Neither a Borrower nor a Lender Be: America Attempts to Collect its War Debts, 1922 – 1934

A thesis

presented to

the faculty of the Department of History

East Tennessee State University

In partial fulfillment

of the requirements for the degree

Master of Arts in History

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by

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December 2011

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Key words: World War Foreign Debt Commission, War Debts, World War I

ABSTRACT

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During and immediately after World War I the United States lent over $10 billion to various countries to sustain their war efforts and to provide post-war relief. The United States's insistence that these loans be repaid led to sharp disagreements with its erstwhile allies as to the nature of these loans and whether they should actually be repaid.

This thesis examines the processes, and the policies upon which those processes were based, by which the United States attempted to compel the debtor nations to begin repaying their loans.

The central theme of the thesis was developed largely from primary sources, including Annual Reports of the Secretary of the Treasury, diplomatic message traffic, and minutes and reports of the World War Foreign Debt Commission. Secondary sources supported the development of the economic and political context in which these events occurred as well as the perspectives of the foreign governments involved.

ACKNOWLEDGEMENTS

I would first like to thank East Tennessee State University and its History Department for making its master's program accessible to part-time and "non-traditional" students like me. It has been an outstanding intellectual experience. To the members of my committee, my thanks for their support, advice, and encouragement not only in the preparation of this thesis but also throughout the course of my studies. I would also like to thank Mr. Steven Spain, friend and advisor, for guiding me through some of the finer points of international financial operations. And to my wife Rebecca, my thanks for her support throughout this endeavor and for bearing with grace the stacks of musty books with obscure titles and a husband distracted by matters of long ago and far away.

CONTENTS

CHAPTER 1

INTRODUCTION

When the United States entered World War I it was not in a position to make an immediate contribution to the military effort against the Central Powers. Its army was little more than a colonial constabulary. Its navy, while possessing a respectable number of modern dreadnoughts, was neither trained nor equipped to counter the most dangerous maritime threat of all, the submarine. But the United States did possess in abundance that most critical of all resources of war, money. Immediately following its declaration of war, it began to extend billions of dollars in credits to its co-belligerents, thus allowing them to purchase in the United States the food, supplies, raw materials, and munitions they needed to sustain their war efforts. After the Armistice, the United States continued to loan large sums for relief purposes and largely to the new nations that had been created from the wreckage of the Russian and Austro-Hungarian empires.

A fundamental attribute of these loans, in the view of the United States, was that they were, in fact, loans. The United States fully expected that the countries that had borrowed these billions would repay them. In the spring of 1922, the Congress enacted legislation creating the World War Foreign Debt Commission and charged it with securing from the debtor nations firm agreements to repay their loans. These negotiations, conducted over a four-year period, would prove difficult and, at times, highly contentious, exposing as they did sharp differences between the United States and its erstwhile allies and associates over the nature of the debts, the terms under which they might be repaid, and the ability of the debtor nations to repay them.

This thesis focuses principally on the details of the process by which the United States attempted to negotiate long-term repayment agreements with its debtors. By necessity, it also examines the origin of the debts and the development of the sharply different positions regarding them in the United States and Europe. Finally, this thesis briefly considers the degree to which the debtor nations were able to comply with their payment plans throughout the late 1920s and early 1930s.

CHAPTER 2

THE UNITED STATES MAKES SOME LOANS

On April 6, 1917, when the United States declared war on Germany, the Allies, having been fighting for nearly three years, were approaching financial exhaustion. By at least one reckoning, Britain on April 1, 1917, was within one month of actual insolvency.[1] Congress and the Wilson Administration moved quickly to provide financing necessary to sustain the Allied war effort. On April 24, 1917, the first Liberty Loan Act became law. It authorized the Secretary of the Treasury to issue up to $5,000,000,000 in bonds "on the credit of the United States…to meet expenditures authorized for the national security and defense." One provision of the act would later prove to be of some importance in the formulation of the United States' policy regarding the collection of the war debts. The bonds authorized under the act were to be first offered as "a popular loan, under such regulations prescribed by the Secretary of the Treasury as will give all citizens of the United States an equal opportunity to participate therein."[2] This provision reflected the determination of William McAdoo, President Wilson's Treasury Secretary, to exploit the heightened patriotism engendered by the war to tap directly the wealth of the American people.[3] Convinced that a man "who could not serve in the trenches in France might nevertheless serve in the financial trenches at home," McAdoo also hoped that such patriotic appeals would allow the bonds to be sold at reduced interest rates.[4]

Section 2 of the legislation provided that of the $5,000,000,000 to be raised by the sale of United States government bonds $3,000,000,000 was to be used "for the purpose of more

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[1] Kathleen Burk, *Britain, America and the Sinews of War,* Boston, George Allen & Unwin, 1985, 95. See also pp.93-95 for details of deterioration of British financial condition from Jan. 1, 1917 forward.
[2] Public Law 65-3, *U.S. Statutes at Large* 40 (1917): 35.
[3] William G. McAdoo, *Crowded Years, the Reminiscences of William G. McAdoo,* New York, Houghton Mifflin, 1931, 378-379.
[4] McAdoo, *Crowded Years,* 378.

effectually providing for the national security and defense and prosecuting the war by establishing credits in the United States for foreign governments."[5] These credits would not be gifts; the governments receiving them would be incurring a debt to the United States. The First Liberty Loan Act provided that any credits extended were to be exchanged for bonds of the foreign governments "bearing the same rate of interest and containing in their essentials the same terms and conditions as those of the United States issued under authority of this Act."[6]

Congress's decision that the credits it was providing for foreign co-belligerents would be loans requiring repayment was not a policy unique to the United States. From the outbreak of the war in 1914, Great Britain and France had treated the aid they had provided to their allies as loans. This policy implemented a general consensus that each Ally would bear the full cost of its participation in the war. In addition, treating aid as loans was seen to encourage the correct setting of priorities and the effecting of economies in the overall war effort. Allies who understood they were incurring debts in receiving aid, it was expected, would carefully consider the nature and amount of the assistance they were requesting.[7] By the time the Unites States entered the war Great Britain had extended loans to its allies amounting to $3,814,400,000 and France $514,500,000.[8] In requiring repayment by recipients of its aid the United States was following a well-established precedent.

Beyond conforming to an existing practice there were practical advantages to the United States Government becoming the sole conduit through which the Allies would henceforth receive American aid. The U.S. Treasury would have a clear field in which to tap the financial and

[5] Public Law 65-3, *U.S. Statutes at Large* 40 (1917): 35.
[6] Section 2, Public Law 65-3, *U.S. Statutes at Large* 40 (1917): 35.
[7] R. Trouton, "Cancellation of Inter-Allied Debts," *The Economic Journal,* Vol. 31, No. 121 (Mar. 1921) p.38-45, 39-40.
[8] Harold G. Moulton and Leo Pavolsky, *War Debts and World Prosperity,* The Brookings Institution, New York, 1932, 425, For detail of this period of war financing see also Harvey E. Fisk, *The Inter-Ally Debt, An Analysis of War and Post-War Public Finance 1914-1923,* Bankers Trust Company, New York, 1924, 120-149.

material resources of the country. It would face no competition from foreign governments whose desperation or destitution would compel them to pay higher interest rates, thus driving up the cost of U.S. borrowing as well. In fact, it was not unreasonable to believe that the conditions of some governments whose continuing participation in the war was deemed essential might deteriorate to such a point that they could no longer raise money in the United States from private sources under any terms. Finally, by controlling the amount and timing of the credits released to its co-belligerents the Treasury could coordinate their purchases with those of the United States. This could be expected to yield greater efficiencies and mitigate the upward pressure on prices that would otherwise occur because of competitive purchasing by the respective governments.[9]

While making a vast new source of financing available to the United States's allies, the legislation placed limits on the manner in which those credits would be issued and for how long. The language that provided for "establishing credits in the United States" was intended and understood to mean that the money advanced as credits by the United States would be used to purchase materials, supplies, munitions, and other required items in the United States. The actual mechanism provided in the Act by which the credits would be advanced was a grant of authority to the Secretary of the Treasury to purchase bonds that the foreign governments would issue for such purpose. The Act required that these foreign bonds would have essentially the same terms and interest rate as the bonds issued by the United States under the Act to raise the money being advanced as credits. In the event, the United States never required the borrowing governments to actually issue bonds. According to Treasury Secretary William G. McAdoo, the Treasury was simply "too busy" to indulge in the negotiations required of formal bond issues.[10]

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[9] Moulton and Pavolsky, *War Debts and World Prosperity,* 36-37.
[10] Ellen Schrecker, *The Hired Money,* New York, Arno Press, 1978, 24-25.

Instead, the Treasury accepted certificates of indebtedness that were, in effect, promissory notes. Generally the notes bore an interest rate of about 5% and were payable on demand.[11] Finally, the authority of the Secretary of the Treasury to purchase bonds from foreign governments was to end "upon the termination of the war between the United States and the Imperial German Government."[12]

The Allies began to access the newly available credit immediately. On April 25, 1917, one day after the passage of the First Liberty Loan Act, Great Britain drew $200,000,000. On May 3, $25,000,000 was advanced to Italy. $25,000,000 more went to Great Britain on the 5th and again the same amount on the 7th. On the 8th, France opened its borrowing by accessing $50,000,000. By the end of May, the United States Government had advanced $657,500,000 in credits to various Allied governments.[13]

The financial demands of the war were unrelenting and the allied powers soon needed additional money. In September 1917, Congress passed the Second Liberty Loan Act.[14] Among its provisions was the authorization of an additional $4,000,000,000 in credits for co-belligerents. The Second Liberty Loan Act also continued the requirement that the credits extended be exchanged for bonds of the recipient governments but modified this provision somewhat by mandating that the rate of interest of such bonds be at "the highest rate" borne by the United States bonds issued to raise the funds from which the credits were provided. A Third Liberty Loan Act and a Fourth Liberty Loan Act followed in April and July 1918, respectively. Each authorized an additional $1,500,000,000 in credits. They also retained the "highest rate"

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[11] For a specimen of the form of certificate of indebtedness see World War Foreign Debt Commission, *Combined Annual Reports, With Additional Information Regarding Foreign Debts Due the United States, Fiscal Years, 1922, 1923, 1924 1925 and 1926,* Washington D.C., United States Printing Office, 1927, 314. Cited hereinafter as *Combined Reports.*
[12] Public Law 65-3, *U.S. Statutes at Large* 40 (1917): 35.
[13] Exhibit 116, "Statement showing dates and amounts of cash advances to foreign governments under the Acts of April 24, 1917, September 24, 1917, April 4, 1918, and July 9. 1918," *Combined Reports,* 318-325.
[14] Second Liberty Loan Act, Public Law 65-43, *U.S. Statutes at Large* 40 (1917): 288.

requirement for the bonds that the recipient governments were to exchange for the credits they would receive.[15] In total, the four Liberty Loan Acts authorized $10,000,000,000 in credits to support foreign governments in the fight against Germany. By the time the last credit, of $717,834.36, was extended to the newly formed country of Czechoslovakia on May 29, 1922, a grand total of $9,598,236575.46 had been loaned by the United States under the various Liberty Loan acts.[16]

A final bond issue to provide for war-related expenditures was authorized by Congress in March 1919. This "Victory Liberty Loan Act" did not provide for any additional credits for foreign governments.[17] It did, however, include a provision that underscored Congress's view that the credits provided to those governments were loans for which repayment was expected. Looking forward to the day when the principal on all of the Liberty and Victory Bonds would be due, Section 6 of the Act directed the establishment of a sinking fund. Additions to this fund were to be made annually in an amount equal to 2 ½% of the face value of the bonds outstanding as of January 1, 1920, "less an amount equal to the par amount of any obligations of foreign Governments held by the United States" on that date.[18] There was no need for the United Sates government to provide for the payment of the principal on that portion of the Liberty Bonds whose proceeds had been transferred to foreign governments because those governments were expected to provide the funds to do so.

The bonds sold under the Liberty and Victory Loan programs carried varying terms reflective of the market conditions prevailing at the time of their offering. Interest rates varied between 3¾% and 4½%. Depending on the issue, these bonds were to mature at various dates

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[15] Third Liberty Loan Act, Public Law 65-120, *U.S. Statutes at Large* 40 (1918): 502; Fourth Liberty Loan Act, Public Law 65-192, *U.S. Statutes at Large* 40 (1918): 844.
[16] Exhibit 116, *Combined Reports,* 325.
[17] Victory Liberty Loan Act, Public Law 65-328, *U.S. Statutes at Large* 40 (1919): 1309.
[18] Section 6 (a) (1), Public Law 65-328, *U.S. Statutes at Large* 49 (1919):1312.

between 1923 and 1947. In order to attract as many individual buyers as possible to service in the "financial trenches," the bonds were issued in denominations as low as $50 and $100.[19] Public response to government sponsored bond drives was strong particularly with the earlier bond issues. In a single day, for instance, 17,500 people were reported to have appeared at the Liberty Loan Association in New York City.[20]

The credits issued under the Liberty Loan acts, as large as they were, did not comprise all of the inter-governmental lending undertaken by the United States during and immediately after World War One. A provision of a 1918 act providing for Army appropriations authorized the President to direct the sale of war supplies and materials to Allied governments.[21] Although enacted in July 1918, the fact that actual fighting came to an end the following November 11 meant that the majority of these sales took place after the Armistice. The supplies that were sold had largely been stockpiled in France to support the Allied war effort. With the end of the war, United States authorities determined that it would be preferable to sell these materials *in situ* rather than incurring the effort and expense to ship them home, where there was no particular demand for them.[22] In all, almost $575,000,000 in credits was extended to a variety of countries, though the bulk of the materials and the credits, $407,000,000, went to France.[23]

Another $84,000,000 in credits was extended under the provisions of a Congressional act of February 25, 1919, providing "for the relief of such populations in Europe and countries

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[19] Gilbert, *American Financing of World War I,* 119-124. For complete details of the various Liberty and Victory loan issues see U.S. Treasury, *Annual Report of the Secretary of the Treasury on the State of the Finances for the Fiscal Year Ended June 30, 1921,* Washington D.C., United States Printing Office, 1922, 451-453. Cited hereafter as *Treasury Annual Report.*
[20] J. Herbert Case, "Preparation for War and the Liberty Loans," *Annals of the American Academy of Political and Social Science,* Vol. 99 (Jan, 1922), 126.
[21] Public Law 65-193, *U.S. Statutes at Large* 40 (1918): 845.
[22] For the sale of surplus war materials to France, see Schrecker, *The Hired Money,* 85-86.
[23] For detail of credits extended by country, see "Obligations of Foreign Governments Held by the United States, Together with Interest Accrued and Remaining Unpaid Thereon as of the last Interest Period Prior to or Ending with November 15, 1922," *Treasury Annual Report, 1922,* 281.

contiguous thereto."[24] Eight countries received assistance under this program with Poland receiving the major portion, over $51,000,000.[25] Finally, legislation enacted March 30, 1920, authorized the United States Grain Corporation "to sell or dispose of flour now in its possession, not to exceed five million barrels, for cash or on credit" in order to "relieve populations in the countries of Europe or contiguous thereto suffering for the want of food."[26] Under this program almost $57,000,000 in credits was advanced to five countries.[27]

A Treasury compilation as of November 15, 1922, of the amounts owed the United States as a result of the lending discussed above showed that the principal owed by twenty countries totaled $10,102,140,829.09. Another $1,554,791,908.36 was owed in the form of interest accrued but not yet paid. On September 26, 1919, the Treasury had announced that it was willing to defer receipt of interest payments on outstanding debt for a period of two or three years.[28] Up to this point the debtor nations had been able to make interest payments on their debt even if those payments had been made from the proceeds of additional borrowing. With the decreasing availability post-war of credit from the United States and faced with the financial burdens of rebuilding their war-ravaged economies, it was becoming apparent that many of the debtor nations would soon be unable to meet their scheduled interest payments. But this moratorium on interest payments was only a deferral and not a cancellation; the interest would have to be paid at some point. When the accrued interest was added to the principal borrowed, the amounts owed by the debtor nations as of November 15, 1922, totaled $11,656,932,737.45. This, then, was the debt which the World War Foreign Debt Commission would try to collect.

[24] Public Law 65-273, *U.S. Statutes at Large* 40 (1919): 1161.
[25] For detail of credits extended by country, see "Obligations of Foreign Governments," *Treasury Annual Report, 1922,* 281.
[26] Public Law 66-167, *U.S. Statutes at Large* 41 (1920): 548.
[27] For detail of credits extended by country, see "Obligations of Foreign Governments," *Treasury Annual Report, 1922,* 281.
[28] Harold G. Moulton and Leo Pavolsky, *War Debts and World Prosperity,* New York, The Brookings Institution, 1932, 40.

Details of this borrowing by nation and purpose are presented in Table 1 below.

Table 1
Obligations of Foreign Governments Held by the United States as of November 15, 1922[29]

Country	Liberty Bond Acts		Sales of surplus war material		Relief credits		Sales by U.S. Grain Corp.		Total		Total Indebtedness
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	
Armenia					8,028,412.15	1,204,261.83	3,931,505.34	472,995.05	11,959,917.49	1,677,256.88	13,637,174.37
Austria							24,055,708.92	2,886,685.08	24,055,708.92	2,886,685.08	26,942,394.00
Belgium	347,251,013.40	60,073,383.65	29,872,732.54						377,123,745.94	60,073,383.65	437,197,129.59
Cuba	7,740,500.00								7,740,500.00	0.00	7,740,500.00
Czechoslovakia	61,974,041.10	10,136,141.81	20,612,300.11	2,959,392.88	6,428,089.19	964,213.38	2,873,238.25	344,788.60	91,887,668.65	14,404,536.67	106,292,205.32
Estonia			12,213,377.88	1,832,006.70	1,785,767.72	257,618.96			13,999,145.60	2,089,625.66	16,088,771.26
Finland					8,281,926.17	1,012,436.10			8,281,926.17	1,012,436.10	9,294,362.27
France	2,933,405,070.15	503,386,035.61	407,341,145.01						3,340,746,215.16	503,386,035.61	3,844,132,250.77
Great Britain	4,135,818,358.44	611,044,201.85							4,135,818,358.44	611,044,201.85	4,746,862,560.29
Greece	15,000,000.00	750,000.00							15,000,000.00	750,000.00	15,750,000.00
Hungary							1,685,835.61	202,300.28	1,685,835.61	202,300.28	1,888,135.89
Italy	1,648,034,050.90	284,681,434.61							1,648,034,050.90	284,681,434.61	1,932,715,485.51
Latvia			2,521,869.32	252,014.20	2,610,417.82	391,562.67			5,132,287.14	643,576.87	5,775,864.01
Liberia	26,000.00	3,518.85							26,000.00	3,518.85	29,518.85
Lithuania			4,159,491.96	623,923.80	822,136.07	123,320.40			4,981,628.03	747,244.20	5,728,872.23
Nicaragua			170,585.35						170,585.35	0.00	170,585.35
Poland			59,678,604.07	7,042,817.10	51,671,749.36	7,750,762.41	24,312,514.37	2,825,229.50	135,662,867.80	17,618,809.01	153,281,676.81
Romania	23,205,819.52	3,925,703.00	12,922,675.42	1,938,401.34					36,128,494.94	5,864,104.34	41,992,599.28
Russia	187,729,750.00	39,214,326.16	406,082.30	10,152.06	4,465,465.07	488,192.56			192,601,297.37	39,712,670.78	232,313,968.15
Serbia	26,126,574.59	4,611,738.14	24,978,020.99	3,382,349.78					51,104,595.58	7,994,087.92	59,098,683.50
Total	9,386,311,178.10	1,517,826,483.68	574,876,884.95	18,041,057.86	84,093,963.55	12,192,368.31	56,858,802.49	6,731,998.51	10,102,140,829.09	1,554,791,908.36	11,656,932,737.45

[29] *Treasury Annual Report, 1922,* 281.

CHAPTER 3

EARLY CONTROVERSIES

In view of the economic and political chaos gripping much of Europe in the immediate aftermath of the war, U.S. Treasury officials realized that it would be some time before the debtor nations would be likely to enter serious negotiations regarding the repayment of their loans. Up to this point the debtor nations had been able to make interest payments on their debt even if those payments had been made from the proceeds of additional borrowing. With the decreasing availability post-war of credit from the United States and faced with the financial burdens of rebuilding their war-ravaged economies, it was becoming apparent that many of the debtor nations would soon be unable to meet even their scheduled interest payments. In, "Observations upon the European Situation," a secret report submitted to President Wilson May 15, 1919, during the course of the Paris Peace Conference, economic advisors to the American delegation recommended that "[s]ome provision should be made for temporarily refunding the interest" on the debts owed the United States. "Refunding" in this case meant the suspension of interest payments for a period of time, which, the advisors suggested, should be "at least three years." At the end of this period the unpaid interest would be added to and become a part of the principal of the existing debt.[30]

The Treasury acted on this recommendation the following September 26, announcing "the deferring of interest collection during the reconstruction period of two or three years from the spring of 1919."[31] In a subsequent letter to Joseph Fordney, chairman of the House Ways and Means Committee, Secretary of the Treasury Carter Glass discussed the reasons supporting the action. After asserting that the interest deferral was not a precursor to outright cancellation

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[30] Ray Stannard Baker, *Woodrow Wilson and World Settlement, Volume III: Original Documents of the Peace Conference,* New York, Doubleday, Page & Company, 1922, 359-360.
[31] *Treasury Annual Report, 1920,* 59.

of the debts, Glass maintained that it was simply impossible for the majority of the debtor nations to pay their interest given the current state of the their industries and economies. Until such time as these nations could once again engage in normal levels of trade with the United States, they would not be able to acquire the foreign exchange credits with which the loans would be repaid. In the alternative, Glass acknowledged, external loans could be paid in gold. However, given the size of the debts, "the payment of one year's interest alone would exhaust about 50 per cent of the gold reserves of our debtors."[32] The decision to defer interest payments, therefore, was a necessary concession to the realities of Europe's economic distress.

