be said that the department itself was occasionally either willfully or unwittingly involved with underwriters in terms of solicitation of loan contracts with foreign governments. These, however, were limited.

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137 U.S. State Department, Decimal Files, 832.51/289, October 28, 1921.


140 Personal interview with Mr. Frederick Livesey, former acting Economic Advisor to the State Department at his office, Washington, D.C., July 31, 1950 and August 28, 1952.
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Effectiveness of the loan policy--
A summary

Several evaluations may be summarized from the analysis of the above evidence.

1. Basically, the inadequacies of the U.S. loan policy stemmed from a lack of executive understanding of the magnitude and implications of the lending program. Ancillary to this was the mistaken judgment that a purely voluntary program of control would be satisfactory as opposed to a statutory program.

2. A key difficulty was introduced when the Cabinet decided against continuing with investment merits of loans which precluded the State and Commerce departments from dealing with the rash of ill-conceived lending coming after 1927.

3. Perhaps in the application of foreign loan policy the State Department allowed itself to be too much influenced by the political and private pressures on loan policy. This resulted in a highly legalistic posture in the execution of its charge and in failure concerning the economic aspects of foreign lending.
CHAPTER III

THE ROLE OF THE COMMERCE DEPARTMENT IN THE FLOTATION AND DEFAULTS OF FOREIGN-DOLLAR BONDS

Introduction

The role of the Department of Commerce in expanding U.S. private long-term foreign investment, especially foreign-dollar bonds during the decade of the 1920's, was very much influenced by the state of domestic economic condition and the problems of international uncertainty at the end of World War I. The over-expansion of U.S. farm production, designed to meet the needs of the Allies during the war, caused a readjustment in commodity output and prices to take place at the end of the war and again during 1920-1921 when the belligerent nations finally restored their own domestic production. International uncertainty, stemming in a large measure from the inability of the Allies to agree on the amount of reparation due from Germany, made for a pessimistic tone in the capital markets and a tightening of credit conditions generally. Domestic trade began to fall off and unemployment increased throughout the land. Thus in 1921, when the new Harding Administration took over, the most important problems it had to face were those connected with the depression.¹

Another major factor affecting our foreign economic policy relating to foreign investment and specifically the role of the Department of Commerce in making and executing this policy, was the problem of the readjustment of government-to-government debts between the United States and its Allies for the prosecution of the war. These debts amounting to approximately $11 billion had to be funded and a priority scale placed upon their payment. The U.S. Government, believing that these loans were not and should not be related to the whole question of reparations arising from claims which the Allies had upon the defeated powers, was anxious to press for a quick settlement of the amounts involved. President Harding, the Cabinet, and his advisers, realizing the probable difficulties of the Allies in resolving these government-to-government loans due the United States, and cognizant of the many other readjustment problems of the Allies, including convertibility, were anxious to make it clear to the Allies that any problems of recovery and the financial means to their solution would have to come not from the United States Treasury but from the private capital markets of the Allies, including the United States.  

The question of the determination and the means of financially funding German reparations due the Allies occupied a most important position in the minds of the Cabinet members and their advisers in the determination of our foreign economic policy during this period. The United States was cautious lest it become directly involved in a scheme involving many more billions of the public's funds. The administration

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was quite cognizant of Mr. Wilson's failures at Versailles and had decided on a program of non-entanglement. The Allies unfortunately had not been able to agree upon a specific amount which was due from Germany, and the problem finally resolved itself into a debate centering about the capacity of Germany to pay. Eventually there was a realization that debt amounts might have to be scaled down and that some financial priming of Germany would be necessary in order that Germany could commence making payments on reparations account. During the interim, not only did the financial and political structure of Germany suffer a major collapse, but the major financial markets of all major powers were likewise affected by the discord and the slowness of arrangements.³

The place and influence of Mr. Hoover, the Secretary of Commerce, in the determination of our foreign economic policy, with particular reference to foreign investment, was an extremely important one. Mr. Herbert Hoover came to the Cabinet from an important post with the previous administration, that of directing foreign relief in Europe at the close of the war. His background was a distinguished one, that of a successful mining engineer who was personally acquainted with foreign countries and their problems. As an engineer, he brought to the Cabinet a zeal for efficiency that has not been equaled by many Cabinet officers. This zeal for efficiency was only matched by a lofty humanitarian purposefulness originating in part from his simple early agrarian Iowa background and from the wholesome convictions of the Quaker tradition.

Mr. Hoover was much imbued with transforming ideas of efficiency to the realm of government operations. He had great faith in such ideas of efficiency and the private enterprise system in dealing with the problems of world financial reconstruction. He believed that through a system of careful cooperation between business leaders, bankers, and others that the United States could restore its export trade, and at the same time deal effectively with conditions of unemployment and declining prices in the domestic economy.  

The basic place of Department of Commerce influence in making foreign economic policy was partly influenced by the historical and traditional role of the Department of Commerce in being concerned with the economic aspects of foreign trade relations. The Department of Commerce has always occupied an important role in foreign economic policy of the nation through its promotion, its informational facilities, and other aspects relating to foreign trade. With the achievement of the United States as a creditor nation on long-term foreign investment account, this traditional role was a rapidly increasing one. In addition, Secretary Hoover was able through his personal esteem and personality to raise the status of the Department as a cooperating agency in shaping foreign economic policy. He must be regarded, at least in the early days of the Harding Administration, as being one of the three most dominant people influencing administration policy along with Secretary Hughes of the State Department and Secretary Mellon of the Treasury Department. Probably the most important single factor, however, in raising the status of the Department of Commerce as a joint-decision-making

4Herbert Clark Hoover, op. cit.
agency along with the Treasury and State departments, particularly in regard to foreign investment policy, was the over-all policy of Mr. Harding to conduct the affairs of Government along business-oriented, laissez-faire lines and to avoid foreign entanglement. Specifically, the approach to readjustment in foreign economic affairs and the problem of domestic unemployment came from increasing foreign trade abroad through a program of deliberate fostering of private foreign investment.⁵ (See note below.)

⁵Beard, op. cit.

Note: The Department of Commerce had for a long time prior to the Harding Administration been an important factor in stimulating foreign trade and investments abroad. A major step took place in 1912 under the Taft Administration when the Bureau of Foreign and Domestic Commerce was organized for the express purpose of the promotion and development of United States trade abroad. While a major role in the formulation of the investment implementation of our foreign economic policy must be credited to Secretaries Huntington Wilson and Robert Lansing of the State Department in the Taft and Wilson administrations respectively, the Department of Commerce also shared in the execution of this policy in the development of the national interest. A prime factor in the development of the role of the Department of Commerce as an agency in the formulation and development of our foreign investment policy came in 1915 with the creation of the program of the Commercial Attache under the leadership of Secretary William G. Redfield in the Wilson Administration. The appointment of ten Commercial Attaches, sent into the field in July, 1915, inaugurated a system of special officers economically trained to assist in the promotion of our foreign investment and trade. This single move created the organizational structure, which when expanded during the twenties, gave the Department of Commerce a more important voice in the formulation of our foreign economic policy in the national interest. See John T. Madden, Marcus Nadler, and Harry C. Suavain, America's Experience As a Creditor Nation (New York: Prentice-Hall Inc., 1937), p. 174; New York Times, May 1, 1927, Sec. 9, p. 12.
Basic changes in the loan policy of the Department of Commerce, 1921-1930

While the State Department played the most important role in the determination of our foreign investment policy, the Department of Commerce during the Harding Administration was well represented in the decision making at the Cabinet level by Secretary Hoover. As early as the Presidential campaign of 1920 Mr. Hoover stated: "There is only one remedy and that is by the systematic permanent investment of our surplus production in reproductive works abroad. We thus reduce the return we must receive to a return of interest and profit." Shortly after his installation as Secretary of Commerce, Mr. Hoover, in one of his first major speeches as Secretary of Commerce, divulged extensive plans for the comprehensive reorganization of the Department of Commerce. He proposed that the Commerce Department actively assist in developing foreign markets for American producers. A new bureau of the department would cooperate with industries to assist them in expanding U.S. foreign trade. The need for U.S. foreign loans to accomplish this goal is indicated by Mr. Hoover's remark, "Foreign credits are better than rotten food."

Later, following the White House conferences with American bankers, which were attended by President Harding, Secretary Mellon, Secretary Hoover, and Governor Benjamin Strong (of the Federal Reserve Bank of New York), administrative officials resolved several important issues relating to foreign loans in the domestic market. It was agreed that

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6See Chapter II of dissertation, "The Role of the State Department in Foreign Dollar Lending."


8New York Times. March 11, 1921, p. 3.
American capital must be invested abroad and that there should be active cooperation between the government and businessmen for the revival of export trade. A humanitarian approach was added in a speech by the President when he stated as follows:

Our strength in the industrial, financial, and commercial world, our capacity to produce, our ability to extend credits which others cannot give and which brave but unfortunate peoples sorely need, all of these make it necessary that we shall adopt new commercial methods, whereby to insure the fullest possible service to civilization. I bespeak the help of every organization of intelligent, understanding businessmen to enable the nation to meet these demands.

At the same time administration officials were considering our new foreign economic policy, business interests were busy expounding the new approach conditioned by their special problems. Former Secretary of Commerce, William C. Redfield, who was retiring as President of the American Manufacturers Export Association, gave a speech at the Waldorf Hotel in New York City in which he stated: "What American firms must do to regain our competitive advantage in exporting goods is to export something else than merchandise, that is . . . our capital."

Another speaker at the same convention with former Secretary Redfield, Mr. William Kies, stated another reason for the promotion of capital exports abroad. Capital uses in this country had in his judgment about reached the saturation point particularly with reference to further construction of railroads, factories, and office buildings. Thus, a

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sizeable portion of our annual capital formation can be employed abroad more profitably than it can be at home.\textsuperscript{12}

Bankers, who were not totally unaware of the profitability of foreign loans to themselves, extolled the virtues and necessities of foreign investment. Mr. Charles Mitchell, President of the National City Bank of New York, stated the issue cogently:

Full prosperity in this country can never be obtained until foreign markets are achieved or available to our products. . . . We have a potentiality of billions of credits, even tens of billions which cannot be kept out of use indefinitely. . . .\textsuperscript{13}

Once the major objectives of our foreign economic policy by the Administration and the Department of Commerce had been perceived, the organization and methods for attaining these objectives resembled in some respects a major military campaign. Secretary Hoover clearly delineated the problem when in reporting in December of 1921 some of the results of his effort toward efficiency in the Department of Commerce:

It is increasingly important that the service of the foreign and domestic division be developed and intensified to meet the increased demands of American manufacturers who are planning to hold and extend their market abroad. . . . Not only should more attention be given to trade promotion, but it should be possible to make more detailed economic surveys abroad that are so indispensable because of the enormous financial interest we have in foreign fields.\textsuperscript{14}

In drawing the lines of the commercial battle to secure export trade abroad, Dr. Julius Klein, Director of the Bureau of Foreign and

\textsuperscript{12}\textit{Ibid.}


Domestic Commerce, in his annual report at the end of 1922, indicated the importance of awakening interest from American business establishments. He suggested the transfer of the governmental statistical organization from the Treasury Department to the Department of Commerce in order to give the Commerce Department control over the preparation of the statistics concerning trade which it now distributes. Dr. Klein added that the great interest shown by the American businessman in foreign trade must not be allowed to wane stating that American businessmen could dominate world markets provided they continue to fight for the business. As a result of a new system of press releases, the Bureau of Foreign and Domestic Commerce was able to make available information concerning specific market openings in all parts of the world. The services of the Bureau of Foreign and Domestic Commerce were a major contribution in the effort to expand our foreign trade in the 1920's.

A major economic target for exploitation was the area of Latin America. Mr. Grosvenor M. Jones, Chief of the Finance and Investment Division of the Bureau of Foreign and Domestic Commerce, organized this important division dealing with Latin American trade promotion. Commenting upon the development of promotional materials on this area, Mr. Jones stated, during the Senate Finance Committee Hearings:

It was my hope to have a five foot shelf of handbooks when I organized the division in July, 1922. That was my aim, and we concentrated primarily on Latin America because we thought that was an area of the world that was likely to

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15 New York Times, December 19, 1922, p. 27.
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borrow heavily in our market, and it was also an area on which the information extent was rather meager. So we made it a practice to put out, in printed or multigraphed form, whatever information came into us from the foreign officers of the government, and quite a good deal did come in.\(^{16}\)

The printed publications from Mr. Jones' division included "Trade Information Bulletins," the more exhaustive "Trade Promotion Series," and the "Latin American Financial Notes."\(^{17}\)

Dr. Julius Klein, Director of the Bureau of Foreign and Domestic Commerce, had chief responsibility for the development of the Commercial Attache program and the internal changes in the Bureau during most of the period of the 1920's. Commercial Attaches were carefully selected and specialists in commodities were brought in directly from industry to head up the various desks associated with their specialized field. Although the program had begun earlier under Secretary Redfield in 1915, it was during the 1920's that the major expansion took place. By the middle of 1927 there were over 45 Commercial Attaches in foreign countries, many with large and specialized staffs. The new commodity experts in the Department, due to their daily contacts with manufacturers and exports, were able to direct in detail the investigations of the foreign representatives of the Department. The results of the investigations were then digested and analyzed by the Division chiefs and communicated to the businessmen known to be interested. An indication of the importance of information may be gained by noting that business

\(^{16}\)Johnson Committee Hearings, Part II, p. 724.