The scale and complexity of the economic challenges facing Europe at this time also engendered proposals from debtor nations, principally France and Great Britain, regarding their debts to the United States. As with the British, the French early on argued for a cancellation of some or all of their war debts. The French first broached the subject in the form of informal overtures to American representatives during the preliminary phases of the Paris Peace Conference. The proposals were generally cast as attempts to place on the Conference's agenda a discussion of "a joint consideration" of the war debts.[33] The French government then raised the issue more formally on January 15, 1919, in a letter from French High Commissioner Eduoard de Billy to Secretary of the Treasury, Carter Glass. Claiming that the various aspects of the war debts "are closely interwoven," he observed that it appeared that if future adjustments were to be made the "object of separate and distinct agreements, privileged situations might arise to the prejudice of some of the governments concerned." But if "all debts and credits were considered at the same time," it would be easier "according to equity, to settle the respective situations of these governments." This general consolidation of the debts issue was logical and should be

[32] Glass to Fordney, December 18, 1919, *Treasury Annual Report, 1920,* 59-61.
[33] Moulton & Pavolsky, *War Debts and World Prosperity,* 52-53.

considered at the Conference, de Billy claimed, because the ability of the debtor nations to pay those debts would effectively be considered on a consolidated basis as well. De Billy also argued that it appeared "that the possibility of reimbursement by some governments" could be "deeply affected by the conditions of the Treaty of Peace, especially by indemnities to be received eventually from Germany and, in the case of some countries, as Serbia, for instance, by the distribution of territory and the establishment of new boundary lines."[34]

Secretary Glass responded on January 29. Recognizing de Billy's arguments as either an effort to build a solid debtors' front against the United States or as a mechanism for proposing debt cancellation, or both, Glass refused to agree to a discussion of the debt situation at the Peace Conference. It was unnecessary and premature. The United States, he said, was willing to wait until the Conference had been completed and the financial situation of the debtor nations thereby made clear. Discussions, Glass wrote, "should take place in Washington as soon as possible after the financial terms of the peace settlement have been decided, or earlier in the case of any Government which so desires."[35]

At about the same time, the French appeared to attempt to float a trial balloon advocating a far more radical approach to the entire inter-Allied debt situation. On March 8, Assistant Treasury Secretary Albert Rathbone wrote to de Billy concerning a proposal that had surfaced at a recent meeting of the Financial Drafting Committee at the Paris Peace Conference. With apparently strong French support, the committee had discussed "a reapportionment and consolidation of war debts." This would have involved pooling all of the war debts and then apportioning them among the Allied, and Associated, governments on the basis of some measure of national wealth. The inevitable result of such a process would be that the United States,

[34] de Billy to Glass, Jan. 15, 1919, *Treasury Annual Report, 1926,* 63.
[35] Glass to de Billy, Jan. 29, 1919, *Treasury Annual Report, 1926,* 64-65.

currently owed billions, would now be liable for a significant portion of the total cost of the war. Rathbone rejected this concept outright and appended a threat that the debtor governments could not ignore. The United States, he wrote, "will not assent to any discussion at the peace conference, or elsewhere, of any plan or arrangement for the release, consolidation, or reapportionment of the obligations of foreign Governments held by the United States." In closing, he cautioned de Billy to "appreciate" the fact "that the Treasury cannot contemplate continuance of advances to any Allied Government which is lending its support to any plan that would create uncertainty as to its due repayment of advances made to it by the United States Treasury."[36] The French quickly relented. On March 18, de Billy replied claiming, first, that the idea had originated with the Italian rather than the French delegation to the Financial Drafting Committee and also that it had not been intended as a definitive proposal. Instead, the purpose in raising the issue was "purely and simply to make a list of the questions which the representatives of the Powers now assembled in Paris might find it expedient to consider."[37]

The British government was also active during this period in advancing various proposals for dealing with the problem of the inter-Allied debts. One British line of thought somewhat followed the French concept of a consolidated settlement of the overall debt situation. In the British view, this would require "close cooperation between the British and American Treasuries."[38] The United States continued to reject this position out of hand. In reply, Rathbone reiterated American objections to a general settlement of the debts issue. He emphasized that the United States Treasury "has in no wise changed the views it has expressed, or modified the position that it has taken in the past, and regards the several obligations of the

[36] Rathbone to de Billy, March 8, 1919, *Treasury Annual Report, 1926,* 65.
[37] de Billy to Rathbone, March 18, 1919, *Treasury Annual Reports, 1926,* 66.
[38] Basil Blackett, British financial representative to Peace Conference to Rathbone, November 8, 1919, *Treasury Annual Reports, 1926,* 66-67.

various Allied governments held by the Government of the United States as representing the debt of each to the United States."[39]

The British continued to pursue other approaches to achieving some general solution to the debt problem. In April 1919 at the Peace Conference, Prime Minister Lloyd George forwarded to President Wilson a "Scheme for the Rehabilitation of European Credit and for Financing Relief and Reconstruction." Devised by John Maynard Keynes, this "Keynes Plan" envisioned Germany and other former Central Powers floating a massive bond issue totaling £1,345,000,000, £1,000,000,000 of which would be issued by Germany. Payment of interest on these bonds would be guaranteed by the Allied governments. Twenty percent of the bonds would be retained by the issuing governments so that they could be used to raise capital for the purchase of foodstuffs and raw materials with which to prime the recovery of those countries' economies. The remaining bonds would be "paid over to the Allied and Associated Governments on account of sums due for Reparations." As "down payments" on the ultimate reparation indemnities to be imposed on the defeated governments, these bonds would be distributed among the Allied governments "in the proportions determined upon by them for the division of Reparation receipts generally." Finally, and most significantly for the debt question, the bonds thus distributed were "to be accepted at their par value plus accrued interest in payment of all indebtedness between any of the Allied and Associated Governments."[40]

In his cover letter to Wilson, Lloyd George said that the British Government wanted to present the Keynes Plan for consideration by the Big Four, describing it as Britain's "constructive contribution to the solution of the greatest financial problem ever set to the modern world."[41] Wilson clearly thought otherwise, asserting that Keynes's plan "does not seem feasible from the

[39] Rathbone to Blackett, November 18, 1919, *Treasury Annual Reports, 1926,* 67.
[40] For text of Keynes Plan see Baker, *Woodrow Wilson and World Settlement, Vol. III,* 341-343.
[41] Lloyd George to Wilson, April 23, 1919, Baker, *Woodrow Wilson and World Settlement, Vol. III,* 336-341.

American point of view." His financial advisors, Wilson said, "are convinced that the plan lacks many elements of economic and financial soundness." Besides, the Congress would never agree to place a United States guarantee on foreign bonds. The most basic problem with the plan was its fundamental hypocrisy. It sought to provide new capital to foster the economic reconstruction of Germany while simultaneously insisting on harsh reparation indemnities that stripped that same economy of most of its financial and tangible assets. “How can anyone,” Wilson pointedly inquired, “expect America to turn over to Germany in any considerable measure new working capital to take the place of that which the European nations have determined to take from her?”[42]

That exchange of capital would occur when the Allied governments that had received the bonds used them to pay their foreign debts. As the United States was the ultimate creditor of all of the Allied nations it was clearly foreseeable that most if not all of these bonds would end up in the hands of its Treasury. Instead of holding bonds from more apparently credit-worthy governments, the United States would thus find itself holding upwards of $5,000,000,000 worth of bonds of very dubious value given the state of the German economy and the clear prospect of future demands being imposed upon it for additional reparations. In addition, the payments on these bonds effectively would make the United States perhaps the largest single recipient of German reparations payments, which type of payments Wilson had consistently renounced. Little more was heard of the Keynes Plan.

In February 1920, the British tried again, this time with a proposal for a general cancellation of all war debts. In a letter of February 4, 1920, to Assistant Secretary of the Treasury, Arthur Rathbone, Mr. Basil Blackett of the British Treasury referred to informal "suggestions" the British government previously had floated for a general cancellation of war debts. "The suggestions have not hitherto been placed on formal record," he said, “and it is for

[42] Wilson to Lloyd George, May 5, 1919, Baker, *Woodrow Wilson and World Settlement, Vol. III,* 344-346.

the purpose of formal record that they are mentioned here."[43] Five days later, in a message to Assistant Secretary of the Treasury, Russell Leffingwell, Chancellor of the Exchequer Austin Chamberlain made specific the British proposal for a general cancellation of debts. Britain, he wrote, would "welcome a general cancellation of the intergovernmental war debts." "The moral effect," he claimed, "would even be a greater practical change and fresh hope and confidence would spring up everywhere." Chamberlain argued that the existence of "these international debts deters neutrals from giving assistance, checks private credits, and will, I fear, prove a disturbing effect in future international relations."[44] Such a course of action would not have been unprecedented. A century earlier, Britain had provided massive subsidies to fellow members of the anti-French coalition during the Napoleonic Wars. To a great extent, the amounts advanced had been considered subsidies and not loans requiring repayment.[45]

The American response to Chamberlain revealed the virtually unbridgeable gap between the two governments' positions. In a wide-ranging letter dated March 1, 1920, Secretary of the Treasury David Houston laid out all of the essential elements of the American policy on the war debts. A general cancellation of the debts would, he said, "serve no useful purpose." Rather, it would give false hope to the peoples of the debtor nations that this expedient would restore their prosperity. Besides, it was "certain that neither the American people or our Congress whose action on such a question would be required is prepared to look with favor upon such a proposal." Houston also pointed out that of all the Allies that would be affected by a general cancellation of war debts the United States would be the only country that would receive no benefit in the form of a reduction in its liabilities. The proposal "does not involve mutual

[43] Blackett to Leffingwell, February 4, 1920, *Treasury Annual Report, 1926,* 67.
[44] Chamberlain to Leffingwell, February 9, 1920, *Treasury Annual Report, 1926,* 67.
[45] Moulton & Pavolsky, *War Debts and World Prosperity,* 62-63.

sacrifices on the part of the nations concerned. It simply involves a contribution mainly by the United States."

Houston then challenged Chamberlain's basic premise that the war debts stood in the way of European reconstruction. These debts were "not a present burden on the debtor Governments, since they are not paying interest or even...providing in their budgets or taxes for the payment of principal or interest." The debts, Houston claimed, did not prevent the debtor nations from obtaining credits in the private financial markets in America nor did they limit the amounts of such credits. Furthermore, he did not believe that they could obtain "a single dollar more" were the debts to be cancelled.

The reference to private financial markets touched on another major difference between the European and American approach to economic reconstruction. The Europeans believed that government participation in the reconstruction process would be required for the foreseeable future. In the American view, it was time for governments to get out of the banking business. Houston pointed out that since the Armistice the United States had provided various governments "financial assistance to the extent of approximately four billions of dollars." What the United States could do "for the immediate relief of the debtor countries has been done. Their need now is for private credits."[46] Houston here was reiterating the long-standing American preference for private rather than public solutions to reconstruction problems.[47] It followed. then, that the problems of European reconstruction must be solved by Europeans prepared to face

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[46] Houston to Chamberlain, March 1, 1920, *Treasury Annual Report, 1926,* 67-69.
[47] See e.g., correspondence between Bernard Baruch and Lord Robert Cecil in April,1919 at the Peace Conference, in which Baruch urges the lifting of all restraints on "individual initiative" and Cecil insists that large-scale government intervention is needed to effect reconstruction. Baker, *Woodrow Wilson and World Settlement, Vol. III,* 332-335.

the realities of their situation. Among other things they must raise taxes sufficient to balance their budgets, reduce expenditures, and accelerate the pace of disarmament.[48]

The British made one last effort later in 1920 to move the United States from its obdurate insistence on full payment of the debts. During May and June, the British and French governments had participated in a number of discussions on fixing the amount of Germany's reparation obligations. One of the proposals that had been considered in the course of these conferences was a policy of "parallel liquidation" of war debts and reparations. Parallel liquidation linked the payment of war debts by the Allied debtor nations to their receipt of reparations from Germany. The debtor nations would agree to pay over to their creditors any and all amounts they received as reparations. In turn, the creditor nations would agree to accept these payments, whatever their amounts, in full satisfaction of the debts owed them. In effect, Germany would pay the war debts.[49]

On August 5, Prime Minister David Lloyd George wrote to President Wilson proposing that the United States accept parallel liquidation. The British Government, he said, considered the concept to be "eminently fair." However, the British Government could not agree to cancel any of the debt owed it by France "except as part and parcel of all round settlement of interallied indebtedness." British public opinion would never support "a one-sided arrangement at its sole expense." Therefore, it was necessary that the United States agree to treat its British debtor as Britain was prepared to treat its debtor nations.[50] Lloyd George failed to explain why he thought American public opinion might be any more inclined to accept "a one-sided arrangement at its sole expense" than would his own.

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[48] Houston to Chamberlain, March 1, 1920, *Treasury Annual Report, 1926,* 67-69.
[49] Robert Self, *Britain, America and the War Debt Controversy: The economic diplomacy of an unspecial relationship, 1917-1941,* New York, Routledge, 2006, 28.
[50] Lloyd George to Wilson, August 5, 1920, *Treasury Annual Report, 1926,* 71-72.

Wilson did not reply until November 3. At virtually the end of his Presidency, he largely reiterated the long-standing American position on the debt question and reparations. As long ago as the Peace Conference the United States had stated its opposition to any manner of debt reduction or cancellation and had consistently maintained that position ever since. Besides, the President lacked to power to modify the terms of the debt agreements. The Congress had provided the legal authority under which the United States had made the loans and only Congress could agree to cancel them. Wilson doubted that Congress or, as in Britain, public opinion would support such action. The British Government was free to make any decision it wished with regard to debts owed to it, but, Wilson cautioned, it should do so "with the understanding that any such arrangement would not affect the payment in due course of the debt owed the United States by Great Britain."[51]

By the last months of the Wilson administration the parties to the war debt controversy had developed starkly different positions as to the nature of the debts and the manner in which the issues surrounding them might be resolved. These differences combined matters of high principle and baser elements of international competition and domestic politics.[52] The essence of the debtor nations' position, as espoused principally by Britain and France, regarding their debts to the United States was that these were "political" rather than "commercial" debts and, as such,

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[51] Wilson to Lloyd George, November 3, 1920,*Treasury Annual Report, 1926,* 72-73.

[52] For discussions of the competing positions see Benjamin H. Williams, *Economic Foreign Policy of the United States,* New York, McGraw Hill, 1929, 229-235; for various aspects of the American position see Moulton and Pavolsky, *War Debts,* 48-52, Frank Costigliola, *Awkward Dominion, American Political, Economic, and Cultural Relations with Europe, 1919-1933,* Ithaca, NY, Cornell University Press, 1984, 36, Melvyn Leffler, "The Origins of Republican War Debt Policy, 1921-1923: A Case Study in the Applicability of the Open Door Interpretation," *The Journal of American History,* Vol. 59, No. 3 (Dec., 1972), 585-601, Eliot Wadsworth, "the Inter-Allied Debt Problem and a Stable Monetary System Abroad," *Proceedings of the Academy of Political Science in the City of New York,* Vol. 10, No. 2 (Jan., 1923), 151-161; for some aspects of the British view see Self, *Britain, America and the War Debt Controversy*, 15-33, Roberta Allbert Dayer, "The British War Debts to the United States and the Anglo-Japanese Alliance, 1920-1923," *The Pacific Historical Review,* Vol. 45, No. 4 (Nov, 1976), 569-595; for a French perspective see generally Schrecker, *The Hired Money,* also, Benjamin D. Rhodes, "Reassessing 'Uncle Shylock': The United States and the French War Debt, 1917-1929, *The Journal of American History,* Vol. 55. No. 4 (Mar., 1969), 787-803.

were amenable to reduction or outright cancellation. They were clearly not commercial debts, the argument ran, because they would not have been made if ordinary standards of creditworthiness had been applied to the nations seeking them. Therefore, they were granted under a different standard, a political one. The loans were necessary to keep the Allied nations in the war against Germany. The United States's loans were seen as its contribution to the overall Allied war effort. Cast in this light, they had to be considered as different only in kind from the sacrifices other Allied nations had made in the joint struggle to defeat the Central Powers. Britain and France would compare the approximately one million deaths they each suffered in the war to the 50,000 Americans likewise lost.[53] Belgium would point to the fact that its sacrifices during the war included the fact that virtually the whole of its territory had been occupied by the Germans for the duration of the war. If these countries and their people could make such painful contributions to the mutually beneficial victory over Germany, was it not unreasonable to ask the United States, now easily the most powerful economy in the world, to sacrifice a little treasure?

These lofty sentiments notwithstanding, the debtor nations had as well more basic concerns about the effects of American insistence on prompt and full repayment of the loans. Raising the money to make the payments would further burden their populations with taxes and hamper the reconstruction of their economies because of the loss of the capital exported to the United States as loan repayments. For Britain and France this latter consideration meant the loss of markets and trade to the United States, whose industrial base had emerged from the war expanded, modernized and undamaged.

The contrasting American position on the debts was that they were entirely commercial in nature. This position was articulated by the Treasury as early as late 1917. In a bulletin

[53] Williams, *Economic Foreign Policy,* 232.

discussing the significance to the war effort of the credits then being advanced to the Allies, the Treasury emphasized that the loans were not contributions but rather an extension of credit to solvent borrowers who were temporarily in need of cash.[54] As commercial debts, the loans must be repaid to uphold the validity of contracts and the obligations that go with them. In November 1918, Treasury Secretary William McAdoo had refined the official American position on payment of the debts. In doing so he outlined a policy that would be followed not only by the Wilson Administration but also by the succession of Republican ones that followed. The debts would not be cancelled or used as political bargaining chips. In addition, the United States would conduct debt negotiations with each debtor nation separately and in Washington. This would, it was hoped, not only forestall the formation of a bloc of debtor nations seeking to negotiate a single agreement applicable to all but also permit the United States to exert more effective pressure on each individual country.[55]

As with the debtor nations, American policy was also influenced by domestic politics and the desire for commercial advantage. It was argued that cancelling the debts would place the burden of European war expenditures on the shoulders of American taxpayers. The Liberty Bonds that financed the European loans would still have to be repaid. If the money to do this did not come from repayments of the foreign loans, it would have to be raised by the United States government through taxation. The fact that millions of American citizens had bought Liberty Bonds raised the issue of cancellation to a rather high level of political sensitivity. The burden of increased taxation would also fall on businesses that, it was argued, would result in American companies being less competitive in international markets.

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[54] Moulton and Pavolsky, *War Debts,* 49-50.
[55] Costigliola, *Awkward Dominion,* 36.

CHAPTER 4

CONGRESS CREATES A COMMISSION

By the summer of 1920, the unresolved war debts situation had become an issue in the Presidential campaign. Republicans accused the Democrats of doing nothing to convert the "scraps of paper" into enforceable debt agreements and promised to ensure the Europeans honored their obligations.[56] After Warren G. Harding became President in March 1921, his millionaire Secretary of the Treasury, Andrew W. Mellon, began to work toward a resolution of the debt problem – a problem considered "pressing." Of the total amount owed the United States, nearly $9.5 billion was in the form of notes payable on demand. The remainder was made of up short-term notes maturing at various dates throughout the 1920s.[57] In addition, more than $1.1 billion in unpaid interest had accrued since interest payments had been suspended in 1919.[58] In light of conditions in Europe, it was clear that the debtor governments would not be able to make the required payments as they came due.

However, it was unclear what power, if any, the Treasury had to negotiate agreements with debtor governments to put their debts on sound bases for repayment. Upon taking office as Secretary of the Treasury, Mellon directed that a study be made to resolve the question. The study found that the various Liberty Loan acts contained a variety of conflicting requirements as to the terms of the bonds that the Treasury could accept from the debtor governments. The legislation authorizing the granting of relief credits and the sale of grain and surplus war supplies contained no provisions in this regard. As a result, "it seemed clear that additional legislation

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[56] Moulton & Pavolsky, *War Debts and World Prosperity,* 71.
[57] *Treasury Annual Report, 1921,* 33-35.
[58] *Treasury Annual Report, 1921,* 35.

was needed in order that this important problem might be dealt with on a satisfactory and business-like basis."[59]

On June 21, 1921, Mellon wrote to Harding describing the results of Treasury's analysis and the authority he needed to negotiate satisfactory debt agreements. He also attached draft legislation providing such authority. Given the situation presented by legislation currently in effect, he argued, the interests of the United States would be better protected "if the entire debt of each country could be dealt with as a whole and free from such restrictions." It was also important to keep in mind that most of the United States's debtors also owed large amounts to other countries. It would be necessary "to consider comprehensively the entire debt of such countries, its financial condition and resources so as to work out a refunding plan reasonably within the ability of such country to carry out." The Treasury also needed flexibility to deal with countries that might not be able currently to pay even interest on their debts let alone principal. "To insist on payment might be disastrous to the peoples of such countries." The Treasury must have "full authority" with regard to terms and conditions of debt settlements so as to "deal fairly with the debtor countries while at the same time protect the interests of this country."[60]

The attached draft legislation gave the Secretary of the Treasury, "with the approval of the President," virtually a free hand to craft the terms of debt refunding agreements. He could set interest rates, the period over which the debts would be repaid, and other terms. He was also specifically empowered to accept in payment not only securities of the nation with whom an agreement was being negotiated but also the securities of any other country in satisfaction of the debt.[61] The following day the President forwarded Mellon's letter and draft legislation to the Hill. Mellon must be given a broad grant of authority, Harding argued, so that the Treasury

[59] *Treasury Annual Report, 1921,*40.
[60] Mellon to Harding, June 21, 1921, *Treasury Annual Report, 1921,* 41.
[61] *Treasury Annual Report, 1921,* 41-42.

would have the flexibility to deal with the full complexities of current world conditions. If that were done, Harding claimed, "we reasonably may expect a satisfactory handling of the obligations due and the claims of our Government which are awaiting settlement."[62]

The Administration's bill did not receive a warm welcome on the Hill. In a series of hearings before the Senate Finance Committee during June and July, Mellon and his subordinates were closely questioned on various aspects of the bill. Most of the issues addressed presaged amendments that the Senate would impose on the legislation ultimately enacted. In general, members of the committee were not inclined to cede all control and decision making to the Executive Branch with regard to such a politically sensitive issue. On more specific points they were opposed to any cancellation of any portion of the principal or accrued interest owed by any of the debtor nations. They were also reluctant to permit the Treasury to accept from a debtor government bonds of another government. Also prevalent throughout the hearings was an acknowledgement of the politically sensitive fact that if the foreign debtors did not meet their obligations, the American people would bear that burden in the form of higher taxes.[63] Deliberations on the Administration's bill continued through much of the rest of the year. By November the House had passed a funding bill.[64] As the Senate had not yet acted on its refunding bill, Harding felt a need to mention in his State of the Union Address in December the increasing urgency of passing the legislation.[65]

The legislation that Congress finally passed and sent to the President was hardly the grant of broad discretionary power Mellon had sought. Sensitive to the significant domestic political

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[62] President to chairmen of House Ways and Means Committee and Senate Finance Committee, June 22, 1921, *Treasury Annual Report, 1921,* 42.
[63] 67th Congress, I Session, *Refunding of Obligations of Foreign Governments,* Hearings on S.2135 before the Committee of Finance.
[64] *Treasury Annual Report, 1921,* 42.
[65] Warren G. Harding, *State of the Union Address,* December 6, 1921, *http://stateoftheunion.org/category/warren-harding/p/2,* accessed February 10, 2010.

implications of the foreign debts issue, Congress included provisions in the World War Foreign Debt Commission Act designed to give it some measure of control over the terms of the debt settlements. The power to negotiate refunding agreements with foreign governments was invested not in the Secretary of the Treasury alone but in a five-member commission that would have a term of three years. While the Secretary of the Treasury was designated as the chairman of the Commission *ex officio,* the other four members were to be appointed by the President "by and with the advice of the Senate."