\(^{17}\)Ibid., pp. 748, 825.
inquiries which averaged about seven hundred per day in 1921 increased to about nine thousand per day by mid-1927.\(^{18}\)

It was no exaggeration when Secretary of Commerce Hoover, in a speech at Newark, New Jersey, on September 17, 1928, stated, "We mobilized our manufacturers and our exporters; cooperated with them in laying out and executing strategic plans for expanding our foreign trade in all directions."\(^{19}\)

In commenting in a Sunday magazine section editorial on the role of our foreign trade, Miss McCormick of the *New York Times* indicated the success and the magnitude of the Department of Commerce role.

In sixty foreign cities there are now representatives of the Department of Commerce, and the offices and personnel of this Department are larger than those representing the Department of State. The staff is better organized and better paid. The sharp shift in emphasis from political and diplomatic to economic and trade relations between nations has a significance not yet fully realized or appraised. For that shift, which means the eventual disappearance of the old diplomat with his predominately social mission, the American Department of Commerce, is largely responsible.\(^{20}\)

When the volume of U.S. foreign trade fell off enormously during 1920, the United States Chamber of Commerce began its efforts to attempt to revitalize it. A report on foreign commerce and revenue laws presented by the chairman, Mr. William E. Peck, reported early in 1921 that the

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\(^{18}\) *New York Times*, May 1, 1927, Sec. 9, p. 12.

\(^{19}\) *New York Times*, September 18, 1928.

\(^{20}\) *New York Times*, June 16, 1929, Sunday Magazine, Sec. 5.
export business of the United States had fallen off by not less than one and a half billions of dollars. The report went on to state:

It is absolutely essential for the welfare of the country, of our producers and of our manufacturing industries that our foreign business be preserved and increased to the fullest extent possible. It will be impossible, however, for the merchants of the country to hold their normal trade abroad unless they are placed promptly in a position to sell their bills of exchange and to handle the business along usual lines.21

The gravity of the situation can be properly indicated by the fact that business interests ordinarily accustomed to taking a position of economy of government became quite vociferous in demanding that congressional cuts in appropriations for the consular service and the State Department's diplomatic service be rescinded and increases in these expenditures be made. Colonel Fred Cardway, Vice-president and General Manager of Packard Motors Export Corporation, stated in regard to the action of the House Committee slashing the diplomatic and consular bill appropriations:

The time is near at hand when we must extend credits to the foreign purchasers of our goods. It is to the U.S. consuls we must look for the protection of these credits, which in many countries will total hundreds of millions of dollars.22

The new Harding Administration, which admittedly was a businessman's administration, did not wait long to answer the needs of its constituents. On March 20, 1921, Mr. Herbert Hoover, the new Secretary of Commerce, announced plans to bring about a closer relationship between

the Department of Commerce and various branches of business. The Chamber of Commerce was to name a committee to cooperate with the Department of Commerce. This advisory board was to consist of representatives of business, agriculture, and labor. Mr. Hoover stated that by bringing about this kind of cooperation, he hoped to make the Department of Commerce a vital organization in the advancement of export trade. This procedure of forming industry groups for advisory counsel purposes in conducting the business of the Department of Commerce was a format of operation that continued during Mr. Hoover’s tenure of office as Secretary of Commerce as well as after he became President.

These industry committees along with technical assistance from University Professors such as Professor Alyn A. Young of Harvard and Professor Wesley Clair Mitchell of Columbia University and Mr. Hoover’s assistants, Dr. Julius Klein, formerly of the business school of Harvard, completely discussed the reorganization of the Department of Commerce along lines to meet the needs of the industrial community. Mr. Hoover was anxious not only to obtain close cooperation between the Department and the representatives of industry, but also to secure as much efficiency as could be obtained. A critical area under consideration concerned the reports by Commerce and State Department representatives from abroad relating to potential foreign business.

A more subtle factor involved in the promotion of our foreign trade abroad was the presence of trained, business-oriented Commercial

23 New York Times, March 20, 1921, p. 3.
Attaches who developed the art of business and loan findings to a degree never before attained. These Commercial Attaches were carefully directed by their officers in the Department of Commerce and were encouraged to leave no stone uncovered that could possibly lead to an American order or a possibility for a loan for American investment bankers. They worked extremely close with American business representatives in providing these representatives with all the information contained in their office reports and memoranda as well as foreign documents obtained from various foreign governmental offices, and helped to arrange appointments with officials of foreign governments.

Commercial Attaches became very proficient in uncovering potential loans and construction contracts under the zealous direction of the Director and Assistant Director of the Bureau of Foreign and Domestic Commerce. The Bureau of Foreign and Domestic Commerce upon receipt of a potential loan or construction contract would disseminate this information to a select group of bankers or contractors via their field offices. Quite frequently these groups would not be aware of the

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25 U.S. Department of Commerce, Office of International Trade Files, Instructions to Foreign Service, "Opportunities for Investment of American Capital, Proposed Loans, Bank Statements, and Public Finance" (Instructions were revised continuously).

Note: Perhaps an aspect of this type of action not so readily seen, at least in its early days of inception, was that by permitting business organizations to share in the role of formulating and executing plans for trade expansion, that it might not be so easy to deter some of their over-zealous business acumen.

26 U.S. Department of Commerce, Office of International Trade Files, Weekly Consular Report from Rio de Janeiro, Brazil to Director of Bureau of Foreign and Domestic Commerce, Department of Commerce (February 13, 1928).
possibility of a loan in the country indicated, or might indicate lack of interest; in other cases the new knowledge would lead to investigation and quite frequently the closing of the contract.  

Frequently, due to the urgency of procuring a potential loan, the consular officer worked directly with the representatives of the banking firm in providing information, contacts, and in making representations on their behalf. Often consular officers corresponded with a certain banking firm directly from the legation office. Apparently this practice was discouraged starting sometime in 1924, by the Bureau of Foreign and Domestic Commerce. As late as 1928, however, Commercial Attaches were still acting as finders and the Department reprimanded an Attache on February 23, 1928.

Lest . . . our fieldmen . . . come to be regarded by certain concerns as their "look out" men or even as their representatives. Another problem is that this would cause cries of favoritism by other business firms.

A major problem in the direction of the activities of our Commercial Attache and other foreign officers by the Department of Commerce came in an apparent division of policy between the top group of policy makers, including Secretary Hoover, Director Klein, Assistant Director Taylor, and others, and the Divisional Chiefs such as Mr. Jones

27 U.S. Department of Commerce, Office of International Trade, Letter from Boston District Office to Finance and Investment Division (June 25, 1925), and Commercial Attache Weekly Report (June 17, 1925), Bogota, Columbia, to Director of Bureau of Foreign and Domestic Commerce.

28 Ibid.

and his assistants. The top policy makers were quite anxious to expand
the volume of our exports abroad by all means possible. Secretary
Hoover and Director Klein regarded the representatives of the Department
of Commerce as actual representatives of American business. Indeed, as
the Senate Finance Committee Hearings indicated, the Department's business
was that of American business, and its representatives were advised to
make sales despite difficulties. Commercial Attaches were upon occasion
encouraged to be more aggressive in the development of business. Mr.
Oliver Townsend, in testifying before the Senate Committee, related the
advice that he had received from the Assistant Director of the Bureau of
Foreign and Domestic Commerce in a personal letter:

Right in this connection, I should like to emphasize that
the spirit of the Bureau follows the spirit of American
business, which is to make sales in spite of difficulties, or
to find ways of doing seemingly impossible things. As
officials we should be encouraging whenever possible and
discouraging only in the last extremity. We are builders,
promoters—even propagandists, although never to such an
extent that we fail to recognize and point out difficulties.  

Mr. Jones and Mr. Corliss, as well as other commodity experts in the
Bureau operating at a lower eschelon of policy and operation, were
apparently somewhat concerned about the results of the operation. On
several occasions Mr. Jones reprimanded consular officials abroad for
overt actions which might lead them to be regarded as "finders."  

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30 Testimony of Mr. Oliver Townsend, Johnson Committee Hearings, Part III, pp. 1613-1615.

In exchanges of letters with exports outside the government, Mr. Jones indicated that the growing volume of loans, loans for non-productive purposes, and the growing volume of loans to German municipalities were of some concern to him. Furthermore, a problem of some consequence was the delineation of policy dealing with the review and approval of loans under the joint responsibility of the State Department, the Treasury, and the Department of Commerce. This last problem will be examined in more detail later.

During the years 1926-28, a period which may be generally called the period of "awakening skepticism" concerning the scale of American lending abroad, Department of Commerce officials as well as the State Department were receiving a large number of reports from their representatives abroad concerning poorer lending conditions. While the top policy makers including Mr. Hoover, Dr. Klein, Dr. Taylor, and others were actively pushing for expanded trade along lines of an efficient cooperation between the Department, its representatives, and industries in this country, lesser divisional departmental officials such as Mr. Jones and their assistants such as Mr. Corliss became increasingly concerned about the consequences of this lending. Reports came in from Latin America that these countries were over-borrowing, that the proceeds were in many instances for unproductive works, and that even in many cases there were charges of irregularities including bribes and graft.

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32U.S. Department of Commerce, Balance of Payments Division, File 1925, Letter from Mr. Jones to Mr. White, Republican National Committee Men (February 3, 1925); also File 1925, Letter from Max Winkler to Mr. Jones (February 20, 1925).
The Department was slow to take action on these reports of its consular officials abroad. As time went on the reports became more serious. Several consular officials requested that action be taken against "unbridled lending." The Commercial Attache at Rio de Janeiro suggested that loans be submitted to the U.S. Embassies of countries involved in loans to permit more judicious handling of these issues. The Director of the Bureau recalled the 1922 policy of the President which specifies Department of State clearance.

At first the requests from Commercial Attaches abroad calling for action on unbridled lending were unanswered. Later, the Bureau of Foreign and Domestic Commerce suggested that loan inquiries be handled more circumspectly. In cases where smaller and less reputable firms were attempting to use the Bureau's foreign facilities as "finders," the Attaches were advised to be more careful. Furthermore, the Attaches were reminded that all inquiries coming to them directly from U.S. firms should in turn be directed to the Bureau for advisement.

In a dispatch from Bogota, Columbia, from the Commercial Attache, came the report that "probably not one of ten of the bond buyers in the United States could tell where the Magdalena River is if they were asked." This Attache went on to note that "there was a good opportunity for the government of the United States . . . to render a service . . .

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33 U.S. Commercial Attache, Rio de Janeiro, Brazil, to Director Klein, U.S. Department of Commerce, Bureau of Foreign and Domestic Commerce (September 10, 1927).

34 U.S. Department of Commerce, Bureau of Foreign and Domestic Commerce, Director Klein to Commercial Attache, Rio de Janeiro, Brazil (September 10, 1927).
to oversee a more judicial spending of borrowed funds." He suggested that the Secretary of State should have an oral discussion with the Columbian minister to the United States regarding construction underway. 35

Later on, on June 11, 1928, this same Commercial Attache at Bogota in view of the inaction of the Department of Commerce to his continuous reports of bad lending conditions, wrote to the director of the Bureau of Foreign and Domestic Commerce:

There is something radically deficient in a system which permits American bankers to persuade confiding, uninformed citizens to invest their capital in the bonds of foreign countries when the bankers themselves feel that the money is being badly invested. . . . The question in my mind is as to whether it is not a proper function of the government to protect the public against imposition. . . . 36

Mr. Jones, Chief of the Finance and Investment Division, in replying to the Commercial Attache at Bogota noted that the Department of Commerce cannot take a direct stand on cautioning bankers regarding bad loans because of the danger of criticism and the fear of upsetting the foreign bond market. However, Mr. Jones went on to state that there is to be a modification of the Bureau's circular on Columbia. In this manner investors may come to know about the facts of Columbia's finances. 37


37 U.S. Department of Commerce, Office of International Trade, Chief of Finance and Investment Division to Commercial Attache, Bogota, Columbia (June 21, 1928).
CHAPTER I

INTRODUCTION

Statement of the problem

The problems of reconstruction and development following the termination of World War II created needs for capital which were well beyond the capacity and interest of private markets to supply them. The Atlantic Community countries recognized the need for collective action and undertook to provide along with other nations an approach through the United Nations and their specialized agencies.\(^1\) In addition, the U.S.A. took unilateral action in the forms of grants, loans, military and technical assistance which by 1960 amounted to about $80 billion.\(^2\)

As early as 1949, however, especially after Truman’s enunciation of Point Four,\(^3\) observers began to ask the question of whether there might not be some kind of modest reawakening of interest in private foreign-dollar-bonds as a means of financing the new technical assistance program. Indeed, the House Committee on Foreign Affairs Report on

\(^1\)U.S. Treasury, Articles of Agreement: International Monetary Fund and International Bank for Reconstruction and Development, 1944.