The Debt Commission Act also imposed strict limits on the terms the Commission could offer debtor governments when negotiating their debt refunding agreements. No agreement could extend the time for repayment beyond March 15, 1947, a term of 25 years. But, because the Act specified a date certain, the longer it would take a government to reach agreement with the United States the shorter the time that government would have to complete repayment of its debt. The Act also specified that the minimum rate of interest to which the Commission could agree was 4¼%. These terms were roughly equivalent to the terms of outstanding Liberty Bonds, thus demonstrating Congress's original intent that the loans to foreign governments should impose no burden on American taxpayers, Liberty Bonds had been issued carrying interest rates varying from 3½% to 4½% and terms from 25 to 30 years.[66] Thus, the 4¼% interest rate and the 25 year payment term could be seen as reasonable "averages" of the Liberty Bonds' terms.

Reflecting the concerns raised in Congressional hearings, the Act imposed some additional limitations on the Commission's discretion in negotiating refunding agreements. The Commission was specifically prohibited from cancelling any portion of the principal of any debtor nation's debt. The entire principal, plus the outstanding accrued interest, which would

[66] *Treasury Annual Report, 1919,* 75.

also be capitalized as principal, must be paid. The Commission also could agree to accept no securities other than those of the country with whom it was negotiating a refunding agreement. This provision was designed to eliminate the possibility of the United States being seen even indirectly as receiving reparations from Germany, which receipt would run contrary to repeated statements of an American opposition to participation in the reparations scheme. Finally, the Act provided that once a refunding agreement had been negotiated and signed it could not be renegotiated at a later date.[67]

Harding signed the bill into law on February 9, 1922. The Administration moved quickly to complete the membership of the Commission. On February 21, the President appointed to the Commission Secretary of State Charles Evans Hughes, Secretary of Commerce Herbert Hoover, Senator Reed Smoot of Utah, and Representative Theodore Burton of Ohio, all Republicans. The Senate confirmed the appointments of Hughes and Hoover on February 28 and those of Smoot and Burton on April 11.[68]

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[67] Public Law 67-139, *U.S. Statutes at Large* 42 (1922): 363.
[68] *Treasury Annual Report, 1922,* 25.

CHAPTER 5

EARLY NEGOTIATIONS

The World War Foreign Debt Commission held its first meeting on April 18, 1922. This was largely organizational in nature. The members of the Commission were announced and Assistant Secretary of the Treasury Eliot Wadsworth was appointed as secretary. Room 272 of the Treasury Building was designated as the Commission's office. The Commission also passed two resolutions. The first asked Congress to appropriate $20,000 to cover certain Commission expenses for the next year. With its second resolution, the Commission began its work, requesting the Secretary of State to inform each debtor government of the formation of the Commission and its purpose and that "the Commission desires to receive any proposals or representations which said Government may wish to make for the settlement or refunding of its obligations under the act."[69] Immediately following the meeting, Wadsworth dispatched a letter to the Secretary of State formally requesting this action by the State Department.[70]

The Commission would meet an additional seventy-three times through May 1, 1926. There would be no set format or schedule to the meetings. Some meetings would provide updates of the current situation. At these, issues and events relating to multiple debtor nations would be discussed. Other meetings would involve the substantive work of the Commission, negotiations with the delegations of debtor governments over the terms and conditions of their refunding agreements. Meetings would be held as needed. During negotiations with foreign delegations meetings would usually be concentrated into brief time periods. They would take place on a daily basis and, on a few occasions, twice a day. But there were also long periods of

[69] World War Foreign Debt Commission, *Minutes of the World War Foreign Debt Commission,* Washington D.C., United States Government Printing Office, 1927, 1-2. (hereinafter cited as *WWFDC Minutes).*
[70] United States Department of State, *Papers Relating to the Foreign Relations of the United States, 1922, Volume I,* Washington D.C., United States Government Printing Office, 1938, 397-398. (hereinafter cited as *FRUS*)

inactivity. The Commission would meet only four times during all of 1924 and eight months would elapse between its final 1924 meeting in December and its next meeting in August, 1925. However, the Commission would adhere to the principles originally promulgated by Secretary McAdoo in 1918. All of the meetings would be held in Washington and all of the negotiations with debtor governments would be bilateral. The Commission would never negotiate with a debtor bloc, only with individual debtors.

In attempting to secure funding agreements with the debtor governments the Commission would not be in the normally powerful position of a creditor seeking to extract payment from a recalcitrant debtor. These would be negotiations among sovereign nations. No court would be available before which to obtain a judgment against the debtor or to foreclose upon its assets. The Commission would have to rely to a considerable extent on moral suasion to convince a debtor government to honor its obligations before the court of world opinion. But the Commission did have one additional tool it could use to encourage or, if necessary, coerce a debtor to the negotiating table, access to American capital markets. All of the European debtors were in great need of additional capital to finance their recovery and reconstruction operations. Capital on the scale required was only available from the United States.

Although the Harding Administration was committed to the principle that international lending is best accomplished through private channels, it was nevertheless loathe to surrender complete control over these financial activities. Accordingly, in 1921 the Administration put in place a mechanism for exercising capital embargoes on foreign loans. A not uncommon practice at the time, capital embargoes were used by governments to control the granting of loans to foreign interests. Capital embargoes might restrict the parties to which loans could be granted, the amounts to be loaned, or the purposes for which the money could be used. The authority to impose a capital embargo could be granted formally by statute or could arise from other less formal extralegal sources.[71] The Harding Administration chose the latter alternative. On May 25, 1921, Harding convened a conference at the White House of representatives of the major banking houses. The bankers agreed to inform the government of any loan applications they received from foreign governments "so that the State Department might have an opportunity to notify the bankers in case the interests of the Government demanded that it raise an objection to such financing in the American market."[72] While the parties to this arrangement may not have intended it to target specifically the war debt situation, the Commission's ability to threaten a capital embargo would greatly strengthen its bargaining position in the negotiations to come.[73]

On April 21, 1922, the State Department began to notify certain of the debtor governments in accordance with Wadsworth's letter of the 18th.[74] Some debtor governments, Russia among them, were not contacted because the United States did not recognize them. Armenia, on the other hand, could not be contacted because, by mid-1922, the Armenian government had ceased to exist.[75]

The responses the United States began to receive to its invitations to submit "proposals or representations" were varied. Some came in the form of reports of American ambassadors and ministers of their contacts with the governments to which they were accredited. Others came directly from a government to the Department of State or even to the Commission itself. The

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[71] For a near-contemporary general discussion of capital embargoes see Williams, *Economic Foreign Policy of the United States,* 82-99. For additional detail on the development of United States capital embargo policies see Benjamin H. Williams, "Capital Embargoes," *Political Science Quarterly,* Vol. 43, No. 2 (Jun,. 1928), pp. 229-248.
[72] *Treasury Annual Report, 1925,* 54.
[73] In his *Memoirs,* Herbert Hoover, Harding's Secretary of Commerce, claims that the need for the arrangement with the banks arose out of concerns that the increasing volume of foreign borrowing in the United States was raising "disturbing questions" as to those loans' "security, their reproductive character, and the methods of promotion." Herbert Hoover, *The Memoirs of Herbert Hoover, The Cabinet and the Presidency, 1920-1933,* New York, MacMillian Company, 1952, 85.
[74] Secretary of State to Ambassador in France, *FRUS 1922 I,* 399.
[75] For message traffic relating to this initial phase of negotiations, see *FRUS 1922 I,* 399-417.

Commission was also contacted directly at its Washington offices by representatives of various governments. Some of the responses were administrative in nature being acknowledgements of the initial American communications or broad statements of intent with regard to plans for considering negotiations. Others, however, were harbingers of the challenges the Commission would encounter over the next four years in its efforts to craft refunding agreements.

The Commission would meet another seven times during 1922. At these meetings it considered the materials and reports that had been submitted, evaluated the evolving situations and positions of various debtor nations, and met with delegates from a number of these countries. By its third meeting (June 30, 1922) the Commission was able to review a statement that had been submitted by the Bulgarian ambassador describing his country's financial situation.[76] A June 3 dispatch from the U.S. minister in Prague reported that the Czech government would include in its budget for the coming year a provision to fund the payment of interest on outstanding foreign loans.[77] Responses of varying degrees had also been received from the three principal debtor governments, Britain, France, and Italy. The American ambassador in London had telegraphed that despite "repeated representations in accordance with instructions," the British Foreign Office claimed to be unable to offer any information regarding its intent to negotiate the debt issue until it had been discussed by the Cabinet. It was expected, the ambassador reported, that an answer "might be shortly forthcoming."[78] On June 16, the American ambassador in Paris had cabled that a M. Parmentier had been appointed by the French government to negotiate with the Commission and that he was expected to sail for the United States on July 1.[79] Finally, in a series of business-like contacts, the Italian government

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[76] *WWFDC Minutes,* 3.
[77] *WWFDC Minutes,* 4.
[78] *WWFDC Minutes,* 4.
[79] *WWFDC Minutes,* 4.

announced the designation of its negotiator and inquired as to when the Commission would be prepared to receive an Italian delegation and what information it would want to obtain regarding Italy's financial situation. In response, the Commission, among other things, stated that it "would like to have complete information on Italy's financial situation, trade development, etc."[80]

Initial contacts with some other governments were less promising. The Polish commercial advisor, a Mr. Hipolit Gliwic, called at the Treasury on June 20 and "unofficially submitted" a memorandum stating that the Polish government was ready to begin negotiations with the Commission on the debt issue but it hoped the United States "would take into consideration Poland's difficult financial situation and release her from payment of interest up to 1926 without insisting upon settlement of any interest outstanding."[81] On June 29, the representative of the Lithuanian government, V. Carneckis, had called at the Treasury and "stated that his government would not be able to repay any part of its indebtedness to the United States at the present time or for a considerable period." This position, he stated, was based on the fact that reparations from Germany which Lithuania had expected to receive would not likely be forthcoming.[82] This would not be the last time that a debtor government would attempt to make the payment of its debt to the United States contingent upon receipt of reparations from Germany.

By the time of its fourth meeting (July 22, 1922), the Commission had received from Czechoslovakia, Finland, and Hungary notification of the appointment of their representatives to the Commission.[83] Lithuania continued to submit information on its financial situation. By letter of June 30, the Lithuanian representative stated that by virtue of those "conditions in his country

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[80] *WWFDC Minutes,* 4-5.
[81] *WWFDC Minutes,* 5.
[82] *WWFDC Minutes,* 5.
[83] *WWFDC Minutes,* 7-8.

during the last two or three years, and stating that on account of such conditions the Lithuanian Government 'is obliged, regretfully, to advise that she is not in a position whereby a liquidation of her promise and obligation to the United States is possible.'" The letter also contained a request that certain notes currently held by the Treasury be cancelled "on the ground that these grew out of transactions which might be deemed to be in the nature of relief measures." The Commission rejected this request on the grounds that the obligations in question could be cancelled "only by act of Congress."[84]

This meeting also saw the Commission's first face-to-face discussion with the delegation of a major debtor, France. There was some discussion of previously submitted material relating to France's financial situation. Parmentier, the leader of the French delegation, would discuss this material, but he informed the Commission, "he did not have any suggestions to make to the commission on behalf of his Government concerning the funding or settlement of the French debt…" In addition, he stated, the French government "at the present time did not consider it possible to enter into any definite agreements in this regard."[85]

When the Commission next met, its fifth meeting, on August 10 there had occurred additional developments relating to the Polish and French situations. Reacting to news that the Polish government might be asked to make interest payments on Polish relief bonds held by the British government, the Commission requested the State Department to seek information on any loans taken out by Poland with any other governments for reconstruction or relief purposes. At the time, the United States held some of these loans.[86] The Commission here was acting in the role of the prudent creditor trying to ensure that its right to payment from a debtor would not become subordinated to that of some other creditor. The Commission would have this concern

[84] *WWFDC Minutes,* 8.
[85] *WWFDC Minutes,* 8-9.
[86] *WWFDC Minutes,* 13.

with other debtors as well. For example, the Romanian government was reported to be conducting negotiations with private British banking interests for a "consolidation loan" which would be of a form to prejudice the United States's position as a creditor of that country. The object of these negotiations was viewed by the Commission as contrary to earlier promises by the Romanian government that it would not take such action. The fact that Poland and Romania were engaged in such negotiations showed that for the debtor nations the question of their debts was more complex than the need simply to figure out how to pay the United States. They were in debt to other nations as well and sometimes for larger amounts than they owed the United States.

A meeting between the Polish representative, Gliwic, and the secretary of the Commission, Eliot Wadsworth, on August 3 gave further evidence of Poland's reluctance to settle its debt with the United States anytime soon. Poland, Gliwic claimed, "is unable to pay any interest at the present time, but would be willing to issue new notes on which interest will begin to be payable in 1926." He also stated that Poland would not be able to pay at maturity a bond maturing in 25 years, a direct statement that Poland viewed as unacceptable one of the key provisions of the Debt Commission Act. In fact, the Polish government saw the debt as being repaid over a far longer term. If the United States were to insist on a 25 year maturity for the bonds it accepted from Poland, the Polish government envisioned further refunding negotiations "perhaps in 10 or 15 years, so that the 25 year bonds could be extended to run for 75 or 100 years with a very modest sinking fund."[87]

During August, three additional countries were contacted with regard to their debts. A letter from the Secretary of State had informed the Commission that diplomatic recognition had been extended to the governments of Estonia, Latvia, and Lithuania. The Commission

[87] *WWFDC Minutes,* 14.

accordingly requested the State Department to inform those governments of the Commission's mandate and to invite them to send delegations to Washington to negotiate refunding agreements.[88] The State Department sent the requested invitations through the U.S. commissioner in Riga on August 8.[89]

Some matters relating to the British debt situation also arose during August. A telegram dated the 2nd was received from the U.S. Embassy in London reporting its receipt of a formal note from the British government. It contained a request for a statement of the exact amount of interest coming due on the following October 15 and November 15. This was the interest that had been accruing unpaid since the American agreement in 1919 to a deferral of interest payments for "two or three years." The payment of that interest was now coming due and Britain, alone among the United States's debtors, intended to pay. The British note also requested that that interest be calculated at 4¼% rather than the 5% as provided for in the outstanding notes. This reduction was requested in light of the fact that such was the minimum rate specified by Congress in the Foreign Debt Commission Act. The Commission provided the amount of interest due and, after considering the issue at its fifth meeting, acquiesced to the British request for a reduction in the interest rate.[90]

The Commission's fifth meeting included another inconclusive discussion with the French delegation. Parmentier and his associates appeared once again "to discuss further the question of the refunding of the indebtedness of the French Government to the United States." Parmentier "expressed the desire of his government to postpone for an indefinite period

[88] *WWFDC Minutes,* 14.
[89] Secretary of State to Commissioner at Riga, *FRUS 1922 I,* 411-412.
[90] *WWFDC Minutes,* 15-17.

consideration of the funding of this indebtedness until the financial situation of France became more clear."[91]

As discussed at the Commission's sixth meeting (August 29, 1922), Belgium had made its initial contact concerning the settling of its debt. Belgium was America's fourth highest debtor though, at $478 million, a distant fourth behind Italy which owed $1.9 billion. On August 26, the Belgian charge d' affairs, a M. Fanson, met with the secretary of the Commission "to enquire what was expected of the Belgian government." Wadsworth told him that the Commission "would be happy to meet with the Belgian ambassador at the earliest convenience." Since Belgium was currently paying 5% interest on its debts, Fanson mentioned news reports that Great Britain would be paying 4¼% on its debt and asked if that rate would be available to other countries. Wadsworth responded that no new rate had been set and that the Commission did not have the power to reduce rates on current debts unless that was done as part of a refunding agreement.[92] This was a rather curious response given that the Commission had granted just such a rate reduction to Britain despite the fact that no refunding negotiations were in progress with that government either.

During August, the United States became increasingly concerned over the proposed Romanian consolidation loan. On the 10th, the State Department advised the Treasury that it had given instructions to the U.S. legation in Bucharest to protest the terms of the loan. On September 2, the State Department reported that the Romanian government had rejected the American protest maintaining simply that United States interests would not be prejudiced by the impending loan agreement. The State Department requested clarification of the Romanian response and noted further that Romania was in significant arrears on a variety of its debts. A

[91] *WWFDC Minutes,* 17.
[92] *WWFDC Minutes,* 18.

$5,000,000 loan for the purchase of war materials had matured on June 30, 1922. Neither the principal nor interest on this loan had yet been paid. The rest of the Romanian debt, on which interest had not been paid since May 15, 1919, remained unpaid. There was also a concern that the Romanian government had yet to take the most preliminary of steps to begin debt settlement negotiations, the designation of a representative to conduct such negotiations. The Romanian Foreign Minister, however, indicated that such a designation "would be made in the near future."[93]

The minutes of the Commission's sixth meeting also reported the sputtering conclusion of the first attempt at negotiating a refunding agreement with France. On August 17, Parmentier and his associates met with Mellon and Wadsworth to inform them that they had been recalled to France for consultations with their government on matters relating to the debt situation.[94]

The Commission's seventh meeting (November 20, 1922) was brief and dealt solely with Romanian issues. The Romanian government had informed the United States on October 20 that it had appointed two delegates to conduct debt settlement negotiations.[95] Wadsworth held a preliminary meeting with the Romanian delegation in mid-November. The Romanians had intended to submit two official statements to the Commission, one addressing the terms and purposes of the consolidation loan and the second "stating exactly the position of their country toward the refunding of its existing obligations to the United States." At the time of the meeting with Wadsworth, however, these documents had not yet been completed.[96]

Two days later, November 22, the Commission met again. The single item on the agenda was a meeting with the Romanian delegation to discuss that country's debt. The Romanian

[93] *WWFDC Minutes,* 22-23.
[94] *WWFDC Minutes,* 19.
[95] Romanian Charge to Secretary of State, *FRUS 1922 I,* 415-416.
[96] *WWFDC Minutes,* 23.

delegation was led by Eftimie Antonesco, counselor of the Supreme Court at Bucharest and professor at the Commercial Academy in that city. As a preliminary matter, it was agreed in principle that the principal amount then owed the United States by Romania was $36,128,494.94 with two immaterial adjustments to be made when those amounts were determined.[97] The bulk of the meeting was devoted to a detailed presentation by Antonesco of Romania's situation and the challenges its government was facing in trying to stabilize its economy. Antonesco's presentation is worthy of a detailed discussion as it describes a situation then being faced by many of the smaller debtor governments in the midst of the chaotic political and economic conditions of immediate post-war Europe.[98]

The Romanians first discussed in general the financial, economic, and political situation of Romania, which discussion was supplemented by various exhibits. These included data on the Romanian financial situation, the Romanian budget for the coming fiscal year, and a description of economy measures being implemented by the government.

Next, the Romanians submitted a statement relating to the consolidation loan. This described the purpose of the loan as being to consolidate into one bond issue various issues of debt denominated in different currencies and held by private interests in a variety of countries. The statement took the position that though the holders of these new bonds would have priority with regard to foreign government securities to the extent that those foreign securities remained in their current form, the Romanian government had "deemed it equitable to meet the private debts without discrimination as to citizenship before taking up the debts to governments." However, no loans from the United States would be subordinate to those from any other government.

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[97] *WWFDC Minutes,* 24.
[98] The discussion of the Romanian presentation to the Commission relies primarily on *WWFDC Minutes,* 25-29 supplemented as indicated.

Antonesco continued to elaborate on the obligations Romania had incurred as a result of the war.[99] These included

Redemption of Austro-Hungarian currency in Transylvania

Redemption of Russian currency in territory acquired from Russia

Redemption of "Banca Generala" bank notes from the period of German occupation

Payment of value of Government property in territory acquired by Rumania

Payment for damages done to civilian property during period of German occupation

For a part of the "liberation debt"[100]

For sums owed to landlords for expropriated land divided among peasants.

While the total of all of these obligations was yet to be finally settled, "in the aggregate all of these items constituted a very heavy burden for a nation the size of Rumania." In addition, the country was facing great difficulties stabilizing its currency because a substantial part of its gold reserve had been transferred to Russia for safe-keeping early in the war and had not yet been returned. Finally, Antonesco expressed the opinion that the portion of reparations allocated to

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[99] Romania's involvement in World War I was convoluted. Initially a nominal ally of Austria-Hungary, she remained neutral for the first two years of the war. Coming into the war on the side of the Allies in 1916, she was defeated and occupied by the German Army. Following the end of the war, she acquired various territories, such as Transylvania, whose populations were majority ethnic Romanians.

[100] The "liberation debt" was a curious variation of reparations. The origin of liberation payments was a special agreement reached at the Paris Peace Conference. Briefly, those countries which had been created from the dismemberment of the Austro-Hungarian Empire or states, such as Romania, which had received territory previously Austro-Hungarian were required to pay to the Allied Powers amounts toward the expenses of liberating those territories. This scheme could lead to curious results. The reconstituted country of Poland found itself both receiving reparations payments while at the same time being required to make liberation payments. This was because a portion of its territory had previously been Russian. Since Russia had fought on the side of the Allies she was entitled to reparations. But since another portion of her territory had previously been Austro-Hungarian she was held liable for liberation payments.

Romania by the Spa Conference was unfair and that Romania hoped to obtain a larger share in the near future.

From another document submitted by Antonesco it was clear that his delegation had no power to enter into any binding agreement with regard to Romania's debt to the United States. The delegation had only the power to present Romania's position to the Commission, to determine the amounts actually due to the United States and to discuss any suggestions the Commission might offer for refunding the Romanian debt.

Antonesco then presented his government's general views regarding its American debt. His government, he said, "was entirely unwilling to sign any agreement which it did not feel it could carry out." He believed that "it must be obvious from the facts submitted to the commission that his Government could not at this time make any payments, either of principal or interest, and said that his Government could give no assurance that it would be in a position to make any such payments within the terms authorized by Congress..." Antonesco continued by saying of his Government “that it could undertake payment only on a long-term basis, at a low rate of interest, all payments of interest deferred until such time as the value of the leu [the Romanian unit of currency] should increase and become stabilized as a result of the present governmental policy at home." The United States, he said, "should consider the comparative situation of countries with weak and strong currencies."