On September 15, 1928, while awaiting the publication of Special Circular 305, "Columbian Foreign Loans and Public Finances," the Commercial Attache at Bogota, Columbia, wrote to the Department as follows:

I have a conviction that American bond buyers are being separated from their capital under circumstances which in many cases would properly be designated as a swindle. There is a laxity in our system of law which permits banking houses to avail themselves of any kind of misleading information regarding the financial responsibility of foreign entities. I feel that a statute should be enacted. . . . 38

Several weeks later the new United States charge d'affaires to Columbia stated in his report to the Secretary of State the following:

I do not believe that one holder in a hundred, if he could have foreseen conditions in Columbia and how his money is really spent, would have purchased Columbian bonds. . . . I do not hesitate to say that they either deliberately or unknowingly have misrepresented conditions existing here. . . . While I realize that it is not the Department's [State] province to intimate to a foreign government what works it shall or shall not construct, I feel that "morally" some protection should be extended to the American bond holder who does not and cannot know the facts. 39

It is interesting to note the remarks of the Assistant Secretary of State in charge of the Latin American division of the Department of State to the above report. He observed that "perhaps Matthews is unduely discouraged and pessimistic, but this dispatch is extremely interesting. . . ." 40

39U.S. Department of State, Decimal Files, 821.51/453, U.S. Minister to Columbia, Report to Secretary of State, Bogota, Columbia, November 8, 1928.
40Ibid.
During the last two years of the decade of the twenties the quality of loans began to change quite noticeably. Cumulatively Commercial Attaches' reports from Latin America and elsewhere were indicating a much larger proportion of loans for refunding purposes, loans for marginal, less productive types of projects, and frequently loans for frivolous items such as spas, electric fountains and the like. A noticeable aspect accompanying the decline of quality of loans was the greatly increased competition, especially by smaller firms with less reputable business histories. Reports reached the Department of Commerce of attempted bribery on the part of local officials who thought Commercial Attaches might be in a position to obtain a loan for their political entities. As the Commercial Attache at Rio de Janeiro stated, "the methods of awarding contracts . . . are such to almost precipitate a dog fight." Latin American codes of ethics are revealed quite distinctly in the notation made by the Commercial Attache at Lima, Peru, when he reported that the son of the President had been very intimate with negotiators for loans and "is extremely anxious to share in any commissions to be derived from concessions for foreign loans."

Outside of Latin America, lending conditions were somewhat similar, even though the methods of procurement of loans were not always

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so abusive. A major problem existed with regard to conditions of over-
borrowing on the part of German states and municipalities. In mid-
1928 another complication came in the weakening of the bond market in
the United States, and it became difficult for many countries to float
new securities. Germany was beginning to find it difficult to meet the
schedule of reparations payments under the Dawes Plan, and a new financial
arrangement, popularly called the Young Plan, was being considered.
Perhaps under ordinary conditions U.S. lending abroad might have ended
at this juncture if it were not for the fact that optimism persisted
under "the new era doctrine."

The Department of Commerce, once apprised of the decline in the
quality of foreign-dollar loans, could not take adequate steps to deal
with the problem. One reason was that the State Department would not
consider loans on a basis of their "investment merits." Another reason
was the indecision of the Commerce Department itself. However, the
Commerce Department did finally decide in mid-1928 to publish the facts
of this lending in order to protect the investor.

A case in point occurred with respect to Bolivia and its attempt
to procure a loan in 1928. At this time, based upon advice from
Commercial Attaches and other evidence, the Department of Commerce with

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44 Johnson Committee Hearings, Part II, pp. 882-887. See Text of State Department and S. Parker Gilbert's warning on German loans.

the approval of the Director of Foreign and Domestic Commerce left a
protest with the Department of State. The letter, in part, read as
follows:

The financial position of Bolivia is so precarious that fail­
ing to obtain this loan, it must default at once. . . .
Disapproval of the loan should not cause criticism. If it
does, it is unfair. The conditions in this case, warrant an
exception. [To the position of not taking a position on the
business merits of loans] Our government would be derelict
in its duties toward the American public and remiss in the
conduct of foreign affairs if it did not take a decisive
stand in this affair.46

However, it is reported that the Secretary of State quite vigor­
ously denied the ground of the objection by the Department of Commerce.47

Mr. Livesey, the acting Economic Advisor of the State Department,
indicated that the Department of Commerce still had a recourse through
issuing a circular presenting the facts.48 Thus in the summer of 1928
the Department of Commerce, Division of Finance and Investment, was
engaged in revisions of circulars on both Columbia and Bolivia.
Unfortunately in the case of Columbia the special circular on Columbian
finances, which was completed by Mr. Corliss on August 23, 1928, was
delayed in being disseminated by the diplomatic action of the Columbian

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46 U.S. Department of State, Decimal Files, 824.51/D581/26, Letter
from Finance and Investment Division, U.S. Department of Commerce to
Assistant Secretary of State for Latin American Affairs (June 23, 1928).

47 Personal Interview with Mr. Frederick Livesey (August 28, 1952)
at his office in the Department of State, Washington, D. C.

48 U.S. Department of State, Decimal Files, 824.51/D581/38 (July 24,
1928).
Minister to the United States. The Minister had learned indirectly from one of the New York underwriting firms interested in Columbian finances that the Department had an adverse circular under preparation on Columbian finances. Dr. Olaya came to the Department of Commerce and protested "the issuance of this hostile statement." Failing in this, he requested he be allowed permission to examine this document prior to its publication. The acting Secretary of Commerce, Mr. Hopkins, made the final decision to hold up publication. It was not until September 29, 1928, that the Special Circular Number 305 of the Finance and Investment Division of the U.S. Department of Commerce entitled "Columbian Foreign Loans and Public Finances" by Mr. J. C. Corliss was issued. In the interim, the government of Columbia in conjunction with the firms of Hallgarten and Company, and Kissil, Kinnicutt and Company developed a reply to Special Circular Number 305 entitled, "Rectification to Special Circular Number 305 of the Department of Commerce." This reply attempted to state that certain statements made by the Department of Commerce with respect to Columbian finances were incorrect.

The issuance of the Department of Commerce circular on "Bolivian Loans and Public Finances," which was completed on July 16, 1929, was also held up; however, for a somewhat different reason. The Department

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49 U.S. Department of Commerce, Office of International Trade, Letter by Director of Foreign and Domestic Commerce to Chief of Finance and Investment Division (September 7, 1928).

50 U.S. Department of State, Decimal Files, 824.51/446, Assistant Secretary Morgan to Secretary of State (October 27, 1928); U.S. Department of Commerce, Office of International Trade, Dr. Klein to Mr. Jones (September 7, 1928).

51 Ibid. See penciled notation on letter.
of State, which was involved in extending its good offices to the settlement of a dispute over territory between Bolivia and Chile, desired the issuance of the report held up for two months until the Commission of Inquiry and Conciliation, meeting in Washington, completed its deliberation.\(^5^2\)

It may be stated that although advice had been received by the Department of Commerce from its representatives abroad concerning the quality decline in U.S. lending, especially in Latin America, that the Department was unable to take effective steps partly through its own indecision and failure to crystallize policy, partly due to difficulties with the Department of State regarding protests on the investment merits of loans, and partly due to foreign diplomatic protests.

**The determination and execution of loan policy by Department of Commerce**

In relating the specific role which the Department of Commerce had in the determination and the execution of our national foreign loan policy, it may be well to consider the Cabinet decision to actively promote the expansion of our private overseas capital. As has been noted above, Mr. Hoover came to the Cabinet with fairly definite ideas regarding the role of the government in promoting the economic rehabilitation of the Western world following the upheaval of the war.\(^5^3\) On January 7, 1920, he stated: "The world needs to get away from the notion of governmental help, both internally and externally, and get back to work and to business."\(^5^4\)

\(^{52}\)U.S. Department of State, Decimal Files, 824.51/521, July 16, 1929.

\(^{53}\)Lawrence Dennis, *op. cit.*

\(^{54}\)Herbert Clark Hoover, *op. cit.*, I, 13.
In a statement on January 19 and again in April of 1920 Mr. Hoover said:

I insisted that private credit was needed, but that our government should not mix with the affair, and that our system for extending private credit should be better organized to prevent fraud, waste, and loss.55

At the time Mr. Harding formally tendered Mr. Hoover the appointment as Secretary of Commerce, Mr. Hoover stated some conditions relating to his role as Secretary of Commerce.

I stated I was interested in the job of reconstruction and development in front of us; that for the Department to be of real service, I must have a voice on all important economic policies of the administration. I stated this would involve business, agriculture, labor, finance, and foreign affairs so far as they related to these problems. I stated that, if I accepted, I wanted it made clear to the other departments from the very beginning. He said that this was what he wanted and would make it clear to all the other Cabinet members. He subsequently informed me he had done so except to Mr. Hughes, who was to be Secretary of State. He said he did not know how Mr. Hughes would take to this idea. He seemed a little afraid of his stiff Secretary of State. I replied that I would see Mr. Hughes about it myself. Mr. Hughes was enthusiastic over both the idea and my entry into the government.56

During the first year of the Harding Administration the Cabinet acted cautiously with respect to foreign loan policy. In general this followed the President's message to Congress on March 4, 1921, which emphasized that the administration would not commit the United States to further foreign entanglement. The President suggested a pragmatic approach to foreign economic policy with chief reliance upon private domestic capital for foreign reconstruction and development.57

55 Ibid.
56 Hoover, op. cit., p. 36.
Furthermore, it may be noted that the President's Cabinet were relatively new to governmental affairs and they had much to do with departmental affairs as well as a host of other problems, such as the economic depression, currency problems, German reparation settlement, foreign governmental debt settlements, the tariff, and so forth. Mr. Hoover, for example, was quite busy with plans for the reorganization of the Department of Commerce.

No major action was taken with respect to the specific formulation of foreign loan policy until it became imminent with the reported loan to the French Government for $100 million. When it was learned that there might also be a possible loan to the government of Great Britain, a Cabinet meeting to formulate policy was unavoidable. As Mr. Hoover states in his Memoirs:

The situation became so alarming that President Harding, at my suggestion, called a conference at the White House of Secretaries Hughes, Mellon, and myself with representatives of the bond-issuing houses and banks, to discuss the problem. It was finally agreed that all proposals for new foreign loans should be submitted to the State Department for its opinion, . . . The State Department in turn was to submit these proposals to Commerce and Treasury. The Commerce Department gave advice to the promoters, as to security and reproductive character. The State Department advised upon political desirability and undesirability. We made no pretense of authority, but relied upon cooperative action.

The White House Conference with the bankers on May 26, 1921, accomplished a number of things. The Cabinet group consisting of Hughes,


59 *Hoover*, op. cit., pp. 85-86.
Mellon, and Hoover besides the President had the opportunity of discussing the implications of the policy of promoting private foreign loans. The President was concerned, as was Mr. Hoover, about the effect of large withdrawals of funds for the foreign market upon the determination of interest rates and the availability of funds for domestic commerce and agriculture. Cabinet officers had also explained to them the principle of "triangular trade." Nonetheless, all the Cabinet officers were in favor of some effort on the part of the bankers, upon making the loans, to require, as much as possible, that these loans be "tied" loans. In general there was no hard and fast rule that was formally agreed upon at this stage other than the request which the President made of the bankers that they should consult with the Government to determine how the national interest would best be served prior to making loans. It was agreed that it was quite necessary to the preservation of our agricultural and manufacturing interests that our exports be expanded abroad. Mr. Hoover disclosed his plans for the promotion of American capital abroad to assist this goal.  

The Department of State, under Mr. Hughes, acted cautiously, and slowly. However, the Commerce Department, anxious to get on with the job of national recovery, occasionally acted hastily, to the dismay of the State Department. For example, in July, 1921, the firm of Kuhn, Loeb, and Company notified the Department of State that they were interested in a possible loan to the Argentine Government. Mr. Louis

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Strauss of this firm, who had been a former Secretary to Mr. Hoover during the Belgium relief days, contacted Mr. Hoover, at the Department of Commerce, regarding this loan. Mr. Hoover, who had been actively engaged in attempting to relieve the distressed condition of exporters, was quite anxious that this loan to Argentina be approved. In fact, Mr. Hoover stated that we "should be on all fours" with respect to this loan. In view of this endorsement, the Assistant Secretary of State for Latin American affairs placed the embassy at Buenos Aires in action to solicit an inquiry on behalf of the Kuhn, Loeb firm with the Argentine Government. It is interesting to note that a similar proposed loan to the City of Soissons, France, was turned down by Mr. Hoover in view of the fact that exchange conditions were bad, and the fear that foreign currency demands might cause domestic interest rates to be higher. Through the solicitation on behalf of Kuhn, Loeb and Company, the State Department became embarrassingly involved with the Argentine Government, and, perhaps in this way influenced the decision taken later not to involve itself in the details of loans.

During the autumn of 1921, the administration realized that a clear and explicit statement of our foreign loan policy would be necessary. Both the Commerce and State departments became aware of the fact that some bankers were not living up to the suggestion of the President in his May 26 "White House Conference" with Eastern Bankers,

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61 U.S. State Department, Decimal Files, 835.51/253, July 21, 1921; U.S. State Department, Decimal Files, 835.51/256, July 26, 1921.