In response to Antonesco's statement that the Romanian delegation would be happy to listen to any suggestion that the Commission might want to make regarding the overdue $5,000,000 note, the Commission replied by stating that by the terms of the Debt Commission Act it was authorized by Congress to offer to negotiate a refunding all of Romania's debt. In addition, the Commission "stated its strong desire to accomplish this refunding [in] its belief that such a step would be an advantage to the Government of Rumania, and its [the Commission's] unwillingness to believe that the Rumanian Government desired to leave matters in their present condition without [offering] any suggestion whatsoever."[101]

Antonesco's reply revealed something of the predicaments faced by the smaller debtor governments. They were indebted to two or more of the larger governments and were working to avoid being pressed into disadvantageous settlements. Antonesco said that "it was impossible for his Government to regard the matter as purely between itself and the Government of the United States." Romania owed larger amounts to both Great Britain and France than it did to the United States. He feared that if Romania agreed to refund its debt under the terms demanded by Congress "a precedent would be established." The other debtors would demand similar terms "with the result that Romania would be faced by bankruptcy due to interest payments alone." He noted that Great Britain had already consented to better terms on one of the loans it had extended to Romania. Interest had been set at 4% and payments of principal were deferred for 40 years.

In conclusion, Antonesco stated that the Romanian government did intend to enter into a refunding agreement. However, it wanted to wait until "the larger powers might be given opportunity to establish precedents as to refunding before Rumania should be called upon to commit herself. He felt that as soon as England and France had acted, Rumania would be glad to appoint delegates with full powers to conclude immediately the necessary agreements."

[101] The accepted spelling of Romania seems to have changed over time. In documents of the time covered by this study it is variously rendered as "Rumania" or "Roumania." Spellings used in cited documents will be retained. Otherwise the modern spelling of Romania will be used.

CHAPTER 6

AN AGREEMENT WITH BRITAIN

The Commission held its first meeting of 1923 on January 6. Though brief, the subject matter was of great importance. Chairman Andrew W. Mellon announced that the first meeting with a British delegation would be held two days hence. There followed a general discussion "regarding the upcoming negotiations with Great Britain."[102]

Much would be riding on these "upcoming negotiations." Great Britain was the United States's single largest debtor. A funding agreement with its government would settle almost half of all the amounts owed to the United States. A reasonable agreement would also establish the "precedent" Romania and other smaller countries were seeking, thus encouraging them to begin serious negotiations to settle their debts. Finally, the negotiations would test whether the settlement terms mandated in the Foreign Debt Commission Act were realistic.

The negotiations could not necessarily be expected to go smoothly. There remained the rancorous residue from the failed discussions and negotiations of 1918 – 1920. But with the advent of a new administration in Washington the British government had begun to nurture a renewed hope of obtaining a cancellation of the debts. In a meeting on May 10, 1921, the Cabinet concluded that the Harding Administration "seemed to adopt a more conciliatory attitude" toward the debts issue and "if given time, might well be guided toward the policy of universal cancellation."[103] The British began to perceive some evidence of this "more conciliatory attitude" during negotiations leading up to the convening of the Conference on the Limitation of Armament. The Harding Administration's signal achievement in international relations, the Conference was held in Washington November 12, 1921 - February 6, 1922. In

[102] *WWFDC Minutes,* 30.
[103] Cabinet Minutes, May 10, 1921, quoted in Dyer, "The British War Debts to the United States and the Anglo-Japanese Alliance," 580.

addition to securing agreement to a sharp reduction in the level of naval armaments, the United States had as a major objective the abrogation of the Anglo-Japanese Alliance.[104] It feared that if war broke out in the Western Pacific the United States Navy could find itself facing a combined British-Japanese fleet. Accordingly, the United States sought to replace the Anglo-Japanese Alliance with a more general agreement among the three major Pacific naval powers.[105]

Though the subject of the war debts never appeared on an official agenda at the Conference, it proved to be a pervasive subtext running through many of the Anglo-American deliberations. The British writer H. G. Wells, who was covering the Conference for a group of newspapers, commented that "[i]n the official proceedings of the Washington Conference the war debts are never mentioned. It is an improper subject." Nevertheless, "[i]n the talks and discussions and the journalistic writings...the war debts are perpetually debated."[106] There was a considerable level of "unofficial" contact between British and American Treasury and private banking figures both before and during the Conference that continued to encourage British hopes for cancellation. Lloyd George's private Secretary, Sir Edward Grigg, recalled "being told on very high authority…that if Britain abandoned the Anglo-Japanese Alliance, certain other matters in which she had need of American cooperation would be greatly advanced." "One major question," he said, was "the funding of the war debt."[107] The British also viewed the failure of the Congress thus far to pass the Administration's foreign debt bill as a further sign that the ultimate American position on cancellation would depend upon British cooperation at the Conference.

[104] See Dyer, "The British War Debts and the Anglo-Japanese Alliance."
[105] In the event, the treaty that resulted, the Four Power Treaty, included France.
[106] H. G. Wells, *Washington and the Riddle of Peace,* New York, The MacMillan Company, 1922, 274.
[107] Quoted in Dyer, "The British War Debts and the Anglo-Japanese Alliance," 582.

During the course of the Conference, the British conceded much. They agreed to abandon their alliance with Japan for the ambiguous consultative Four Power Treaty as well as to accept naval parity with the United States. In return the United States offered no concessions on the debt issue. Toward the end of the Conference, the Senate, on January 31, 1922, passed and sent to the White House the Foreign Debt Commission Act, a clear statement of the United States's intent to collect every dollar owed to it. On February 9, just three days after the close of the Conference, President Harding signed the Act into law. This failure to obtain any concessions from the United States sharply divided the British government and led to further temporizing in its response to American "invitations" to begin negotiations on a debt settlement.[108]

As the British internal debate continued into the summer of 1922, two policies with regard to the American debts seemed to suggest themselves. Britain could pay the United States and deal with her debtors in ways best calculated to promote the economic recovery of Europe. Alternatively, Britain could refuse to pay the United States unless such payment was part of a general settlement of the entire inter-Allied debt situation.[109] Ultimately, Britain attempted to pursue elements of both policies. On August 1, 1922, the British government published the so-called "Balfour Note." Purportedly an official letter from Arthur Lord Balfour, Acting Secretary of State for Foreign Affairs, to the French ambassador to Britain, it was widely understood to be a message directed at the United States.

The substance of the Balfour Note was that Britain, despite its strong desire not to do so, was compelled to insist on payment from its debtors because the United States was insistent that

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[108] Self, *Britain, America and the War Debt Controversy,* 34-38.
[109] Self, *Britain, America and the War debt Controversy,* 38.

it be paid by Britain.[110] In light of the current unsettled political and economic situation facing its debtors, Balfour said, "His Majesty's Government have silently abstained from making any demands upon their Allies either for the payment of interest or the repayment of capital." Despite the sacrifices it would entail, Britain was prepared to write off all of the debts owed her as well as renounce any reparations from Germany "if such a policy formed part of a satisfactory international settlement." However, demands by the United States that Britain repay its loans in full "make such a policy difficult of accomplishment." This change of policy, though undesirable, was also unavoidable. The policy Britain had followed to date of not demanding payment from its debtors “is only tolerable so long as it is generally accepted.” “It cannot be right,” he asserted, “that one partner in a common enterprise should recover all that she has lent, and that another, while recovering nothing, should be required to pay all that she has borrowed.” Consequently, Britain must ask for payment of its debts. But Britain would demand from its debtors only enough to pay its debts to the United States. “And, while we do not ask for more,” Balfour concluded, “all will admit that we can hardly be content with less. For it should not be forgotten, though sometimes it is, that our liabilities were incurred for others, not for ourselves.” In short, Britain’s magnanimous desire to remit all debts due it was being thwarted by a shortsightedly rapacious American demand for repayment.

Not surprisingly, the Balfour Note elicited a vigorous response from American authorities. On August 24, Mellon issued a sharp response to the press. He took particular exception to the Note’s implication "that the United States Government virtually insisted upon a guarantee by the British Government of amounts advanced to the other Allies." This, he said, was "evidently based upon a misconception." The actual facts were quite to the contrary. In its

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[110] The "authentic text" of the Balfour Note was reported to the State Department by the ambassador to Great Britain in a cable of August 4, 1922, *FRUS 1922 I,* 406-409. Quotes from the Note following are from this source.

loans to foreign governments, he said, it was the United States's position that "it would make advances to each Government to cover purchases made by that Government and would not require any Government to give obligations for advances made to cover the purchases of any other Government."[111] The Legislative branch of the United States government also chimed in. Congress amended the Soldiers' Bonus Bill then before it to make the amounts to be paid under its provisions "a first charge upon the interest received by the United States of America on the obligations of foreign Governments."[112] Typical newspaper comments included the likes of, "Lord Balfour seems to think he can call us sheep thieves in language so elegant that we shall not understand it."[113]

Having vented its spleen with the Balfour Note, the British government nevertheless shied away from conditioning payment to the United States on a general settlement of the entire inter-Allied debt issue. On September 28, it informed the State Department that a delegation had been appointed "for the purpose of negotiations with the Debt Funding Commission" and would be departing for the United States on October 18.[114] This delegation, however, was never to leave England. Continuing turmoil led to the fall of the Lloyd George government on October 19. Key members of the delegation, also members of that government, resigned.[115]

The new British government of Prime Minister Andrew Bonar Law held views of the debt issue similar to those of its predecessor. Although the terms imposed by the Americans were onerous and unjust, it was necessary to settle the issue with the United States so as to be in a position to deal with the rehabilitation of Europe.[116] Accordingly, on December 19 London

[111] *FRUS 1922 I,* 413-414.
[112] Self, *Britain, America and the War Debt Controversy,* 42.
[113] Quoted in Self, *Britain, America and the War Debt Controversy,* 41.
[114] *FRUS 1922 I,* 415.
[115] Self, *Britain, America and the War Debt Controversy,* 43.
[116] Self, *Britain, America and the War Debt Controversy,*43.

informed the State Department that a new debt negotiation delegation had been appointed and would sail for the United States on December 27.[117]

The prospects of obtaining a debt settlement with the Americans on acceptable terms did not appear to be particularly favorable to the British. Bonar Law had given the delegation "verbal authority" to settle the debt as they saw fit so long as the annual payments did not exceed £25 million.[118] Yet a strict application of the provisions of the Foreign Debt Commission Act, payment in 25 years at 4¼% interest, would require, the British Treasury calculated, annual payments of between £40 million and £60 million at a time when Britain could probably pay no more than £35 million.[119] Though the general tenor of public and official opinion in the United States seemed to point to a strict application of the Debt Commission Act's terms, there were some hopeful signs for the British. Mellon and Secretary of State Charles Evans Hughes were understood to be interested in crafting a workable settlement. There were also some indications that the Administration was coming to the view that the strictures imposed by Congress on the Commission might make it impossible to reach refunding agreements with any of the debtor governments. President Harding made this point in a letter to Congress on December 29 in which he asked it to free the Commission to negotiate as it saw fit.[120] That same day, Hughes, a member of the Commission, made a similar point in a speech to the American Historical Association in New Haven.[121] This, then, was the state of things when the British delegation arrived in Washington.

[117] *FRUS 1922 I,* 417.
[118] Self, *Britain, America and the War Debt Controversy,* 44. At current exchange rates, £1 = about $4.86, Moulton & Pavolsky, *War Debts and World Prosperity,* 432.
[119] Self, *Britain, America and the War Debt Controversy,* 45.
[120] Self, *Britain, America and the War Debt Controversy,* 44.
[121] For text of speech see Harold G. Moulton and Leo Pavolsky, *World War Debt Settlements,* New York, MacMillan Company, 1926, 168-174.

The British delegation, which first met with the Commission on January 8, 1923, was a distinguished one. Led by Stanley Baldwin, Chancellor of the Exchequer, it included Montagu Norman, Governor of the Bank of England, Loring Christie, legal advisor to the Department of External Affairs of Ottawa, P. J. Grigg, Baldwin's private secretary, and E. Rowe-Dutton of the British Treasury.[122] Following a fulsome welcome to the delegation from the Commission, Baldwin made a lengthy statement of the British position. He opened with the obligatory expressions of gratitude to the United States for its support to the Allies and its contribution to their victory. He then reaffirmed Britain's intention to pay its debt. But, he then asked, how could repayment be effected? There was not enough monetary gold in the world to do so. It was also virtually impossible to make payment in the form of goods. To do so, Britain would have to flood the United States with materials and manufactured goods in volumes beyond the capacity of the American economy to absorb, assuming that such could even be done given the prevailing high tariffs. Furthermore, the additional taxation that would have to be imposed on the British public to fund the repayment would further impoverish an already heavily taxed people. In the end, he said, "[o]ur wish is to approach the discussion as businessmen seeking a business solution of what is fundamentally a business problem."[123]

According to the Commission's minutes of the meeting, Baldwin's statement was followed by "a general discussion." In the course of this discussion "it developed that the British representatives were unable to consider terms within the authority of the commission under the act of February 9, 1922. The commission accordingly concluded that it should proceed by informal discussion in order, if possible, to arrive at an arrangement upon terms which it might

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[122] *WWFDC Minutes,* 30-31.
[123] *Combined Reports,* 90-93.

feel justified in recommending to Congress for its consideration."[124] Here is revealed the basic approach the Commission would follow not only in its negotiations with the British but in all of its later negotiations. It likely originated with Mellon, the banker. He knew that the terms of debt payment agreements were constrained by practical realities. Parties would only agree to terms that were acceptable and reasonable. The problem as Mellon saw it was that Congress had mandated unreasonable terms in the Debt Commission Act, terms unlikely to be seen as acceptable or reasonable by any of the debtor governments.[125] The Commission, therefore, would approach its negotiations with debtor governments with the objective of reaching agreements that those governments could reasonably accept and, most importantly, actually repay. If the terms of those agreements fell outside the parameters set by the Debt Commission Act they would be submitted to Congress for approval.

It was perhaps fortuitous that the first test of a businesslike approach to debt negotiations occurred with the British delegation. Mellon, the banker, found like-minded counterparts in Baldwin, a businessman, and Norman, another banker, a situation that likely facilitated discussions. Over the following ten days, the Commission and the British delegation would meet eight times. By the end of their sixth meeting, on January 14, 1923, the Commission "arrived at a conclusion as to the terms which it would feel justified in recommending to the President for presentation to Congress and orally outlined such terms to the British representatives."[126]

Exactly how the Commission and the British delegation crafted their agreement over the course of these meetings is not particularly clear. Toward the end of their inaugural meeting the parties decided to proceed in secret. The Commission's minutes for this meeting record an agreement between the parties that ensuing discussions "be considered as strictly informal and

[124] *WWFDC Minutes,* 31.
[125] David Cannadine, *Mellon, An American Life,* New York, Vintage Books, 2008, 289-290.
[126] *WWFDC Minutes,* 34.

that nothing that might be said upon either side should be considered as a commitment." Accordingly, "no stenographer should be present or records kept of the proceedings."[127] True to this decision, the remaining meetings with the British delegation are described in the Commission's minutes with nothing more revealing than the likes of "[t]he general discussion of the previous meeting was continued."[128] The minutes for the prior day's meeting were equally cryptic. "The general discussion of possible methods of accomplishing a refunding was continued."[129]

Other sources shed some light on what happened during these meetings. The British were heartened by the Commission's initial position. Norman recalled that the "Commission acted like gentlemen, never mentioning our 'scraps of paper' at 5% or their limits under the 1922 Refunding Act." Rather, the Commission took the position that "the debt question *had* to be settled and that they would…recommend terms most lenient to Britain which…they thought Congress would accept."[130]

The basic problem in arriving at an acceptable agreement was to set the total annual payments, principal and interest combined, at a level the British would feel capable of bearing. This could be accomplished in three ways, all of which would require disregarding the provisions of the Debt Commission Act. A portion of the debt could be cancelled, the interest rate could be reduced to less than 4¼%, and the term for payment could be extended beyond 25 years. Cancellation of any part of the debt was simply out of the question. The Commission chose instead to both reduce the rate of interest and to extend the term of repayment.

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[127] *WWFDC Minutes,* 32.
[128] *WWFDC Minutes,* 34.
[129] *WWFDC Minutes,* 33.
[130] Norman to Basil Blackett, British Treasury, quoted in Dayer, "The British War Debts and the Anglo-Japanese Alliance," 592.

The Commission presented its initial proposal to the British on January 13. The interest rate was set at 3½% and the term of payment at 61 years. This worked out to an annual payment of $187 million, or about £38 million. Baldwin was greatly disappointed in this figure as he had been led by the British ambassador to the United States, Sir Auckland Geddes, to believe that the Americans would propose a payment of about $140 million (£30 million).[131] As the amount was more than the £25 million he had been authorized to accept and the £30 million which he was permitted to accept under certain conditions, Baldwin had to consult with London. He argued that the American proposal be accepted despite its high cost as it was far better than the Debt Commission Act permitted and was probably "the most we can hope for." Also, he said, the entire British delegation supported acceptance.[132] London failed to see matters Baldwin's way. Bonar Law considered the terms offered by the Americans "most ungenerous." They seemed "harsher than in ordinary business would be employed by a bank to a good customer." After consulting with other members of his government, who were in agreement, he told Baldwin that it was necessary to press for better terms. If such better terms are not attainable, "you have no alternative but to ask for further time and to return."[133]

Upon receipt of these instructions, Baldwin sought a meeting with Mellon the next day, January 14. He asked that the interest rate be reduced to 3%. After consulting with President Harding, Mellon replied that the United States would agree to extend the term of the loan one year to 62. It would also reduce the interest rate for the first ten years to 3%; for the remaining 52 it would revert to 3 ½%. The United States would also agree to reduce the rate on the outstanding accrued interest from 5% to 4¼%. These changes would result in annual payments of $161 million (£33 million) for the first ten years and $184 million (£38 million) for the

[131] Self, *Britain, America and the War Debt Controversy,* 46.
[132] Self, *Britain, America and the War Debt Controversy,* 47.
[133] Self, *Britain, America and the War Debt Controversy,* 47-48.

remaining 52.[134] These terms were considered unacceptable in London and Baldwin was ordered home.

On January 16, the British delegation met once again with the Commission. Now that the "informal discussions" had concluded, the Commission's minutes began once again to describe events in somewhat greater detail. Baldwin reported to the Commission that he had consulted with his government and that, as a result, "his task was not an easy one." His government "had refused to empower him and his colleagues to accept the terms suggested informally by the commission and had instructed them to return home at once for consultation." Planning to sail on the 20th, Baldwin "could only ask that the commission consider his departure as a postponement of negotiations and not as a breach."[135] Two days later, Baldwin and his delegation met with the Commission for the last time. He reported that he had received no further instructions from London. The Commission emphasized that the terms that had been "informally suggested" could not be regarded as an offer by the United States Government. But if the British government should accept such terms the Commission "could do no more than recommend to the President that the terms be presented to Congress for its consideration."[136]

The debate that ensued within the British government upon Baldwin's return home on January 27 was brief but intense. The Prime Minister remained incensed at the terms proposed by the Americans and threatened to resign if they were accepted. Baldwin and Norman argued for acceptance and presented a financial analysis they claimed demonstrated that Britain would be able to make the payments demanded. In addition, they argued, settling this issue would

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[134] Self, *Britain, America and the War Debt Controversy,* 48. The 4½% rate cited here with regard to the outstanding accrued interest may be an error. The eventual debt funding agreement concluded between the two countries charged 4¼%. 4¼% was also the rate which the Commission agreed to apply to the accrued interest which the British paid in October and November of 1922.
[135] *WWFDC Minutes,* 35.
[136] *WWFDC Minutes,* 36.

allow Britain to move on to the critical work of European rehabilitation. On February 1, Bonar Law capitulated. That same day, Geddes was thus able to appear before the Commission and report that he had been instructed to notify the Commission that the British government "accepted in principle the terms informally suggested by the World War Foreign Debt Commission with reference to the refunding of the British obligations held by the United States."[137] Geddes met again with the Commission the following day at which time the terms of the debt agreement "were formulated and embodied in a written document. It was agreed that this statement should be released to the press forthwith."[138]

The Commission met once again on February 3. It prepared a report to the President "unanimously recommending for submission to Congress a settlement with the British Government on the terms as set forth in the statement prepared with the British Ambassador at the nineteenth meeting [February 2] of the commission."[139] In this report, the Commission asserted its belief that a settlement "on this basis is fair and just to both Governments." The Commission also used this report to set out its reasons for ignoring some of the strictures of the Debt Commission Act. The interest rates provided for in the agreement more closely approximated "normal rates paid by strong governments over long terms of years" than did the 4¼% mandated by Congress. Payment of principal and interest over 62 rather than 25 years "will make for stability in exchange and promotion of commerce between the two nations." But the Commission was also careful to point out that the agreement still required full payment of the outstanding principal. "The payment of principal has been established on the basis of positive

[137] *WWFDC Minutes*, 37.
[138] *WWFDC Minutes,* 37. For text of statement to press, see *Combined Reports,* 117.
[139] *WWFDC Minutes,* 38.

installments of increasing volume," the Committee emphasized, "firmly establishing the principle of repayment of the entire capital sum."[140]

This agreement reached "in principle" would require additional months of detailed negotiations before it emerged in its final form. Nevertheless, it was now sufficiently clear and settled in its major provisions that it could be submitted to Congress for approval. This President Harding did in a speech to a joint session of Congress on February 7. In asking Congress to approve legislation authorizing the refunding of the British debt on the terms agreed to by the Commission, he portrayed it as a vindication of the American view of the entire war debts issue. "The call of the world to-day," he said, "is for the integrity of agreements, the sanctity of covenants, the validity of contracts." The agreement with Britain represented "the first clearing of the war-clouded skies in a debt-burdened world, and the sincere commitment of one great nation to validate its financial pledges and discharge its obligations in the highest sense of financial honor."[141] The requested legislation passed through the Congress relatively quickly. It passed the Senate on February 16 and Harding signed it into law on February 28.[142]

For reasons not entirely clear but that likely were an attempt by the Harding Administration to develop some bipartisan support for the conduct of its war debt policies, this legislation also expanded the size of the Commission from five to eight members.[143] As before, the Secretary of the Treasury remained as chairman of the Commission with the remaining seven members appointed by the President. However, '[n]ot more than four members so appointed

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[140] *Treasury Annual Report, 1923,* 257-258.
[141] *Treasury Annual Report, 1923,* 258.
[142] Public Law 67-455, *U. S. Statutes at Large* 42 (1923): 1325.
[143] Russell Leffingwell had earlier recommended as much when he suggested the Administration, much as it had done in constituting the American delegation to the Conference on the Limitation of Armament, should seek to enhance bipartisan support for the Commission's work by adding to it a minority contingent of Democrats. Moultan & Pavolsky, *War Debts and World Prosperity,* 79-80n.

shall be from the same party."[144] The new members of the Commission were Representative Charles R. Crisp of Georgia, former Representative Richard Olney of Massachusetts and Edward N. Hurley, formerly the head of the United States Shipping Board, all of whom were Democrats.