62 U.S. State Department, Decimal Files, 835.51/326, July 29, 1921.
"Point Four" suggested that "the direct sale of foreign securities in the American market is likely to increase as investment possibilities in the underdeveloped areas become more attractive." Some of the experts acquainted particularly with foreign-dollar-bond lending of the 1920's and their subsequent defaults were aware of the fact that as renegotiations of old issues in default took place, and with more stable economic and political conditions, a limited revival of bond financing might take place.5

Unfortunately, Point Four had barely gotten under way when the U.S.A. and other countries were thrust into the Korean conflict, and the stability needed for private dollar lending quickly disappeared. Furthermore, the technical assistance program was somewhat rudely moved aside for a newcomer, The Mutual Security Act, which shortly changed the essential nature of the aid program to one of military orientation.6

Since the end of the Korean War a number of significant changes have taken place which may make foreign-dollar lending more feasible. Most of the remaining dollar bonds in default have been renegotiated except for the "Iron Curtain" countries and a few others. Also, the terms of the renegotiations of some of the major issues, namely, the

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that bankers keep the government informed concerning foreign loan transactions. Departmental memoranda note that a foreign loan policy was under advisement. 63

Another matter gradually crept into loan policy consideration. The Federal Reserve Board had made a study showing some of the relative costs of armament. The gist of the study was that better foreign trade conditions might be possible if there was a general reduction in arms. Exchange might be found in this manner to apply on foreign obligations. 64

Later, on January 23, 1922, Mr. Hoover, speaking before the Pan-American Conference, as Chairman of the U.S. Section, indicated that improved world conditions depended primarily on the adjustment of the German Reparations payment to the "practical power of the German people to pay" and the reduction of armed forces and budgets for military purposes. 65

The appointment of Secretaries Hughes, Hoover, and Mellon to the Foreign Debt Commission in February, 1922, charged to work out solutions to this weighty problem of foreign debts due to the U.S. from its allies, undoubtedly contributed to the establishment of the principle that those foreign governments owing war debts to the United States Government, who have failed to make some kind of a settlement for its payment, should not be allowed access to the private loan markets of the United States. 66

63U.S. State Department, Decimal Files, 832.51/289, October 28, 1921; also 832.51/247, October 25, 1921.
64New York Times, December 8, 1921, p. 4.
All three of the members of the cabinet who were members of the debt commission were in favor of this proposal.67

Official opposition to this policy of foreign loan supervision first came in April, 1922, from Governor Benjamin Strong of the New York Federal Bank who filed a vigorous protest with the Secretary of State and a demand that "we take our hands off." Mr. Hoover, in noting this protest from the Federal Reserve, in a letter to the Secretary of State indicated his own ideas concerning government supervision. In the first instance he felt that the memorandum of Governor Strong of "no supervision of foreign loans" was untenable, because "unless they are so developed, Congress will, sooner or later, impose controls. . . ." In the area of government responsibility Mr. Hoover noted that there is no method by which failure in payment of such loans can be prosecuted except by diplomatic intervention of the U.S. Government. It was also necessary that the security and the form of loans be proper so as not to involve the government. Mr. Hoover furthermore felt that there was a desirability on the part of the U.S. Government to promote political and economic stability through our lending. Lastly, Mr. Hoover noted as an aspect of the moral responsibility of our government that our citizens have had but little experience with investments and are not possessed of the information with respect to the security of these offerings. Another

67 For Secretary Mellon's position, see Annual Report of the Secretary of the Treasury (1925), pp. 54-55.
instance of moral responsibility pertains to loans to countries already
indebted to the United States in large sums. In conclusion Mr. Hoover
states the following:

The whole of these problems or moral responsibilities are
perfectly capable of dialectics in ethics to their total
obliteration, but the test of action of the Federal Govern­
ment in these particulars should at least be the standard
that would be expected of a reputable business man dealing
with his own customers. . . .68

With his background as an engineer, it was only natural that Mr.
Hoover be interested that the proceeds of U.S. loans be expended
productively. The record of the first several years correspondence in
the Department of Commerce clearly shows that Mr. Hoover and his asso­
ciates constantly asked with respect to the review of loan proposals
whether the loan was for "reproductive purposes." In some cases where
bankers omitted details concerning the proceeds, Mr. Hoover or his
associates frequently inquired about the prospectus. Part of their
concernment was another cardinal consideration of Mr. Hoover's, that
full and adequate information be available concerning the details of
loans so that the potential investor might have sufficient evidence to
guide him in his investment decision. It was, however, precisely on
the investment merits of the loans that the greatest bone of contention
took place between the Department of Commerce and the Department of
State.69

68 Recorded in Hoover, op. cit., pp. 86-88.
69 Ibid. See Balance of Payments Division, Department of Commerce
files for early correspondence concerning this point; also see Mr.
Hoover's speeches in 1920, 1921, and 1922.
By early spring of 1922 some basic decisions were made with respect to the broad outlines of our foreign loan policy. The President addressed an open letter to all investment bankers involved in the origination of foreign-dollar loans specifying the interest which the government had in being consulted with respect to new prospective foreign-dollar loans. Not all bankers had lived up to the original request of the President that the government be kept fully informed concerning pending loan arrangements. With an increasing volume of loans, it became quite necessary that the government reemphasize its interest. The communique of the President noted the necessity of adequate and timely information concerning lending arrangements in order for the proper conduct of governmental affairs. It also noted the purely voluntary nature of such information and indicated that it would not pass upon the merits of foreign loans as business propositions nor assume any responsibility therefore. Lastly, but not unimportantly, it noted that "foreign loans should not state or indicate that they [were] contingent upon an expression from the Department of State." 70

In noting that the President's communique to the bankers specifically stating that the government would not concern itself with the investment merits of loans, there is the first public intimation that the concern of Mr. Hoover about the productiveness, or what the State Department called "the details of loans," would not become an official part of policy. It is to be observed that the criticisms of Governor Strong and others, as well as a large number of criticisms from

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business leaders, may well have exerted force in calling the turn on this phase of foreign loan policy. As Mr. Hoover noted in his *Memoirs*:

However, President Harding and Secretary Mellon insisted upon a retreat from our original standards, and President Coolidge reduced the authority of the committee of the three Cabinet members to the limited duty of passing upon the affect which any particular loan might have directly on our foreign political relations.\(^1\)

The line of reasoning adopted by President Harding and Secretary Mellon has been stated, according to Mr. Livesey, in its best form, in the Report of the Secretary of the Treasury for 1925 as follows:

The question of the soundness of a particular loan is not one upon which the Federal Government should pass, but it is the banker floating the loan in this country, who must decide this question in the first instance, and it is the investor using his savings to acquire the security, who must finally decide whether or not the risk is to be accepted.\(^2\)

It may be further noted that while Mr. Hoover in his *Memoirs* attributes the change in policy not to include investment merits of loans to Mr. Harding and to Secretary Mellon, the Secretary of State concurred in the judgment of the President and the Secretary of Treasury.\(^3\)

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\(^1\) Hoover, op. cit., p. 88.

\(^2\) U.S. Department of Commerce, Decimal Files, 824.51/D581/26, June 23, 1928. This notation comes from a memorandum by Mr. Frederick Livesey which accompanied a letter from Mr. Jones of the Department of Commerce to Mr. Klein, which had been left at the State Department for consultation. In this memorandum Mr. Livesey notes that the above statement of Mr. Mellon's is the best considered policy statement regarding the position taken by the State Department, that it does not consider the investment merits of loans.