[144] Section 2, Public Law 67-455, *U. S. Statutes at Large* 42 (1923): 1326.

CHAPTER 7

ANATOMY OF A DEBT SETTLEMENT

The final step in the refunding of the British debt was the execution of a formalized agreement between that government and the United States. On June 18, 1923, the British government transmitted what purported to be a proposed "Agreement for the Funding of the Debt of Great Britain to the United States." In fact, the terms of this "proposal" were those actually agreed to by the Commission and the Baldwin delegation and as a result of the negotiations that had taken place since the original agreement "in principle" had been reached in February. In terms and language, the Agreement took very much the form of any commercial bond contract, reflecting the American view of the war debts as arising out of commercial rather than political transactions. As this Agreement was not only the first negotiated by the Commission but that it was also with the United States's single largest debtor, it had an importance beyond merely settling the debt issue with Great Britain. It also served notice to all of the other debtor countries as to how the Commission might be likely to approach the settlement of their debts. In fact, the agreements subsequently reached with all of the other debtor countries were, with only minor differences, virtually identical in form if not necessarily in terms to that of the British agreement.[145] The British agreement is, therefore, worthy of some analysis.

The Agreement comprised a preamble and eleven articles. In the preamble Great Britain acknowledged that it was indebted to the United States "as of 15th December, 1922, upon demand obligations in the amount of $4,074,818,358.44" plus "interest accrued from 15th April and 15th May, 1919." There then followed a citation of the legal authority, the War Loan Act, 1919, under which the British government was empowered to do what it proposed to do, issue

[145] For the full text of the British debt funding agreement see, *Treasury Annual Report, 1923,* 262-269.

the securities that would be exchanged for the demand obligations currently held by the United States. The preamble next described the undesirability of the current situation in which the United States, under the terms of the demand obligations securing the British debt, could demand full payment of that debt at any time. The preamble concluded with Great Britain's proposal that it exchange new securities meeting the terms and conditions set forth in the body of the Agreement for the demand obligations then in the hands of the United States.

Article 1, "Amount of indebtedness," stated the amount of the indebtedness to be funded under the Agreement along with a calculation demonstrating how that amount was determined. The amount for which Great Britain was indebted to the United States was stated to be $4,600,000,000. It was shown to be computed as follows:

Principal amount of demand obligations to be funded		$4,074,818,358.44
Interest accrued thereon from 15th April and 15th May, 1919, respectively, to 15th December, 1922, at the rate of 4¼ per Cent per annum	$629,836,106.99	
Less-Payments made by Great Britain on 16th October and 15th November, 1922 on account of interest, with interest thereon at 4¼ per cent per annum from said dates, respectively, to 15th December, 1922	100,526,379.69	
		529,309,727.30
Total principal and interest, accrued and unpaid, as of 15th December, 1922		4,604,128,085.74
Paid in cash by Great Britain, 15th March, 1923		4,128,085.74
Total indebtedness to be funded into bonds of Great Britain		$4,600,000,000.00

All of the debt funding agreements negotiated by the Commission featured such a calculation as their Article 1. This calculation accomplished two things. It converted any accrued interest to principal to be funded by the new securities. In this case, the interest accrued on the original principal was adjusted to reflect payments that had been made against that amount prior to the effective date of the agreement. Because the resulting principal amount was not a round number an additional adjustment was made to this amount in the form of a cash payment made on the effective date of the agreement. This was done so as to present the par value of the bonds as a round number.

Article 2, "Issue of long-time obligations," briefly described the terms of the bonds that Great Britain would issue to refund its debt. The principal amount of these bonds would be $4,600,000,000. The bonds would be dated December 15, 1922, and they would mature on December 15, 1984. Interest would be payable semi-annually on June 15th and December 15th. From 1922 through 1932 the interest rate would be 3%. It would rise to 3½ % in 1933 and would remain at that rate until principal was repaid in full.

Article 3, "Method of payment," specified two means by which payment of the principal and interest on the bonds issued to the United States would be made. Payment was to be made "in United States gold coin of the present standard of weight and fineness, or its equivalent in gold bullion." Alternatively, Great Britain could at its option make payments of principal and interest "in any bonds of the United States issued or to be issued after 6th April, 1917, to be taken at par value and accrued interest to the date of payment." The bonds referred to here were generally Liberty and Victory Bonds. Under the proper circumstances, payment in bonds would be beneficial to Great Britain. If bonds of the specified type could be purchased in the American financial markets at a discount, Great Britain would save money to the extent of the difference between the discounted purchase price of the bonds and the par, or face, value at which they would be accepted as payment of its debt. The United States, on the other hand, would suffer no loss. By accepting payment in this manner, the United States would be retiring the bonds without having to pay out their par value upon maturity.

With Liberty Bonds trading at a discount during much of the 1920s, the Article 2 payment option proved to be quite attractive to the debtor nations. From 1923 through June 30, 1931, the United States Treasury received payments of principal and interest under the various debt agreements totaling $1,671,890,788. Of this, $1,116,547,091, or 66.8%, was made in the form of United States bonds. The percentage of British payments made with bonds was even higher. Of its total payments of $1,351,720,000, fully 79.5%, or $1,075,172,836, was made with bonds.[146]

Article 3 also provided for a deferral of a portion of interest payments in the early years of the agreement. For the years 1922 through 1927, Great Britain had the option of paying half of the interest accruing during that period by issuing new bonds rather than paying in cash or U.S. bonds. These new bonds would have a maturity date, interest rates, and other characteristics identical to those of the original bonds issued under the terms of the agreement.

Article 4, "Exemption from taxation," provided that all bonds under the terms of the agreement "shall be exempt from all British taxation, present or future, so long as they are in the beneficial ownership of the United States or of a person, firm, association or corporation neither domiciled nor ordinarily resident in the United Kingdom." This provision assured that the United States would receive the entire amount of principal and interest due under the bond agreement. In addition, the tax exempt feature would enhance the marketability of the bonds in the event that the United States decided to commercialize them.

Article 5, "Form of bonds," provided that the bonds would be issued in denominations of $4,600,000 each and be substantially in the form set forth in an "Exhibit A" attached to the agreement. Under this provision, Great Britain would issue one thousand bonds each having a par value of $4,600,000.

Article 6, "Payment of principal," contained a schedule of the amount of principal that would be due each year from the issuance of the bonds in 1923 to their maturity in 1984. This

[146] *Treasury Annual Report, 1931,* 80.

amount, to be paid in annual installments on December 15th, increased in gradual increments. For the years 1923 and 1924, the principal amount due each year was $23,000,000. By the final two years of the bonds' term, 1983 and 1984, the annual amount due would rise to $175,000,000.

The provisions of Articles 5 and 6 had taken some time to resolve. In letters dated May 16, 1923, the British government "formally withdrew" an earlier offer that the bonds issued under the Agreement would be issued in amounts corresponding to the amount of principal to be paid in each year. Instead, the government wanted to issue the bonds "so far as is possible" in denominations of $4,600,000.[147] It also objected to the Commission's position that the bonds should mature serially; all of them should have an ultimate maturity date of 1984.[148] What lay at the bottom of this seemingly arcane dispute over the minutiae of bond terms was a British fear of "commercialization," that is, that the United States Treasury, once it received the British bonds, would sell them into the private financial markets. If that were to happen, any hopes the British may have entertained of being able at some later date to convince the United States to reduce or even cancel the remaining debt would have been dashed. Once held by private investors the bonds would have to be paid in full. British fears in this regard were not without foundation. American officials had been making statements consistent with such a policy as far back as the Paris Peace Conference. Possible sale of the British bonds had been discussed explicitly during the Senate hearings on the Debt Commission bill.[149]

The British objective, then, was to make its bonds as unattractive to private investors as possible. A serial bond would be more attractive to investors simply because its pattern of interest and principal payment fit the investment objectives of most private investors. If the British issued serial bonds, their debt would essentially be divided into 62 pieces, one piece

[147] *WWFDC Minutes,* 46.
[148] *WWFDC Minutes,* 46.
[149] *Refunding of Obligations of Foreign Governments,* 24-25, 182.

becoming due each year of the term of the Agreement. Investors who wanted safely to “park” their money for a year or two would buy a bond that matured at the end of such a period. They would receive interest over the bond’s term and the principal when it matured. Other investors, such as insurance companies, who were interested in investing a sum of money for a longer term with the objective of receiving a steady, long-term, and predictable income stream might purchase a bond which matured in, say, 1981. To make these investment decisions more difficult, the British wanted all of their bonds to mature in 1984, the year in which the debt would be finally paid off. Although the bonds would have technically “matured” in 1984 they would have been paying both interest and a portion of the principal each year. As such, they were, to the private investor, “neither fish nor fowl,” not aligning well with any normal investment strategy.

This issue of the terms of the British bonds was addressed during the Commission’s meeting of May 21, 1923. The Commission “was unanimously of the opinion that the issue of serial bonds would be most consistent with the agreement reached”[150] Nevertheless, it “would be most unfortunate to permit a mere difference as to form to interfere with the conclusions of the negotiations" and that other provisions of the agreement "tended to restrict from a practical standpoint the marketability of the bonds to be issued by Great Britain."[151] Accordingly, the Commission resolved to accept the British position on the bond terms.[152] This was the only debt funding agreement in which the Commission agreed to accept bonds that were not serial bonds. In any event, the United States never sold any of the debt settlement bonds into the private sector.

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150 *WWFDC Minutes,* 46.
151 *WWFDC Minutes,* 47.
152 *WWFDC Minutes,* 47.

Article 6 also granted Great Britain the ability to postpone principal payments for a period of time past their ordinary due date. At its option, Great Britain could postpone a payment of principal for up to two years. If it elected to do so, it could also postpone the succeeding year's principal payment for no more than one year so long as the previous year's postponed amount remained unpaid. Once the previous year's postponed amount had been paid, the one-year postponement could be extended for an additional year. The principal due for the second succeeding year could not be postponed at all unless and until the principal due two years previously (the amount that had been postponed for two years) was paid. In practice, this would have worked as follows:

Great Britain elects to postpone the principal payment due 12/15/1926 to 12/15/1928. It also elects to postpone the following year's principal payment. Since the 1926 payment has not yet been made it can postpone the 12/15/1927 payment only to 12/15/1928. At 12/15/1928, therefore, the principal payment due on that date must be made unless the 12/15/1926 amount has been paid. If the 12/15/1926 amount is paid, however, two additional postponements become possible. Since the 1926 payment has been made, the 1927 payment, previously limited to a one-year postponement, can now be postponed an additional year to 12/15/1929. And because the 1926 payment has been made, the 1928 payment may now be postponed for a year (the previous year's payment has been postponed for two years) to 12/15/1929. Although this process of postponing principal payments could have been continued over the entire life of the agreement it would not have conferred a major benefit. At most, it offered a two-year period during which no payments would need be made. After that, annual principal payments would have to be made as before. In effect, the term of the agreement was extended for two years which would mean, in the case of the agreement with Great Britain, that the final payment of principal would be due in 1986 instead of in 1984.

Article 7, "Payments before maturity," permitted payments of principal prior to the date they were due under the Agreement. Such early payments would have to be made in increments of $1,000,000.

Article 8, "Computation of interest," provided that the amount of interest due on any interest due date would be calculated based on the principal outstanding on the previous interest date. This amount would, however, be adjusted appropriately in the event that payments of principal had occurred since the previous interest date.

Article 9, "Exchange for marketable obligations," provided that the United States Treasury could "at any time and from time to time" exchange any of the bonds originally issued under the Agreement for "definitive engraved bonds in form suitable for sale to the public." This, of course, is what the British feared when they resisted issuing serial bonds. That this provision would be in the Agreement was also likely the reason the Commission was willing to concede the point regarding the terms of the original bonds.

Article 10, "Cancellation and surrender of demand obligations," described the administrative process by which the "refunding" would take place. Upon receipt of the $4,600,000,000 in bonds the United States would "cancel and surrender to Great Britain the $4,074,818,358.44 in demand obligations it currently held.

Article 11, "Notices," was a typical provision of any contract. It provided the manner in which the parties could provide effective notice to each other. In the case of the United States, it was to deliver any notices to Great Britain either at the British Embassy in Washington or at the office of the Permanent Secretary of the British Treasury in London. The British government was to deliver its notices to the United States at either the American Embassy in London or to the Secretary of the Treasury at the Treasury in Washington.

As noted above, this refunding agreement was very much like any such commercial agreement between private parties. There were, however, a few interesting differences. The agreement contained no *force majeure* clause. Contracts typically include a provision that excuses the parties from performance if that performance is made impossible by the likes of war, natural disaster, or acts of God. Apparently the British were expected to continue paying even in the face of such calamities. The agreement also lacked a "choice of law" provision. Such a provision is invariably a part of contracts entered into by private parties. It identifies under which jurisdiction's laws any dispute between the parties will be adjudicated. Given that there was no court to which countries had recourse at that time, including a choice of law provision would have been pointless.

CHAPTER 8

EIGHT COUNTRIES SETTLE

The publication of the preliminary details of the British debt settlement in early February 1923 and, more importantly, the Congressional approval of them later that month demonstrated to other debtor governments that they might be able to secure better terms from the United States than were provided for under the provisions of the Debt Commission Act. Finland was the first to test the waters. At its March 9 meeting, Mellon informed the Commission that Mr. Axel Astrom, minister of Finland, "had expressed his desire to take up with the commission, on behalf of his government, the subject of refunding the obligations of his Government held by the United States." Astrom was told that the Commission "would be glad to consider such suggestions as he might have to make" at its next meeting, which meeting occurred the following day. [153]

Astrom appeared before the Commission the next day, March 10. He stated that he had been instructed to inform the Commission that the Finnish government desired to refund its debt "as soon as possible, providing the refunding could be accomplished upon terms with which it would be possible for his Government to comply." He then presented "in full the financial and economic situation in Finland, emphasizing the burden imposed upon his Government in making payments to this country by reason of the existing adverse exchange."[154] Following additional discussions, Astrom stated that he "would be willing to enter into an agreement on behalf of his Government to refund the obligations held by the United States on the basis of the terms agreed upon between this country and Great Britain"[155] Finally, Mellon replied that the Commission would accept this proposal "subject to the approval of Congress." The meeting concluded with

[153] *WWFDC Minutes,* 38.
[154] *WWFDC Minutes,* 39.
[155] *WWFDC Minutes,* 39.

the understanding that a draft agreement would be prepared and furnished to Astrom for transmission to the Finnish Parliament.[156]

The Finns moved quickly. By April 12, 1923, Astrom was able to inform Mellon that he had been advised that the Finnish Parliament had passed legislation authorizing a settlement with the United States on the basis of the previously submitted draft.[157] At its next meeting, April 16, the Commission resolved to prepare a final draft for execution with Finland "with the approval of the President and subject to the approval of Congress."[158]

The form of the final agreement submitted to the Finnish government followed the British agreement very closely. The payment of the debt followed the example of the British agreement. The only difference was the amounts involved as the Finns were refunding only $9 million. The principal would be paid over a term of 62 years with the amount gradually escalating from $45,000 in the first year to $345,000 in the 62nd. As with the British agreement, interest was charged at 3% for the first ten years and at 3½% for the remaining 52. The total to be paid each year, principal and interest combined, would be about $315,000 for the first ten years and about $356,000 for the remainder. The bonds that Finland would issue, however, would be serial bonds. Once again acting quickly, the Finnish government executed the agreement on May 1, 1923.[159] By doing so, Finland was the first nation to actually conclude a refunding agreement with the United States, the British agreement not being finalized for another six weeks. With President Harding's approval, the refunding agreement with Finland was submitted to Congress for approval. Due to Congress then being out of session, it was not until

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[156] *WWFDC Minutes,* 40.
[157] *WWFDC Minutes,* 40.
[158] *WWFDC Minutes,* 40.
[159] *Treasury Annual Report, 1924,* 47-48. For text of agreement, 233-238.

the following March that a bill was passed and sent to the White House. It was signed into law by President Coolidge on March 12, 1924.[160]

The completion of the British negotiations and the relative ease with which an agreement was reached with Finland led the Commission to consider ways of expediting their process of negotiating and executing refunding agreements. To this end, the Commission had a general discussion at its April 16, 1923, meeting "as to the policy the commission should pursue toward other nations indebted to the United States."[161] As a result, the Commission adopted a resolution empowering any member who might be in Washington at the time to negotiate agreements with other debtor nations "upon terms substantially the same as those agreed upon with…Great Britain."[162] Similarly, it was resolved that the Chairman of the Commission was authorized to execute such agreements "with the approval of the President and subject to the approval of Congress."[163] At its meeting a month later (May 21) the Commission extended this authority to include agreements with terms substantially the same as those of the agreement with Finland.[164]

From this point on the Commission's negotiations with debtor governments took on one of two forms. Negotiations with one group of countries involved relatively straightforward applications of the British settlement model. The debtor government would make a submission to the Commission perhaps involving a description of the challenges it was encountering in stabilizing its economy. The Commission would offer a settlement along the lines of the British-Finnish agreement and the debtor government would accept. Five countries, in order Hungary, Lithuania, Poland, Latvia, and Estonia, executed debt settlements incorporating all of the principal terms of the British agreement. Repayment would extend over 62 years. Interest

[160]Public Law 68-41, *U.S. Statutes at Large,* 43 (1924): 20.
[161] *WWFDC Minutes,* 41.
[162] *WWFDC Minutes,* 41-42.
[163] *WWFDC Minutes,* 42.
[164] *WWFDC Minutes,* 48.

would be charged at 3% for the first ten years and at 3½% for the remaining 52. And as with the British agreement, the amount of principal due each year would start at a relatively low level and escalate gradually throughout the term of the agreement. Also, the total of principal and interest due each year would be consistent, stepping up only once in the year in which the interest rate increased from 3% to 3½%.[165]

Czechoslovakia and Romania also executed debt settlements based on the British agreement. Interest was charged at 3% for the first ten years and at 3½% for the following 52. and the term of the agreement was 62 years. These agreements departed from the British model only by modifying the manner in which interest was paid. For the first 18 years of the Czech agreement and for the first 14 years of the Romanian agreement a portion of the interest due each year was deferred to the end of that period of years. That unpaid interest was then added to the remaining principal and was paid off over the remaining term of the agreement.[166]

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[165] The agreement with Hungary was signed on April 25, 1924, *Treasury Annual Report, 1924,* 48-50. For text of agreement, *Treasury Annual Report, 1924*, 241-247. It was approved by Congress in legislation signed by the President May 23, 1924. Public Law 68-128, *U.S. Statutes at Large* 43 (1924): 136. With the President's signature approving the legislation the agreement was in force because the authority of the minister signing for Hungary was considered sufficient to effect ratification by that nation. Moulton & Pavolsky, *World War Debt Settlements,* 255.

The agreement with Lithuania was signed on September 22, 1924, *Treasury Annual Report, 1924,* 50. For text of agreement, *Treasury Annual Report, 1925,* 268-273. It was approved by Congress in legislation signed by the President December 22, 1924. Public Law 68-298, *U.S. Statutes at* Large 43 (1924): 719. The agreement was approved by the Lithuanian Cabinet of Ministers September 26, 1925. Moulton & Pavolsky, *World War Debt Settlements,* 263.

The agreement with Poland was signed on November 14, 1924, *Treasury Annual Report, 1924,* 50. For text of agreement, *Treasury Annual Report,* 1925, 268-273. It was approved by Congress in legislation signed by the President December 22, 1924. Public Law 68-299, *U.S. Statutes at* Large 43 (1924): 720. The agreement was approved by the Polish Diet January 17, 1925. Moulton & Pavolsky, *World War Debt Settlements,* 277.

The agreement with Latvia was signed September 24, 1925. *Treasury Annual Report, 1925,* 65. For text of agreement, *Treasury Annual Report, 1925,* 296-301. It was approved by Congress in legislation signed by the President April 30, 1926. Public Law 69-161, *U.S. Statutes at Large* 44 (1926): 376. The agreement was passed by the Latvian Saeima March 26, 1926. Moulton & Pavolsky, *World War Debt Settlements,* 304.

The agreement with Estonia was signed October 28, 1925. *Treasury Annual Report, 1925,* 59. For text of agreement, *Treasury Annual Report, 1925,* 309-313. It was approved by Congress in legislation signed by the President April 30, 1926. Public Law 69-160, *U.S. Statutes at* Large 44 (1926): 377. It was approved by Estonia by the law of March 26, 1926. Moulton & Pavolsky, *World War Debt Settlements,* 329.

[166] The agreement with Czechoslovakia was signed October 13, 1925. *Treasury Annual Report, 1925,* 59. For text of agreement, *Treasury Annual Report, 1925,* 302-308. It was approved by Congress in legislation signed by the President May 3, 1926. Public Law 69-168, *U.S. Statutes at Large* 44 (1926): 386. The agreement remained

The uniformity of the terms of these agreements tends to belie the repeated assurances of the Commission that it was considering each debtor government's situation individually. The Commission devoted a portion of its annual report for Fiscal Year 1925 to this subject. Its objective, it said, was to craft agreements that were within a debtor government's "capacity to pay." In its negotiations with the debtor nations, the Commission claimed, "it has adhered to the principle that the adjustments made with each government must be measured by the ability of the particular government to put aside and transfer to the United States the payments called for under the funding agreements." However, "capacity to pay" does not mean the debtor must pay "to the full limit of its present or future capacity." Rather, the debtor "must be permitted to preserve and improve its economic position, to bring its budget into balance, and to place its finances and currency on a sound basis." The Commission went on to describe a process in which it analyzed a debtor's economic and financial data so as to arrive at a funding agreement appropriate to that government. After all, it concluded, "no settlement which is oppressive and retards the recovery and development of the foreign debtor is to the best interests of the United States or of Europe."[167]

The Commission's explanation of capacity to pay is one that would be familiar to any banker although it had to apply that principle in a manner not ordinarily encountered under normal business circumstances. In most circumstances the lender evaluating a potential borrower's capacity to pay does so knowing all of the essential parameters of the proposed loan, the principal amount, the term over which that principal will be repaid, and the interest rate to be

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unratified by Czechoslovakia at the time of the Commission's dissolution. Moulton & Pavolsky, *World War Debt Settlements,* 316.

The agreement with Romania was signed December 4, 1925. *Treasury Annual Report, 1926,* 77-78. For text of agreement, *Treasury Annual Report, 1926,* 225-230. It was approved by Congress in legislation signed by the President May 3, 1926. Public Law 69-167, *U.S. Statutes at Large* 44 (1926): 385. It was ratified by Romania by the law of March 26, 1926. Moulton & Pavolsky, *World War Debt Settlements,* 340.

[167] *Treasury Annual Report, 1925,* 52-53.

charged. These factors then determine the amount of the periodic payment that must be paid to retire the principal over the term of the loan. The focus of the capacity to pay analysis, then, is to determine whether the potential borrower has sufficient resources and income to make the required loan payment without undue distress.

The Commission found itself applying capacity to pay to a very different situation. The loan in question had already been made. Though the amount of the debt had been established neither the interest rate nor the term of the loan was known. Consequently, it was not possible to calculate the amount of the periodic payment the debtor would have to make to pay off the loan. Where the ordinary banker would use capacity to pay to determine whether a borrower could pay a predetermined periodic payment the Commission had to apply the principle to determine the amount of the periodic payment the debtor was capable of making. Once that amount was calculated, the Commission could juggle interest rates and payment periods to craft a debt agreement under which the debtor could repay the debt.

It is clear that the Commission achieved a result consistent with the capacity to pay principle in the British debt agreement. The British entered the negotiations having already determined roughly what was within their capacity to pay on an annual basis, £25 million to £30 million. Presumably these amounts were set low as negotiation starting points. The parties ultimately agreed to annual payments of the dollar equivalents of £33 million during the first ten years of the agreement and £38 million thereafter. Having determined what the British would pay each year it was then necessary to select an appropriate interest rate. The Commission described the rate chosen, 3% initially and then 3 ½%, as "the approximately normal rates payable by strong governments over long terms of years."[168] With the annual payment and

[168] *Treasury Annual Report, 1923,* 262.

interest rate established it was a matter of simple financial mathematics to determine that it would require 62 years in which to pay the entire debt.

What is not so clear is how a capacity to pay analysis would generate identical or near identical agreements with eight countries with diverse economic situations and which owed vastly different amounts. Finland, for example, owed the United States $9 million, a paltry sum even by the standards of the 1920s. The country had suffered little of the ravages of war and was well positioned to export its forest products to a rebuilding Europe. It is reasonable to believe that Finland with little difficulty could have repaid its $9 million debt much more quickly than the 62 years provided for in its debt agreement.

It is likely that the impetus to negotiate uniform debt agreements arose from domestic political considerations. None of the agreements satisfied the requirements of the Debt Commission Act. The interest rates were lower and sometimes significantly lower than the stipulated minimum of 4 ¼% and the length of the loans two and a half times longer. When the Congress approved the nonconforming British agreement, the Commission probably concluded that if subsequent agreements followed that precedent they would be more likely to secure Congressional approval.

CHAPTER 9

THE BELGIAN SETTLEMENT

The Commission negotiated and executed debt funding agreements with four additional countries, Belgium, France, Italy, and Yugoslavia. The agreements resulting from these negotiations were based on facts and circumstances unique to each of these debtor governments and must be considered separately.

The Commission took up consideration of the Belgian debt issue at its meeting on August 6, 1925. This was, incidentally, the first meeting of the Commission since its term had been extended for two years. It was also the Commission's first meeting since the prior December. In the interim, Frank B. Kellogg had replaced Charles Evan Hughes as Secretary of State. In addition, Eliot Wadsworth had resigned as secretary of the Commission and had been replaced by assistant Secretary of the Treasury Garrard P. Winston.[169]

As it had been over eight months since the Commission had last met, much of this meeting was taken up with a review of the various countries with which the Commission had negotiated debt funding agreements as well as those with which that work remained to be done. The meeting concluded with Secretary Kellogg's detailed review of the Belgian debt situation. This was necessary because the Commission expected to meet in a few days with a delegation Belgium had finally dispatched to Washington to negotiate a settlement. The review was also necessary because of the special treatment accorded Belgium in the Versailles Treaty and other post-war agreements, its recent financial activities and, from the point of view of the United States, its failure thus far to give adequate attention to the refunding of its American debts.[170]

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[169] *WWFDC Minutes,* 62.
[170] *WWFDC Minutes,* 62-68.

At the start of his review, Kellogg "referred particularly to certain 'pre-armistice' advances, Article 232 of the Versailles Treaty and to the Paris agreement of January 14, 1925."[171] These references alluded to various aspects of the Allies' recognition that Belgium's wartime experience was unique among those of the victors. The iron logic of the Schlieffen Plan had required the violation of its neutrality in the first days of the war. Although ultimately futile, the resistance offered by Belgium's tiny army upset the organization and timing of the German attempt to envelop Paris and win the war quickly. While the government and the remnants of its military withdrew to France to continue the fight, Belgium itself subsequently endured four years of German occupation. Although parts of France were also occupied by German troops during the war, Belgium was the only Allied power to suffer virtually total occupation for the duration of the war.

In recognition of its contribution to the Allied victory and of the toll taken by the German occupation, Belgium received singular consideration in the Versailles Treaty. Article 232, which imposed reparations on Germany, also included in its provisions a requirement that Germany "make reimbursement of all sums which Belgium has borrowed from the Allied and Associated Governments up to 11 November 1918."[172] No other Allied power received such consideration. Belgium was to receive two payment streams from Germany under Article 232, one from its share of the reparations Germany would pay to the Allies and a second, which essentially was intended to relieve it of responsibility for the debts it incurred from other Allies during the course of the war. From the Belgian point of view, therefore, the distinction between "pre-armistice" and "post-armistice" debt had real significance; Belgium should be expected to be responsible for only the latter.

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[171] *WWFDC Minutes*, 67.
[172] Treaty of Versailles June 28, 1919, Part VIII Reparation, Section 1 General Provisions, Article 232, http//:Avalon.law.yale.edu/imt/partviii.asp, accessed January 18, 2010.

In mentioning "the Paris agreement of January 14, 1925," Kellogg was referring to the "Agreement Regarding the Distribution of the Dawes Plan Annuities," which had been agreed to by thirteen of the Allied and Associated Powers.[173] One provision of this agreement in particular reaffirmed the preferences accorded Belgium at Versailles with regard to its war debts. Article 4, "Belgian War Debt," provided that 5% of any year's reparation payments, after providing for certain costs, primarily those of the occupying armies, "shall be applied to the reimbursement of the Belgian war debt as defined in the last paragraph of Article 232 of the Treaty of Versailles." These payments would be distributed to Belgium's creditors in proportion to the portion of Belgium's total war debt which was due them. France and Great Britain were to receive 46% and 42%, respectively. Belgium "by reason of her debt to the United States" was to receive the remaining 12%.[174] Likely the reason this 12% was paid to Belgium was that the United States had not ratified the Versailles Treaty. Belgium would have to pay the United States directly.

By early 1925, it appeared to the United States that Belgium had little intention of settling its debt situation at any time in the near future. It had been almost three years since Belgium had communicated with the Commission.[175] Belgium was also known to have made payments on some of its relief, that is, post-armistice, debt to Great Britain and Canada, which payments "were in violation of Belgium's agreement with the United States."[176] The agreement referred to here was that under which the United States extended post-armistice relief credits to Belgium beginning in 1919.

In April 1925, in an effort to bring Belgium to heel, the State Department, "after consulting with the chairman of the commission and Mr. Hoover," dispatched a long note to the

[173] "Agreement Regarding the Distribution of the Dawes Annuities," *The American Journal of International Law,* Vol. 19, No. 2, Supplement: Official Documents, (April, 1925), 63-78.
[174] "Agreement Regarding the Dawes Annuities," 68.
[175] *WWFDC Minutes*, 18.
[176] *WWFDC Minutes*, 67.

Belgian government laying out the United States's view of the situation relating to the Belgian debt."[177] The note opened with a review of the arrangements that had been made in 1919 under which the United States advanced post-armistice credits to Belgium. It gave particular emphasis to the terms of those arrangements under which Belgium agreed not to subordinate its United States debt to any of its debts to other creditors. The note continued with a description of efforts up to mid-1922 to secure some commitment from the Belgian government as to repayment. Beginning in August 1921, the United States had sent a series of notes to the Belgian government requesting information as to its intentions. These had been largely ignored. Yet by April 1925, the records of the Reparations Commission showed, the United States claimed, that Belgium had received in reparations "more than one billion gold marks in cash and 300 million gold marks in kind." Despite these receipts, the Belgian government "has made no suggestion that any portion of such receipts should be applied in accordance with the…understanding between the two Governments."[178] This section of the note concluded with a brief review of the cursory communications the Belgian ambassador in Washington had conducted with the Commission shortly after its establishment in 1922. The note also stated that "the United States would be pleased to have Belgium make a proposal in the near future for the funding of the debt."[179]

Kellogg then described the various "exchanges of views" between the two governments following the delivery of the April 1925 note and said "that it developed that it was desirable for the United States to indicate exactly to Belgium the basis upon which it expected the negotiations for the funding of the debt should proceed." Accordingly, he then read to the

[177] United States Government to Belgian Government, *FRUS, 1925 II*, 107-114.
[178] United States Government to Belgian Government, *FRUS, 1925 II*, 111.
[179] *WWFDC Minutes,* 67.

meeting a memorandum that had been presented to the Belgian government by the American ambassador in Brussels on May 31, 1925. It made to following points:

a. Belgium owes the United States $480,000,000 all but $2,000,000 of which is payable on demand. Germany may not be substituted directly or indirectly for Belgium in respect to the pre-armistice debt.

b. Settlement of the Belgian debt may be made along the lines of the British debt settlement.

c. Postponement of the earlier installments of interest or the modification of interest rates may be made as may be required by the fiscal and economic situation of Belgium.[180]

It was also at this time that American frustration with Belgian prevarication on the debt issue peaked. For a brief period, the United States imposed an embargo on further Belgian borrowing on the private American capital market. The State Department's objection to a new loan was sufficient to extract from the Belgian government a commitment to begin substantive negotiations with the Commission. On June 8, 1925, "definite word" was received that a Belgian delegation would arrive in Washington in July prepared to negotiate a debt settlement based on the basis of the May 31 memorandum. "The State Department thereupon notified the bankers that no further objection was raised to the loan."[181]

The Commission met next on August 10, which meeting was attended by the Belgian debt negotiation delegation. This meeting would mark the beginning of a period of intense negotiations with the Belgians; from the 10th to the 14th the Commission would meet seven times, twice on both the 11th and the 12th. To open the meeting of the 10th the leader of the

[180] *WWFDC Minutes,* 67-68.
[181] *WWFDC Minutes,* 68.

Belgian delegation, Baron de Cartier de Marchienne, made a statement in which he reaffirmed Belgium's intent to honor its debts to the United States, but in which he also enumerated the difficulties his country would face in doing so. There was the matter of the toll of the four-year German occupation "which now amounts to a loss of nearly $2,000,000,000." To this must be added "the sums which we had to spend to rebuild our devastated regions and to restore our wantonly destroyed factories." Though Belgium now had reason to hope that it would be possible to stabilize her financial situation "this hope was only fostered through the levying of crushing postwar taxes, which now weigh so heavily upon our national production." De Cartier closed with a statement of his confidence that it would be possible to reach an acceptable agreement on the refunding of the Belgian debt.[182]

Secretary Mellon's reply was essentially a recitation of the standard American position. After offering praise for Belgium's conduct during the war and admiration for its efforts at reconstruction, he gave some indications as to the possible approach the Commission would take in negotiating an agreement with the Belgian delegation. The United States was not going to ask Belgium "to do the impossible." He assured the Belgian delegation that "your position will have the most sympathetic and friendly consideration by our commission." What was more important, even more than the actual payment of the money owed, was "the refunding of your debt to us within your capacity to pay." Achieving such an agreement, he concluded, would constitute "recognition of the integrity of international obligations and the settlement of a question that might disturb the long friendship of our two nations."[183]

[182] *WWFDC Minutes,* 69-70.
[183] *WWFDC Minutes,* 70.

M. Georges Theunis, a member of the Belgian delegation and a former prime minister, followed with a statement that "it would seem to him that in dealing with Belgium's capacity to pay there were four issues to be discussed and decided:

1. The rate of interest on arrears up to the date of settlement.

2. The granting of a moratorium.

3. The extension of the debt-funding period beyond the 62 years provided in the British agreement.

4. The rate of interest to be paid by Belgium on the funded debt."[184]

He added that the Belgian delegation would be prepared to offer definite proposals on each of these questions at the following day's meeting of the Commission.

Emulating the protocol of the negotiations with Britain, the Commission and the Belgian delegation "agreed that all discussions at the meetings of the commissions and any proposals made during the course of negotiations until a proposal in final form was made by either commission would be treated as entirely unofficial and informal and in no respects binding." It was also agreed "that there should be no statements given to the press regarding the course of the negotiations."[185]

At their meeting with the Commission the next morning the Belgians made good on their promise "to offer definite proposals." M. Felicien Cattier, a member of their delegation, made the presentation. He began with a review of Belgium's special treatment under Article 232 of the Versailles Treaty. He emphasized that what Belgium had been granted was less than that for which she had asked and acknowledged that the United States, by virtue of its failure to ratify the treaty, was not legally bound by it. That, however, was a legal technicality that was lost on the

[184] *WWFDC Minutes,* 71.
[185] *WWFDC Minutes,* 71.

average Belgian citizen who "felt that as the United States signed the treaty it should have been bound by its provisions and believed that in refusing to relieve Belgium of the pre-armistice debt, Belgium was not being treated fairly by this country."[186] He reminded the Commission that both Britain and France had honored their obligations under Article 232 and relieved Belgium of 86% of its pre-armistice debt. He then noted various actions by the United States which seemed to justify Belgium's request for relief on this portion of her debt. Congress had authorized a gift of $25,000,000 to Russia and had extended for 20 years the payment period on the debt of Austria, a former enemy country. Therefore, he concluded, it was not unreasonable that Belgium should receive "special concessions" with regard to its pre-armistice debt and, because that portion of the debt "was peculiar in its nature, that action taken would in no way embarrass the United States in its subsequent negotiations with other governments."[187]

Cattier then proceeded to a detailed presentation of Belgium's current economic situation. Belgium, he said, could not repay its debt on the basis of the terms of the British agreement. Belgium was a small, densely populated country with little in the way of natural resources. As a result, it produced little in the way of exports of either raw materials or manufactured goods. The German occupation had devastated the Belgian economy. What industry that did exist had largely been destroyed by the Germans to say nothing of the widespread and wanton destruction carried out by the German Army in the countryside.[188] Recovering from and repairing this damage had placed great strains on the Belgian economy. Some $2 billion had been spent in this effort thus far. Although some of this money came from German reparations payments 78% of it had come from Belgian resources. The money had come from additional borrowing and from greatly increased taxes on the Belgian people. As a result, Belgium's current debt, even

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[186] *WWFDC Minutes,* 72.
[187] *WWFDC Minutes,* 72-73.
[188] *WWFDC Minutes,* 73.

excluding the pre-armistice debt, was almost nine times what it had been just prior to the outbreak of the war.[189]

Cattier brought his presentation to a close by submitting Belgium's proposal for terms for refunding its debt to the United States. The debt was to be separated into a pre-armistice and a post-armistice component. The pre-armistice debt was to be repaid over 75 years beginning as of December 15, 1922. The payments were to be made on a "progressive scale" and were to be of principal only. No interest was to be paid "past or future." The post-armistice debt was also to be paid over 75 years beginning as of December 15, 1922. No interest would be paid until 1931. From 1931 to 1936 the interest rate would be 1%. In 1936, the rate would increase to 1½%. In 1941, it would be increased to 2%, at which level it would remain until 1946. In that year it would be increased to 3%, at which level it would remain until the debt was finally retired in 1997.[190] With this, the morning meeting came to an end.

The Commission reconvened that same afternoon at 3:00 PM, initially without the Belgian delegation. As a result of a "general discussion" of the Belgian proposal, the Commission agreed "that it was justified in making a distinction between the pre-armistice and post-armistice indebtedness." In making this distinction, however, the Commission "could not in any way agree" to link those payments with Belgium's receipt of payments from Germany under the Paris agreement. However, the Commission concluded that it was "justified in considering Belgium's expectancy regarding such payments as affecting its capacity to make payments to the United States."[191]

In considering Belgium's "expectancy regarding" its payments under the Dawes Plan the Commission was coming close to violating the long-standing American policy that debt

[189] *WWFDC Minutes,* 73-75.
[190] *WWFDC Minutes,* 76.
[191] *WWFDC Minutes,* 77.

repayments were not to be contingent upon a debtor government's receipts from reparations. How close can be seen in how the Commission arrived at the proposal it would make to the Belgians for the repayment of its pre-armistice debt. The Commission decided to propose to the Belgians that they repay this portion of their debt by "annual payments in the nature of an annuity." The total pre-armistice debt of $248,000,000 would be paid in annual installments over 62 years. In the first two years, the payment would be $1,500,000. In the following three years it would rise to $2,500,000. Over the remaining 57 years the annual installment would be $4,000,000. This schedule of payments was understood by the Commission to be "the approximate amount ultimately to be received by Belgium yearly under article 4 of the Paris agreement of January 14, 1925, applicable to its war debt to the United States."[192] Thus, the amounts Belgium would be obligated to pay under this proposal were ultimately determined by the amounts of reparations she was expected to receive relating to her pre-armistice debt to the United States. Despite the close correlation between reparation receipts and debt payments this was still not a "safeguard clause" such as the French would seek in their debt negotiations. The Belgians would still be liable for the specified payments regardless of whether they received the anticipated reparation payments. As to the other component of the Belgian debt, the Commission "felt that it was desirable to take the position that the post-armistice debt should be settled on the British basis."[193]

The Belgian delegation joined the meeting at 4:30 PM and was presented with the Commission's proposal for refunding their debt. The Belgians expressed gratitude that the Commission had recognized the special nature of the pre-armistice debt and was willing to afford it preferential treatment. However, they did not see how it would be possible to settle

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[192] *WWFDC Minutes,* 77.
[193] *WWFDC Minutes,* 77.

either component of their debt on the British model. Chairman Mellon countered that he believed that if the Belgian delegation “considered the actual payments to be made by Belgium under the proposal advanced it would find that they were within Belgium's capacity to pay.” With a promise that the Commission would prepare a schedule of payments demonstrating this point, the meeting was adjourned.[194]

The Commission and the Belgian delegation met again the following morning, August 12. M. Theunis presented the Belgian response to the most recent American proposal for the refunding of the debts. He deferred discussion of the pre-armistice debt and addressed the Belgians' concerns with the post-armistice debt. He began by stating "that Belgium could not morally agree to a settlement which it knew it would be unable to fulfill." It was not possible, he continued, to consider a settlement on the British model. Economic and financial stability had just recently been attained and was even now only precariously being maintained. The main difficulty in settling on the British terms lay in the size of the payments that would be required during the first 20 years. With all the other obligations Belgium would face during those years, payment on the British scale would be impossible.[195]

Chairman Mellon responded "that it was reasonable to suppose that Belgian conditions would continue to improve; that the difficulties in the early years could be met by a moratorium."[196] He then asked the Belgians what they thought Belgium would have available for payments on the American debts. Theunis submitted a schedule showing projected amounts available for debt payments to the United States during the period 1926-1940. The schedule showed not only the total amounts projected to be available each year but also what portion of that amount was projected to come from German reparations payments. Reparations made up a

194 *WWFDC Minutes,* 78.
195 *WWFDC Minutes,* 79.
196 *WWFDC Minutes,* 79.

significant portion of the total, more so in the earlier years than the later. The total available for payments in 1926, for example, was shown as $2,750,000 of which $1,378,000, or 50%, was projected from reparations. By 1940, the last year projected, $15,000,000 would be available of which only $3,300,000, or 22%, was expected to come from reparations. Theunis was also careful to qualify these figures by pointing out that they must be understood to be only approximations and that they were dependent upon Belgium actually receiving all it was supposed to receive under the Dawes Plan.[197]

At this point, the Belgian delegation withdrew to permit the Commission to consider its response. After considering the Belgian proposed payment schedule, the Commission prepared its own "proposal regarding the payments to be made on account of the post-armistice debt." The Commission's proposal covered the same period as the Belgian schedule, 1926-1940, and set forth total payments for each year. The payment for each year was divided into amounts made on principal and on interest.[198] This schedule shows an application of the American policy of not accepting reparations as a source of repayments. The amount called for each year is essentially the amount Belgium claimed to be able to pay net of the amount ascribed to reparations. For 1926, the Belgians estimated that they would have $2,750,000 available for debt repayment of which $1,378,000 would be provided by reparations. Net of reparations, the amount available was $1,372,000. The commission proposed that Belgium pay $1,700,000 in that year. For 1927, the projected net amount available was $1,816,000; the Commission proposed Belgium pay $1,950,000. In 1928, the net amount available was $2,300,000 and the Commission proposed a payment of $2,200,000, an amount that would no longer require even a portion of the reparation payments to meet. This continued to be the case for the remainder of the years covered by the

[197] *WWFDC Minutes,* 79-80.
[198] *WWFDC Minutes,* 80.