\(^3\) U.S. Department of Commerce, Balance of Payments Division, Letter from C. E. Hughes to Mr. Hoover (March 10, 1922).
During the fall of 1922 the application of the State Department's foreign loan policy relating to loans to European countries whose governmental debts to the United States Government had not been resolved, was subject to some misconception by bankers and others. State Department officials were concerned lest the impression be created that the United States Government did not wish financial interests to advance any more money to Europe. A high State Department official attempted to clarify the government's position on loans. It was stated that the American Government was anxious that American investments in Europe be applied for financial and economic rehabilitation and not for political purposes, especially military purposes, which might tend to increase rather than to diminish the world's political uncertainty. In view of the fact that the Harding Administration was committed to a policy of limiting armament, the State Department frowned upon any proposal which might be contemplating the use of the proceeds for war. The American Government was concerned about the apparent disposition of many continental governments to continue to postpone the refunding of their American war debts. The policy of the government was to place an embargo upon private loans in the United States to those European countries failing to make such arrangements. 74

The Secretary of the Treasury, Andrew Mellon, was most insistent that the government exercise a capital embargo in order to collect war claims due the U.S. Government from the governments of Europe. 75

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75 Annual Report of the Secretary of the Treasury (1925), pp. 54-55.
view was shared by most of the members of Congress. Mr. Hoover, who shared this belief, had another thought in mind. Mr. Hoover was concerned that because the U.S. Government had a prior lien claim due to the government-to-government debts, that if the U.S. Government withheld information regarding the possibility of default of private foreign-dollar bonds, then the U.S. Government might not, due to public pressure, be able to press for its claims to the exclusion of the private bondholders. Mr. Hoover was anxious that the investor should have full information concerning foreign commitments. Through his efforts, the Department of Commerce greatly expanded its services regarding economic facts on countries which were in the markets for loans. Nonetheless it was Mr. Hoover's judgment that the interest of the investor might be adequately protected by disclosure of facts concerning investments, supplemented by private advice to the bankers along with public statements if necessary, but not by the use of direct control. This was generally the view held by the other members of the Cabinet.

An important element in the government private loan policy, developed by the Department of Commerce, was the position taken on loans to foreign monopolies producing commodities which had the effect of raising the price of these commodities to American business interests, and ultimately to American consumers. Mr. Hoover, the progenitor of

76 Hoover, op. cit., pp. 86-88.

this portion of our loan policy, stated the issue cogently in his

Memoirs:

In 1922 it became evident that foreign producers of many such commodities were organizing aggressive controls of price and distribution. These took the form of foreign government-fostered combinations, cartels, or trade agreements directed against American and other consumers. The British erected a control of rubber; the Dutch, of quinine; the Germans, of potash; the Chileans, of nitrates; the Mexicans, of sisal (hemp); the Brazilians, of coffee; the Spanish and Italians, of mercury; the Egyptians, of long-staple cotton; and various countries, of tanning extracts. In 1922, before these combinations got to work on prices, we were paying about one billion dollars a year for our needs. Three years later they held us up for about two billion dollars annually for the same quantities.\(^78\) (See further remarks in footnote \(^79\).)

In 1925 the Department of Commerce was instrumental in objecting to a seventy-five million dollar German Potash Syndicate loan on the grounds that it would aid a foreign monopoly and would be contrary to the national interest. In the same year the Commerce Department also objected to a loan to the Sao Paulo Coffee Institute on similar grounds.\(^80\) Although there were not many instances of objection to loans on monopoly grounds, this principle of policy constituted the major area in which the Department of Commerce shared in its formulation.

\(^78\) Hoover, op. cit., p. 81.

\(^79\) In February, 1923, Mr. Hoover made an appearance before a House Sub-committee on appropriations in which he indicated the extent of price and production control of certain strategic commodities by foreign monopolies. Mr. Hoover suggested that Congress investigate rubber, nitrates, and certain other commodities to check on the practicality of interesting American capital. Mr. Hoover relates that in March, 1923, a substantial appropriation was made by Congress to investigate the activities of foreign monopolies and to wage a battle against them.

Later, the Department of State whittled away significantly on this principle.

Besides the principle of no loans to unrecognized governments, which was exclusively a principle stated and exercised solely by the Department of State, the only other area of policy in which the Department of Commerce had a voice and interest, although not explicitly recognized as a major item of policy, was the concern of Mr. Hoover that loans floated in the United States be expressed in United States dollars rather than in foreign currencies. This principle concerned Mr. Hoover in early 1921 and 1922, because of the depreciation of many foreign currencies. In fact, the Department of Commerce issued several bulletins warning investors of such issues and possible losses due to exchange depreciation. After 1922 this issue became less relevant and was discontinued. 81

Several other significant points ought to be mentioned concerning the Department of Commerce's role in policy making before considering the areas of conflict between the Department of State and the Department of Commerce. The Department of State, with respect to U.S. foreign loan policy, continued the policy pursued earlier by former Secretary of State Knox regarding the Caribbean countries. 82 Mr. Hughes, also, exercised a constant paternal interest, which in the case of financial matters, involved the government in setting up extensive financial

81 U.S. State Department, Decimal Files, 832.41/D581/1, April 13, 1922; New York Times, November 7, 1921, p. 5.

controls including customs receiverships, financial advisors, and active supervision over all details of loans to these countries. While it was not generally the policy of the State Department to consult with its so-called partners, namely Commerce and Treasury, on loans to countries falling in the above category, occasionally the Department of Commerce became involved directly by protest of interested parties, or it became implicitly involved by virtue of Mr. Hoover's views in which he expressly favored the device of the customs receivership as a condition to loans of this type.\(^{83}\) This financial control and involvement reached its zenith during the administration of President Coolidge.

Another important point that ought to be examined, prior to the matter of interdepartmental controversy, is the organizational structure for the implementation of U.S. foreign loan policy. Before the late fall of 1921 there was no formal organization for handling foreign loan consultations. Following the reorganization of the Economic Advisor's office in the State Department and the general reorganization in the Commerce Department, a committee was set up to provide for the necessary consultation.\(^{84}\) The Economic Advisor in the State Department handled the initial phases of loan inquiry, and the Finance and Investment Division in the Department of Commerce were responsible for implementing the Commerce Department's interest. Communications regarding loan requests went to the interested divisions of the several departments for

\(^{83}\)U.S. State Department, Decimal Files, 324.51/97, April 3, 1922; also 821.00/500, April 24, 1922; also see Commerce Department Balance of Payments Division Files for 1922 marked "Confidential" for a protest letter from American High Commissioner C. E. McGuire of the Inter-American Commission to Mr. Hoover on the pending twelve and a half million dollar loan to Guatemala dated May 26, 1922.

\(^{84}\)U.S. State Department, Decimal Files, 332.51/289, October 28, 1921.