Commission's proposal. The proposed payment was less than the net amount projected as available by the Belgians.[199]

The Commission's proposal for the post-armistice debt contained other provisions. Interest was to be calculated on the British model, 3% for the first ten years, 3½% thereafter. There was also a need for a capitalization of unpaid interest at the end of the initial 15-year period. The amounts that were to be applied to interest during 1926-1940 were not sufficient to cover all of the interest that would be due during those years. At the end of 1940, that unpaid interest would be added to the principal of the loan to be paid over its remaining term.[200] The Belgian delegation then joined the meeting and was presented with the new American proposal. On initial consideration, they objected to the capitalization of interest at the end of the initial 15-year period. The meeting adjourned on the Belgian's request that they needed to fully consider the Commission's proposal.[201]

The meeting that followed in the afternoon of the 12th was brief and consisted primarily of a Belgian explanation of why the American proposal was unacceptable. M. Cattier indicated that the basic problem concerned the capitalization of accrued interest at the end of the initial 15-year period. When the accrued interest was added to the principal still outstanding in 1940 Belgium would then owe more as principal than it did at the current time. The payments that would then be required to liquidate the debt in the remaining 47 years of the debt term would "be substantially increased" and would be larger than Belgium could make. As a result, it must be clear "that obviously the Belgian commission could not present such a proposal to the Belgian Government."[202] Nevertheless, because Belgium "earnestly sought a settlement and a solution of

[199] *WWFDC Minutes,* 80.
[200] *WWFDC Minutes,* 80.
[201] *WWFDC Minutes,* 80.
[202] *WWFDC Minutes,* 81.

the difficulties," Cattier suggested that each party appoint two or three members to meet in an effort to find a basis for agreement. Shifting briefly to the pre-armistice debt, he asked that the Commission grant a further concession and permit that portion of the Belgian debt to be repaid over the entire 62 year term of the agreement. At this point, the general meeting adjourned. As requested by Cattier, three members of the Belgian delegation, Francqui, Theunis, and Terlinden, continued the discussions in the Chairman's office with Mellon, Smoot, and Winston.[203]

The Commission met the next day, August 13, and, before the arrival of the Belgian delegation, "entered into a general discussion as to a possible basis for a settlement of the indebtedness." It was agreed to accept the Belgian proposal relating to the pre-armistice debt. This would require a payment of "about $2,750,000 a year." As to the post-armistice debt, the Commission decided to accept a settlement "along the lines of the British settlement, the schedule of payments for the first 15 years to be as already proposed to the Belgian commission."[204] While the concession on settling the term of repayment of the pre-armistice debt at 62 years addressed one of the Belgians' concerns, the matter of the capitalization of the accrued interest at the end of the initial 15 years on the post-armistice debts seems to have been ignored. When the Belgian delegation joined the meeting it was only to say that they were still "endeavoring to arrive at a means of settling the debts between the two Governments, but had not been able to do so..." They asked that the meeting be postponed to the next day.[205]

At their meeting the next day, their seventh in five days, the Belgians and the Americans finally struck a deal. The Belgian delegation proposed to pay the pre-armistice debt over 62 years. In the early years the payments would be low, but they would increase in increments over the first five years and level off for the remainder of the term of the agreement. The payment for

[203] *WWFDC Minutes,* 81-82.
[204] *WWFDC Minutes,* 82.
[205] *WWFDC Minutes,* 82.

1926, the first year of the agreement, would be $500,000. It would increase to $900,000 in 1927 and in like manner in the following years until it reached $2,900,000 in 1932, the level at which payments would be made for the rest of the agreement's term.[206]

As to the post-armistice debt, the Belgians proposed, once again, a lowered level of payments during the first 10 years of the agreement. The payments would increase gradually during that period from $2,840,000 to be due in 1926 to $6,650,000 to be due in 1935. These payments would be allocated to both principal and interest but in such a way that there would be no unpaid interest at the end of the period to be capitalized as additional principal. Thereafter, the annual payments would be set at a level necessary to liquidate the loan by 1987 at an interest rate of 3½%.[207] The Belgians also asked that a most favored nation clause be included in the settlement because "it would be unfair and embarrassing to the Belgian Government if at a later time a nation in a similar economic and financial position similar to that of Belgium were accorded more favorable terms without Belgium having the right to revise the terms of her settlement."[208]

Following the withdrawal of the Belgian delegation, the Commission decided to accept the Belgian proposals with minor changes. For reasons its minutes do not explain, the Commission made adjustments to the amounts due in a few years of the pre-armistice debt payment schedule. The amounts due in 1929 and 1930 were each increased by $500,000 and the amount due in 1931 by $150,000. The amount due in the final year of the agreement, 1987, was then reduced by the total of these three adjustments, $1,150,000. The Commission also decided to accept the Belgian proposal for the post-armistice debt but to decline the request for most

[206] *WWFDC Minutes,* 83. The payment due in 1987, the final year of the agreement would , in fact, be $2,880,000.
[207] *WWFDC Minutes,* 83-84.
[208] *WWFDC Minutes,* 84.

favored nation status.[209] The Belgian delegation was informed of the Commission's decision but cautioned that it would have to be approved by the President before it could be officially accepted by the Commission. Mellon then announced that "he and Senator Smoot would confer with the President on Monday, August 17, 1925, at Plymouth, Vt., returning to Washington on Tuesday, August 18, 1925."[210]

The Commission and the Belgian delegation met upon Mellon and Smoot's return to Washington on August 18. Mellon reported that President Coolidge had approved the terms of the agreement. Some minor adjustments to various elements of the proposed agreement were settled and Mellon "stated that a formal written agreement to be signed by the Belgian commission and himself...would be ready for signature at 8 o'clock in the evening."[211] The agreement was duly signed on August 18, 1925.[212] It was ratified by Belgium in the law of March 2, 1926,[213] and approved by Congress and signed into law by President Coolidge on April 30, 1926.[214]

The Belgian debt settlement was the first significant departure by the Commission from the British settlement model. The departure was partly due, of course, to the unique treatment afforded Belgium in the Versailles Treaty and other post-war agreements. The Commission took care to emphasize this consideration in its public comments on the Belgian settlement. In its annual report for Fiscal Year 1925 it noted that while it "was aware of the fact that no legal obligation rested upon the United States as a result of the assurances given Belgium at the time of the Peace Conference," it was prepared to acknowledge that "there continued a weighty moral

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[209] *WWFDC Minutes,* 85.
[210] *WWFDC Minutes,* 85.
[211] *WWFDC Minutes,* 86.
[212] *Treasury Annual Report, 1925*, 55. For text of agreement, 288-295.
[213] Moulton & Pavolsky, *World War Debt Settlements,* 289.
[214] Public Law 69-159, *U.S. Statutes at* Large 44 (1926): 376.

obligation on this Government, since as a result of the action taken by President Wilson Belgium had waived rights which otherwise it might have attained." This, the Commission emphasized, differentiated the pre-armistice debt of Belgium from all other debts due the United States from foreign governments.[215]

While the treatment of the Belgian pre-armistice debt was due to special circumstances, the handling of the post-armistice debt also deviated somewhat from the British model. This deviation occurred in the treatment of the first ten years' payments. The interest rate charged during this period was far less than the 3% charged during the initial period of all of the debt agreements concluded to date. This was accomplished by allocating a disproportionately large amount of each payment to principal. As a result, the interest rate effectively charged in the first year of the agreement was slightly less than .71%. That rate increased gradually to about 2.24% in the tenth year. A simple arithmetic average of the interest paid by Belgium during the first ten years of its agreement is slightly less than 1.36%. From the eleventh year on the agreement was identical to the British model in charging interest at 3½%.

The Belgian debt settlement, while unique, also showed in a general way how the Commission might respond when dealing with other difficult situations. If the Commission would not agree to cancel any of Belgium's pre-armistice debt, it was a virtual certainty that it would not cancel any other government's debt. The term of an agreement would also not likely exceed 62 years. Even with all of the equitable and financial arguments that the Belgians advanced they could not convince the Commission to extend the term of their agreement to 75 years. But it was clear that the Commission was flexible on interest rates. It had agreed to charge no interest on the pre-armistice debt not only to meet a "weighty moral obligation" but

[215] *Treasury Annual Report, 1925,* 56-57. For similar language in the August 19, 1925 press release announcing the signing of the Belgian agreement see *Treasury Annual Report, 1925,* 286.

also to keep annual payments at a level Belgium presumably could afford. And it was for this latter reason the Commission agreed to the reduced interest rates during the first ten years of the post-armistice debt repayment schedule.

CHAPTER 10

SETTLEMENT WITH FRANCE – A FIRST ATTEMPT

The Commission next met on September 24, 1925. Although dealing preliminarily with some matters relating to the Latvian and Lithuania negotiations, the principal purpose of this meeting was to begin refunding negotiations with a newly arrived delegation from France.[216] The negotiations with France would be difficult. In the seven years since the Armistice, the cordial relations between the two countries, arising out of a common war-time effort and long historical affinity, had significantly, deteriorated in no small part because of the war debts issue. During the 1920s France was plagued by highly volatile domestic politics and a succession of financial crises. More than in any other debtor country the war debts issue had stirred strong sentiments of public opinion. Finally, various actions by the French government in the post-war period had created a deep-seated suspicion in American official and public opinion that the French might never agree to pay their debts.

France was the second largest debtor of the United States. In total, it had borrowed over $3.3billion. By 1925, accrued interest on that amount had driven the total French debt to just over $4 billion.[217] The prospects of paying off a debt of this size were grim. France also owed Britain nearly $1.7 billion.[218] Its major industrial areas had been occupied, and devastated, by the Germans and it had suffered over a million men killed and more than four million wounded. In addition, because of an inadequate and inefficient tax structure, France was more highly "leveraged" than perhaps any other major participant in the war. Taxation had supplied only about one-sixth of total war costs. Foreign loans from Britain and the United States provided almost one-fourth of its war costs. The remainder was supplied by short-term internal

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216 *WWFDC Minutes,* 89.
217 *Combined Reports,* 257.
218 Moulton & Pavolsky, *War Debts and World Prosperity,* 426.

borrowing. By the end of the war, interest payments on this debt consumed about 80% of the country's normal revenues.[219]

The arrival of a new Administration in Washington had done nothing to ameliorate tensions surrounding the issue of the French war debts. During the course of the Conference on the Limitation of Armament the French delegation's insistence on France's right to maintain a large army was seen as sabotaging any opportunity to limit land armaments. The French demand for naval parity with Japan and for the right to build unlimited numbers of submarines came close to wrecking the conference. In the end, the French were seen as unreconstructed militarists endangering the prospects for world peace.[220] If the French government had money for military spending at such levels, it seemed logical to ask why it was not willing to make arrangements to pay its debts. The Harding Administration responded by rescinding a previously granted approval for a bond offering in the United States for the Department of the Seine, the first such American action with regard to French loans.[221]

French reaction to the passage of the Foreign Debt Commission Act caused further difficulties. There was unanimity of opinion in France that the debts should not be paid until and unless France began to receive reparations from Germany. It was also generally agreed that the terms for repayment mandated by the Act could not possibly be met. Initially, the French government made no official statements concerning the Act. However, in a speech to a Lyon business group, a prominent former minister, Louis Loucheur, said that France could not pay the debt. In response to strong criticism from the United States, including Congress, Loucheur said that it had been necessary to make the American public aware of the true situation regarding the

[219] Schrecker, *The Hired Money,* 47-49.
[220] Joel Blatt, "France and the Washington Conference," in Erik Goldstein and John Maurer, ed, *The Washington Conference, 1921-1922,Naval Rivalry, East Asian Stability and the Road to Pearl Harbor,* Portland, OR, Frank Cass Publishers, 1994, rpt, 2000, 192-219.
[221] Schrecker, *The Hired Money,* 117.

debts issue as France saw it. As an example, he pointed to newly erected American tariffs which, he claimed, made it impossible for France to acquire through exports to the United States the dollars needed to repay its loans.[222] He might have pointed with equal validity to the effect of Prohibition on France's wine exports.

The furor over the Loucheur speech forced the French government to take some action to mollify American opinion. Thus, the Parmentier mission was sent to meet with the Debt Commission in August 1922, the results of which are described above. This effort has been described as "essentially a good will gesture.[223] The French had no intention of engaging in binding negotiations. Parmentier's instruction from the French Government had made this clear.[224]

Additional irritants followed. The French occupation of the Ruhr in 1923 seemed to indicate that France had the resources to maintain a large army, which it was using to extract substantial payments from Germany. When it was learned in early 1923 that France was extending loans to various Central European countries for the purposes of arms purchases, Undersecretary of the Treasury S. Parker Gilbert requested that the State Department "make some informal inquiries of the French Government as to how it finds itself able to do this at a time when it will not even discuss the refunding of its own obligations with this country."[225]

The death of President Harding in August 1923, followed closely by the 1924 election campaign, postponed further action on the French debt question. Between May, 1923 and

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[222] Schrecker, *The Hired Money,* 149-150.
[223] Schrecker, *The Hired Money,* 151.
[224] "Your mission to the United States has no other object than to inform the members of the World Wide Foreign Debt Commission and to make clear to them that, under the present circumstances, France is not in a position to make any agreement concerning the payment of her political debt...You will act in such a way that the Government of the United States cannot at any moment conclude from what you say to the World Wide Foreign Debt Commission or even from your silence that France has tacitly accepted the principles of the federal law of February 9, 1922." Quoted in Moulton & Pavolsky, *War Debts and World Prosperity,* 83.
[225] Gilbert to Mellon, April 4, 1923, quoted in Schrecker, *The Hired Money,* 117-118.

August, 1925, the Commission met only five times dealing largely with the various countries willing quickly to conclude agreements along the lines of the British settlement.

Following Coolidge's victory, the United States renewed its attempts to bring France to negotiations regarding its debts. When France refused to allow the United States a small portion of German reparations to cover American occupation costs in Germany, the State Department withheld approval of a French request to float a loan of $100,000,000 with J. P. Morgan and Company. When France relented, State approved the loan.[226]

The prospect of a new capital embargo appeared to convince the French government that it would have to make some effort to reach an agreement with the United States. The problem remained, however, that the two sides continued to view the debts issue very differently. The American view was made clear to French Ambassador Jules Jusserand in late 1924 in informal conversations with Secretary Mellon. Mellon reported to the Commission at its December 1 meeting that, although Jusserand had made no "definite proposal" regarding payment, the French government nevertheless appeared to be "desirous of attempting to arrive at some terms for the funding of its indebtedness which might prove mutually satisfactory."[227] After some discussion, the Commission agreed to recommend to Jusserand a settlement based on “the British terms with such modifications as will meet the difference in the immediate economic situation of France.” It suggested that principal payments could begin immediately “and that the differences referred to should find expression in an examination of the various questions which relate to the payment of interest.”[228] In short, the Commission was offering France the same concept of an agreement it would employ successfully with Belgium in the summer of 1925.

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[226] Rhodes, "Reassessing Uncle Shylock, 794; Hughes to Herrick, *FRUS, 1924, II,* 72-73.
[227] *WWFDC Minutes,* 60.
[228] *WWFDC Minutes,* 60.

It soon became apparent that the French government held starkly different views about an acceptable basis for settlement. Shortly after Christmas 1924, the Finance Ministry published over the signature of Finance Minister Etienne Clementel an "Inventory of the Financial Situation." Also referred to as "the balance sheet of France," it appeared not to include the American and British loans among France's liabilities.[229] In fairness to the French, the form in which the "Inventory" was first reported in the press failed to include certain portions in which acknowledgment was made of France's obligation to pay.[230] Other passages in the document as reported, however, seemed to indicate a French determination not to pay anytime soon, if ever. The issue of the debts, it said, must be considered “from the higher view of cooperation and fairness.” If so, “strict justice would seem to demand a general pooling of war expenditures and their allotment among the allied States proportionate to the riches of each one.” It was wholly reasonable, the Inventory continued, that France “could hope the rank she occupied on the long list of sorrows and devastations would give her the right to legitimated concessions in the domain of compensations.” In light of current conditions, the Inventory continued, France “cannot consider the possibility of assuming the burdens of annual payments which may be fixed” until the reconstruction of its “devastated regions” is complete and “until the payments due us under the peace treaty have created for us the necessary resources.”[231]

Predictably, this thinly disguised demand for at least some cancellation of the debts and a tying of that which would be paid to the receipt of German reparations elicited a strong response from the United States. On December 29, Senator David Reed of Pennsylvania, considered a friend of France and a confidant of Mellon, made a speech from the Senate floor attacking the

[229] Rhodes, "Reassessing Uncle Shylock," 794; Schrecker, *The Hired Money,* 174.
[230] Discussed in Herrick to Hughes, December 30, 1924, *FRUS, 1925, I,* 133-134.
[231] Quoted in Herrick to Hughes, December 30, 1924, *FRUS, 1925, I,* 134-135.

French position.[232] Acknowledging an understanding of the difficulties countries such as France, Belgium and Italy faced in dealing with their post-war problems Reed nevertheless portrayed their attitudes, and particularly France's, toward the refunding of their debts as duplicitous attempts to avoid their legitimate obligations to the United States. The publication of the Inventory, he said is "a step that our people cannot fail to regard as being some evidence of an official intention to repudiate that war-time debt." France's "inaction in this matter has puzzled those of us who look toward her most affectionately." But if that is the course upon which France is embarked there will be consequences. It is important that France understand "that each day of delay in achieving a refunding of that debt makes it more difficult to grant her leniency in terms of payment." It also would be virtually certain that "future French loans in America would be made impossible by a repudiation of the existing debt."[233] The State Department also issued precise instructions to the American ambassador to France to deliver a firm message. The Inventory, it observed, has been "widely published and cannot be ignored." In order to "make clear our position and to remove any misunderstanding in regard to a proposal for partial or entire cancellation of the debt," the Department ordered Ambassador Herrick "to take up the matter informally with the Premier and the Minister of Finance." It is necessary that they understand that "public opinion in this country reacts promptly and definitely to statements…which raise a question as to the French Government's intent to pay its debt or as to the equity of such payment." Accordingly," the United States Government must expect that the French Government will take an early occasion to give evidence of its intention to pay and make proper provision for refunding of its debt."[234]

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[232] Schrecker, *The Hired Money,* 192.
[233] Quoted in Hughes to Herrick, December 30, 1924, *FRUS, 1925, I,* 136.
[234] Hughes to Herrick, December 30, 1924, *FRUS, 1925, I,* 137.

Paradoxically, the French government actually made two proposals to refund its debt during this period. Whether they were in accord with the unreported sections of the Inventory reaffirming the French debt or just another delaying tactic was not clear. In any case they were in no way consistent with American views on an acceptable refunding formula. On December 30, 1924, during a visit to the French Premier's home, Ambassador Herrick was handed a note from Finance Minister Clementel. It proposed, first, a moratorium for ten years during which France would pay on neither the principal nor the interest of its debt. Following the moratorium, the debt would be paid over 90 years. No interest would be charged for the first ten of those years. During the final 80 years, the interest rate would be ½%. Herrick considered the terms "so unacceptable to American public opinion" that he didn't bother cabling the text of the note.[235] Clementel tried again in March with a slightly revised, and equally unacceptable, proposal. On the 28th he sent a note to Herrick in which he proposed that France pay its debt over 83 years. During the first 15 years the interest rate would be ½%, for the next 20 years 1%, the following 20 1½% and for the final 28 2%. In addition, the proposal included a "safeguard clause" but only to cover the payments of interest.[236] A “safeguard clause” would permit the French to limit payments on their debt to the United States to amounts no greater than that which they received as reparations from Germany.

American exasperation with what it perceived to be French duplicity in the debts issue peaked with a speech in the Chamber of Deputies by Louis Marin. On January 21, 1925, he argued that because France had suffered so much more than any of the other Allies it was entitled to special consideration. Moral considerations were paramount. “Besides the sacrifices in money which have helped the conduct of the war, he thundered, “we must enter into the

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[235] Herrick to Hughes, December 30, 1924., *FRUS , 1925, I,* 133.
[236] Herrick to Hughes, March 31, 1925, *FRUS, 1925, I,* 147-148.

account the human lives, the destructions and the material and moral sacrifices which have been the price of victory.[237] What gave this speech its significance was not the familiar litany of French suffering, but its reception. In a Chamber perennially divided by intense ideological differences it was received with unanimous and enthusiastic applause.[238] Ambassador Herrick conceded that the speech was "a fairly accurate representation of the views of the man in the street."[239]

At this point the United States determined to increase the pressure on France in hopes of eliciting from its government some reasonably acceptable refunding proposal. In early 1925, the capital embargo on French borrowing in the United States was re-imposed.[240] In early February, Secretary of State Hughes outlined to Ambassador Herrick the new approach to France. The objective, he said, must be to convince the French government that it must send a debt negotiation delegation to Washington to meet with the Foreign Debt Commission. Additionally, that delegation must be prepared to make a refunding proposal along the lines of Secretary Mellon's December note to Ambassador Jusserand. Given that the negotiation of refunding agreements has been legally entrusted to the Commission, continuing to pursue the matter through normal diplomatic channels "will evoke criticism in Congress." Such long-range negotiation usually leads to leaks which cause all manner of problems. Furthermore, such an offer "is practically certain to be unacceptable in its terms and we have no suitable opportunity for negotiation and efforts to arrive at an understanding."[241]

It took some time for the diplomatic and economic pressure to build, but by the summer of 1925 the French began to relent. In a speech delivered at the French Foreign Office to the

[237] Schrecker, *The Hired Money,* 194.
[238] Schrecker, *The Hired Money,* 915.
[239] Herrick to Hughes, January 23, 1925, *FRUS, 1925, I,* 144.
[240] Rhodes, "Reassessing Uncle Shylock," 795.
[241] Hughes to Herrick, February 6, 1925, *FRUS, 1925, I,* 145-246.

American delegation to the Exposition of Decorative Arts, Premier Aristide Briand announced that France would send "in the very near future a commission to the United States to settle the debt, naturally, in such a manner as the state of French finances permits."[242] Finally, on September, 16, 1925, the French Ambassador in Washington informed Secretary of State Kellogg that the French debt negotiation delegation had been selected and was expected to arrive in New York aboard the *Paris* on September 22.[243]

The French delegation first appeared before the Commission on September 24, 1925. It was led by Minister of Finance Joseph Caillaux and was composed of high level officials and political figures from across the French political spectrum. They had been chosen both to give all French political factions a stake in the proceedings and to calm American fears that this French delegation not be a repeat of the powerless Parmentier mission of 1922.[244]

Despite its political strength and the apparently sincere desire of its members to reach an agreement with the United States, the Caillaux delegation would be operating under stringent constraints that were both financial and political. The realities of the French financial situation dictated the level of annual payments to which the delegation could agree. The recently completed Belgian debt funding agreement offered hope in this regard as it showed that the Commission could be quite flexible in scaling payments and cutting interest rates so as to set a debtor's annual payments at an achievable level. The realities of French politics and public opinion demanded the inclusion of a safeguard clause in any debt refunding agreement. Long-standing American policy on this question as well as the example of Belgian agreement indicated the virtual impossibility of achieving this goal. If the Belgians, whose financial and economic

[242] Herrick to Kellogg, July 3, 1925, *FRUS, 1925, I,* 157.
[243] Daeschner to Kellogg, September 16, 1925, *FRUS, 1925, I,* 157-158.
[244] Schrecker, *The Hired Money,* 210-211.

problems mirrored those of France, had not been able to secure a safeguard clause in their agreement, there was no reasonable basis for the French to believe they could obtain one.[245]

The meeting opened with the customary exchange of statements. Caillaux thanked the United States for its support of France during the war and urged both parties to "go to work as practical men" to reach an agreement "so as to fortify peace and help the economic stabilization of the world."[246] Chairman Mellon responded with a statement that included the standard recitation of America's view of the debt refunding process. "To establish the binding character of an international promise and to protect its own citizens, the creditor nation must seek adjustment. To keep good its word and to give itself time to recover its prosperity, the debtor nation must determine its future liabilities. No concern can successfully be reorganized in the face of an unfunded demand obligation. So we meet here in council as business men to conclude the one matter which is in controversy between our two countries."[247]

Caillaux then began his presentation of his government's proposal for refunding its debt. It was replete with all of the themes that had animated the French view of the issue since the Armistice. France had suffered greatly in the war and was engaged in a massive reconstruction effort. Because of the lack thus far of substantial payments of reparations this effort had largely been financed from internal resources. To meet these costs, the government had sharply curtailed its expenditures, had borrowed heavily and had taxed its people to the limit of their toleration. Nonetheless, the high level of expenditures must be expected to be needed for reconstruction and war-related items such as pensions for wounded veterans for many years. This problem was compounded by the fact that the prospects for growing national revenues in the future were also not encouraging. France, "a nation mostly agricultural, whose population

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[245] Rhodes, "Reassessing Uncle Shylock," 797; Schrecker, *The Hired Money,* 202.
[246] *WWFDC Minutes,* 90.
[247] *WWFDC Minutes, 90.*

will not increase in the future any more than it has increased since the Middle Ages," has little in the way of substantial exports."[248]

Despite laboring under all of these difficulties, Caillaux continued, France was determined to pay "without a cent of reduction, the principal of her debt, together with interest, the rate of which is naturally limited by what we have said above." The French would pay their debt over 62 years "for the only reason that the Government of the United States has always adopted [this payment period] in its previous negotiations." For the first five years of the agreement, France would make total annual payments of $25 million. The payments would increase to $30 million for the next five years, then $60 million for the following ten years. For the remaining 42 years the annual payment would be $90 million. In the event that "the transfer of these sums of money should come to exercise a disturbing influence on the exchange rate" France would have the option of postponing payments for a limited numbers of years.[249] This postponement feature was similar to a payment postponement provision in the British and other agreements though the postponement period proposed here was slightly longer. And then there was the need for a safeguard clause. "It must be understood," he pronounced, "that, if for reasons outside the will and power of France, any of the essential elements of her national assets should substantially fall short, the present agreement would be reviewed at the request of the French Government."[250]

In a brief meeting the following day, September 25, the Commission met to discuss its reply to the French proposal and then to present it to them. The Commission informed the French delegation that their proposal was unacceptable. Payments on the basis proposed would provide interest at a rate of only about one-fifth of 1 per cent. In reply, the Commission

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[248] *WWFDC Minutes,* 91-95.
[249] *WWFDC Minutes,* 91-93.
[250] *WWFDC Minutes,* 93.

proposed a refunding on what it described as the British terms with a possible reduction of the interest rate during the first ten years "to meet the financial and economic situation of France." After ten years, payment at the full 3 ½% "will be practicable."[251] There was no mention of the safeguard clause. The meeting adjourned on Caillaux's request for time to study the American proposal.

The Commission next met three days later, September 28, to receive the reply of the French delegation to its proposal. Caillaux revisited all of the points he had made in the initial meeting regarding France's ordeals in the war and its current situation. But his essential message remained that France could not see how it could offer any more than that which it had initially proposed. After Chairman Mellon indicated that the proposal was not acceptable Caillaux asked the Commission to suggest a counterproposal for the French delegation to consider.[252]

Considering this suggestion following the withdrawal of the French delegation, the Commission decided that it would be possible to offer the French a refunding agreement along the lines of the Belgian one. Where the Belgian agreement provided greatly reduced interest rates during the first ten years, this provision could be extended to 13 years. Interest would be set at ½ of 1 percent for the first year. In each succeeding year the rate would increase by a ¼% until it reached 3 ½% in the thirteenth year, at which level it would be maintained for the remaining years of the agreement.[253] Once again, no mention was made of the safeguard clause. The proposal was accordingly submitted to the French delegation that afternoon. Caillaux asked that the American and French technical advisors be given some time to confer regarding the Commission's proposal.[254]

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[251] *WWFDC Minutes,* 97.
[252] *WWFDC Minutes,* 99-100.
[253] *WWFDC Minutes,* 100.
[254] *WWFDC Minutes,*103-104.

The following day, members of the Commission and the French delegation conferred in an effort to resolve some of the issues raised thus far in the formal meetings of the two groups. The results of these meetings were discussed by the Commission on the morning of September 30. The issue of a safeguard clause had finally been joined. Caillaux had said that he had no authority to agree to a refunding agreement unless it contained such a clause.[255] At this point, any prospects for negotiating an agreement effectively vanished as the Commission could not agree to such a provision. Nevertheless, the parties continued to try. In an effort to find some means of addressing the safeguard clause issue Mellon appointed a subcommittee, consisting of Hoover, Smoot, and Crisp, to meet with a French subcommittee to see if something could be worked out.[256]

Late that afternoon, the Commission met with the French delegation to receive a new French proposal. The French proposed repaying their debt over 68 years. They would pay $40 million annually during the first five years, $60 million annually over the next seven years and $100 million annually for the remaining 56. This proposal included two additional provisions, a postponement provision similar to that in the British agreement and a safeguard clause of sorts. The latter had been drafted by Hoover in his subcommittee and provided that the agreement would be "based upon the capacity of France to meet the annual payments set out as viewed by the present negotiators." However, "if it shall be proved that these payments are beyond the capacity of France, taking into account all of its essential elements, then the payments are to be jointly reviewed by the two governments."[257] The French accepted this language even though it

[255] *WWFDC Minutes,* 104.
[256] *WWFDC Minutes,* 104-105.
[257] *WWFDC Minutes,* 105-106.

didn't explicitly mention German reparation payments. The congressional members of the Commission, however, would not accept it.[258]

The Commission met with the French delegation the next morning, October 1. It rejected the latest proposal on the grounds that the interest rate implicit in the payments the French proposed was, at less than 1% throughout the payment term, too low. And, in an oblique reference to the proposed safeguard clause, there were "important conditions attached to this proposal which render these payments entirely uncertain."[259] Understanding that it was currently impossible for the two sides to reach an agreement, the Commission proposed an interim agreement whereby France would pay $40 million toward its debt annually for five years. The Commission suggested that in five years time the economic and financial situation of France would have stabilized and conditions would be more conducive to a permanent settlement.[260]

At the Commission's final meeting with the French delegation that afternoon, Caillaux declined to accept the proposal for a five-year agreement on the grounds that he lacked the authority to do so. With the customary exchange of courtesies, the attempt to secure a refunding agreement came to an unsuccessful close. In truth, there was never a great likelihood that the Caillaux mission would succeed. The French and the American positions were still irreconcilable on the critical issues of France's capacity to pay and the matter of a safeguard clause. Negotiations would continue through other channels, but for now an agreement was simply not achievable.

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[258] Schrecker, *The Hired Money,* 217.
[259] *WWFDC Minutes,* 107.
[260] *WWFDC Minutes,* 108.

CHAPTER 11

ITALY SETTLES

By the Fall of 1925 the only major debtor with which the Commission had not yet conducted negotiations was Italy. Having borrowed over $1.6 billion from the United States, Italy also owed a like amount to Britain and about $75 million to France.[261] The Italian economic and financial situation was on the face of it worse even than that of the French. The Italian economy was smaller and the country had little in the way of natural resources and a perpetually unfavorable balance of trade. In addition, Italy had suffered over 600,000 deaths in the war. Yet there were no Italian calls for cancellation or outrage over rapacious American demands for repayment. As a result, the debt refunding negotiations with Italy, which took place in November 1925, proceeded smoothly and with little substantial disagreement.

The Italian approach to its American war debt emerged at least as early as 1921 during the Washington Conference on the Limitation of Armament. The Italian government saw the Conference more as an opportunity to turn American opinion in the direction of helping Italy in dealing with its grave economic problems. The principal members of its delegation to the Conference were two former Finance Ministers, a businessman and a prominent media mogul. In press interviews and in discussions with State Department officials the Italians skillfully advanced two points, Italy intended to repay all amounts it had borrowed and that it would need American help in rebuilding its economy and finances.[262]

Other than the preliminary inquiries described above that had been made of the Commission in mid-1922 nothing more occurred regarding the Italian debt until early 1925. The

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[261] *Combined Reports*, 10; Moulton & Pavolsky, *War Debts and World Prosperity,* 426.

[262] Brian R. Sullivan, "Italian Naval Power and the Washington Disarmament Conference of 1921-1922," in Erik Goldstein and John Maurer, ed., *The Washington Conference,*227-228; Cyril Arthur Player, *Arms and the Men: Intimate Personal Glimpses of Delegates, Attaches, and Unofficial Personages at the Washington Conference on the Limitation of Armament and pacific and Far Eastern Problems,* Detroit, Detroit News, 1922, 63-70.

reason for this hiatus is not clear, but the Commission was busy with other negotiations through most of the intervening period and Italy was enduring the political upheavals that brought the Fascist government to power. In February 1925, the American Ambassador to Italy, Henry P. Fletcher, cabled Secretary of State Kellogg that the new Italian ambassador to the United States had discussed the war debts issue with him prior to departing for Washington. The Italian ambassador, de Martino, said that Italy had no intention of repudiating its debt though the state of its resources and its capacity to pay would have to be taken into consideration. Fletcher also relayed his impression that the Italians might be considering attempting to negotiate simultaneously with the United States and France. Alternatively, they may wait to see the result of the French negotiations before proposing a settlement.[263]

The next Italian overture on the debt issue came in May 1925 in a discussion between the Italian ambassador and Secretary of State Kellogg. The Italian ambassador repeated the thought that it would be best to wait until the French agreement then under negotiation was finalized. He suggested that the settlement with France could serve as a model for one with Italy "but with a margin of difference in favor of Italy." Kellogg replied that the United States "could not recognize this attitude." Any settlement with Italy would be based on the Debt Commission's assessment of Italy's particular facts and circumstances and would not be dependent on any agreement with any other country. Kellogg also reminded the ambassador that Italy had originally signaled an intention to begin negotiations as long ago as 1922. He thought that "the Italian Government should make this pronouncement effective and take up the matter of settlement of the debts without delay."[264] The Italian government eventually accepted the inevitable. On September 2, Ambassador Fletcher in Rome cabled Secretary of State Kellogg

[263] Fletcher to Kellogg, February 16, 1925, *FRUS, 1925, I,* 162-163.
[264] Kellogg to Fletcher, May 8, 1925, *FRUS, 1925, I,* 163-164.

that the Italian Foreign Office had announced the formation of a debt negotiation delegation that would travel to Washington the following month to meet with the Commission. He also offered an assessment of current Italian opinion on the matter. Italian press opinion, he reported, continued to hold that "Italy is not able to pay anything like the sums expected from her, and will not undertake to do so." The Italian view was that the United States must reduce not only the principal on their debt but the interest rate that would be charged on that reduced principal as well. Fletcher believed that "rather than assume [a] burden which they cannot carry," the Italians "will not make any settlement whatever.[265]

Fletcher's warnings notwithstanding, the negotiations with the Italian delegation went smoothly. The first meeting with the Italians consisted primarily of a presentation by its leader, Count Giuseppe Volpi di Misurata, of the current state of the Italian economy and its finances. His presentation demonstrated the extensive and detailed nature of the Italian preparation for the negotiations. The Italian delegation submitted to the Commission no less than 23 separate monographs on various subjects. These included analyses of assorted aspects of Italian national wealth, resources, demographics and war damages, comparisons of economic issues pre-war and post-war and comparisons of Italian conditions with those in other countries. As all of this material clearly demonstrated, Volpi argued, Italy was poor in resources, its population was already heavily taxed, and the country had little reasonable prospect of ever enjoying a favorable balance of trade. Nevertheless, the Italian government was determined to meet its obligations and hoped that the Commission could agree to a refunding plan that would take into account Italy's true capacity to pay.[266]

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[265] Fletcher to Kellogg, September 2, 1925,*FRUS, 1925, I,* 164.
[266] *WWFDC Minutes,* 115-126.

The Commission next met with the Italian delegation on November 4. The bulk of the meeting was taken up by a further exposition by Volpi of Italy's problems and its poverty relative to other debtor governments with which the Commission had dealt. At the close of his presentation he suggested that further analysis and discussion of the data his delegation had submitted might best be accomplished by subcommittees. Mellon agreed and appointed a subcommittee of himself, Hoover, Smoot, and Crisp to meet with the Italian subcommittee the following day.[267] From this point, most of the substantive work toward an agreement was done in the subcommittees.

At its November 5 meeting, Smoot reported on his subcommittee's analysis of the Italian data. While the data showed that things in Italy were not quite as bad as he had expected and that the Italian representatives were confident as to their country's future, "the country was unquestionably poor and the standard of living of its people low."[268] The next day, Smoot reported to the Commission that the American subcommittee had made a refunding proposal to its Italian counterparts. The debt would be liquidated over, not surprisingly, 62 years. Payments on the principal would start at $5 million per year and would increase by $5 million every five years. In the 61st year, the payment required would be $65 million. In the final year, the amount needed to complete the payment of principal would be only $27 million. During the first five years no interest would be charged. In the sixth year, interest would begin to be charged at ¼%. The interest rate would then increase by ¼% every ten years until it topped out at 2% in the 56th year. The result was a proposal much like that for the Belgian post-armistice debt but much more generous with regard to the interest rate charged. The Italians countered with a proposal that was similar in most respects to the American one except that it would extend over 77 years,

[267] *WWFDC Minutes*, 129-134.
[268] *WWFDC Minutes,* 153.

thus requiring slightly smaller annual payments. The Commission discussed the proposals. It was agreed to meet with the Italian delegation November 9, at which time Mellon said he would "suggest to the Italian commission that they make every effort to meet the terms of the American proposal."[269]

The meeting with the Italians planned for the 9th did not, in fact, take place. Instead the subcommittees continued their deliberations. In essence, these meetings involved attempts to close the relatively small gap between each side's payment schedules. At one point, the Italians pushed for a payment postponement provision as included in the British and other agreements. The Americans quickly agreed to a two-year postponement provision with an interest rate of 4¼% on any postponed amounts for any period during which they might be postponed. This process finally culminated in an agreement that was reached at a meeting of the Commission and the Italian delegation on November 12. [270] The agreement provided for payment of the Italian debt over 62 years. Payments on the principal would start out low, $5 million per year for the first five years. In the sixth year they would rise to $12.1 million and rise gradually each following year to slightly less than $81 million in the final year. For the first five years no interest would be charged. In the sixth year interest at 1/8% would be charged, which rate would apply for the next ten years. The rate would then rise in ten-year intervals to ¼%, ½%, ¾%, and 1%, respectively. For the final seven years of the agreement the rate would be 2%.[271]

Neither side appeared to be particularly satisfied with the result. Volpi said that he felt that the agreement still imposed a level of payments beyond Italy's capacity to pay. Senator Smoot said that he anticipated difficulties in obtaining Congressional approval of the agreement. He indicated his intention to do everything he could to secure passage of the necessary

[269] *WWFDC Minutes,* 154-155.
[270] *WWFDC Minutes,* 157-160.
[271] Moulton & Pavolsky, *World War Debt Settlements,* 362-363.

legislation but that he "was afraid that he had gone too far in consenting to the settlement."[272] The agreement was signed November 14, 1925. Despite the misgivings of both sides, the Italian debt refunding agreement was approved by the Congress and signed into law April 28, 1926[273] and ratified by Italy by the law of February 14, 1926.[274]

[272] *WWFDC Minutes,* 165-166.
[273] Public Law 69-155, *U.S. Statutes at Large* 44 (1926): 329; for text of the agreement, *Combined Reports,* 222.
[274] Moulton & Pavolsky, *World War Debt Settlements,* 353.

CHAPTER 12

SETTLEMENT WITH FRANCE - SUCCESS

The failure of the Caillaux mission did not end efforts to reach an agreement on the French debt settlement. Caillaux had instructed M. Lacour-Gayet, the financial attaché of the French embassy in Washington, to continue negotiations with the Americans. These continued both in Washington where Lacour-Gayet conferred with Mellon and Winston, and in Paris where Herrick tried to encourage French officials to consider offering proposals that would be more acceptable to the Commission.[275] Herrick contacted the Commission beginning in late October 1925 to report on the situation in France and to request instructions. In a telegram of October 29, he reported the results of an interview with Premier Briand in which Briand had said that his government would not try to obtain a ratification of the temporary five-year funding plan the Commission had proposed. It was Briand's desire, Herrick reported, that work continue toward achieving a "definite settlement."[276] Four days later Herrick reported the results of conversations with both Premier Painleve and Foreign Minister Briand and asked for advice. Both had stressed their view of the importance to French financial and political stability of reaching a satisfactory agreement on the debts issue. Briand had emphasized that it was "essential" the French "have assurance in advance that their offer would be acceptable before there could be a resumption of official negotiations."[277] The Commission discussed Herrick's telegrams at its November 4 meeting and agreed that "it would be desirable to have the French Government make any proposal it cared to make through the French ambassador at Washington." If the proposal were

[275] Schrecker, *The Hired Money,* 220-221.
[276] *WWFDC Minutes,* 128.
[277] *WWFDC Minutes,* 129.

submitted in this way, "it could be considered entirely informally and the ambassador could be advised whether such a proposal, if formally made, would be acceptable to the commission."[278]

At the Commission's December 1 meeting, Mellon reported that he had received from a representative of the French ambassador an "informal proposal" for the settlement of the French debt. The French were proposing to repay their debt over a period of 62 years. The payments proposed for the early years of the agreement were even less than had ultimately been proposed by the Caillaux delegation before negotiations had broken down. For the first five years the French proposed paying $25 million, as opposed to the $40 million proposed earlier for this initial period. From the sixth to the tenth year the payment would increase each year by $5 million so that by the tenth year the payment would be $50 million. The payment would rise to $55 million in the eleventh year and to $60 million in the sixteenth. Finally, from the twenty-first to the sixty-second year the annual payment would be $110 million. In addition, the proposal contained a payment postponement provision and a safeguard clause similar in form to the one drafted by Hoover during the earlier negotiations. As the Commission was at a critical point in its negotiation of the Romanian debt settlement, it deferred consideration of the French proposal to a later meeting.[279] This consideration took place two days later. The Commission agreed that the French proposal "did not present a satisfactory basis for discussion and that the French ambassador should be so notified by the chairman of the commission."[280]

At this point the French had to consider the implications of the recently concluded Italian refunding agreement. The French could be encouraged by the considerable flexibility the Commission displayed with payment schedules and interest rates. However, if debtors in as dire

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[278] *WWFDC Minutes,*129.
[279] *WWFDC Minutes,* 187-188.
[280] *WWFDC Minutes,* 190.

straits as the Belgians and the Italians could not coax a safeguard clause out of the Americans the French had to accept that they would have to abandon this lynchpin of their position as well.

In late 1925, the French government appointed a new ambassador the United States, Henry Berenger. American officials saw this move as evidence of a serious intent on the part of the French government to conclude a refunding agreement. Berenger was a powerful political figure and had been a member of the Caillaux delegation. Moreover he was considered to be personally committed to securing an agreement.[281] Berenger met with Mellon on January 23, 1926, to discuss the situation. He didn't offer a proposal at that time but did discuss in a general way what the French proposal ultimately would entail. He said that France would be asking for lower payments in the early years of the agreement and higher ones in the later years than had been proposed by the Caillaux delegation. He also said that France would still desire a safeguard clause but would not insist upon one.[282]

Mellon was not particularly anxious to pursue an immediate agreement with the French. He was concerned about first securing Congressional approval of the Italian refunding agreement. As that was encountering some opposition in Congress he felt it best not to draw attention for the present to another potentially contentious agreement. In an effort to slow the pace of negotiations with the French, he asked Berenger to submit information of the type submitted by the Italians as substantiation of their proposal.[283]

The French responded in about a month with a 140-page memorandum, "France and Her Capacity to Pay." Informal talks continued between Berenger and the Treasury Department. By mid-March, agreement had been reached on the terms of an agreement. Nevertheless, the Commission still refused to take up formal consideration of the French proposal until the Italian

[281] Schrecker, *The Hired Money,* 224-225.
[282] *WWFDC Minutes,* 226.
[283] Schrecker, *The Hired Money,* 228-229.

agreement was approved.[284] The Italian agreement was ratified by the Senate on Aril 21. On April 23, Berenger appeared before the Commission to formally present France's proposal for refunding her debt.[285]

The French proposal envisioned payment of the debt over 62 years. For the first five years the annual payment would be $25 million. Starting with the sixth year the payment would increase to $40 million. Each year thereafter the payments would increase incrementally until they reached $125 million in the seventeenth. The payments would remain at that level for the rest of the term of the agreement. The agreement would also include a postponement provision but not a safeguard clause explicit or implied.[286] The Commission discussed the French proposal in meetings on April 24 and 26. While Mellon argued to accept the proposal as presented as the best that could be extracted from the French, Smoot, more attuned to the sentiments of Congress, countered that the early years' payments must be at least $30 million. After further discussion, the Commission accepted a schedule of payments for the first five years of the agreement which provided for payments of $30 million in each of the first two years, $32.5 million in the third and fourth and $35 million in the fifth. Payments in later years would be proportionately reduced.[287] When the total annual payments were allocated between interest and principal in the final agreement, the French received favorable treatment though not quite as favorable as that received by the Italians. No interest was charged in the first five years. For the next ten years the rate was 1% and for the following ten it was 2%. The rate then increased to 2½% for the next eight

[284] Schrecker, *The Hired Money,* 229-230.
[285] Schrecker, *The Hired Money,* 235.
[286] *WWFDC Minutes,* 237-245.
[287] *WWFDC Minutes,* 244-245.

years and to 3% for the following seven. Finally, in the forty-first year it increased to 3½% for the remainder of the agreement.[288]

Berenger and the French government accepted Smoot's payment schedule and the agreement was signed on April 29, 1926. Ratification, however, would be another matter. Berenger felt that French government approval would be quickly obtained. But the French, mindful of how the divided nature of American governmental decision making had led to such disappointment after the Paris Peace Conference, strongly desired to have Congress ratify the agreement first.[289] The House of Representatives acted quickly in approving the French agreement on June 2. The Senate, on the other hand, would not act until the French government ratified the agreement. Although there were expectations of quick action in Paris, the realities of French political instability and widespread opposition to the very idea of the debt settlement delayed final ratification to July 24, 1929.[290] Senate ratification followed with legislation signed into law December 18, 1929.

[288] Moulton & Pavolsky, *World War Debt Settlements,* 373.
[289] See, e.g., Herrick to Kellogg, May 5, 1926, *FRUS, II, 1926,* 92; Herrick to Kellogg, May 6, 1926, *FRUS, 1926, II,* 93.
[290] Schrecker, *The Hired Money,* 365-366.

CHAPTER 13

SETTLEMENT WITH YUGOSLAVIA

The thirteenth and final refunding agreement that the Commission negotiated was with the newly-created country of Yugoslavia or, more officially, the Kingdom of the Serbs, Croats, and Slovenes. The Yugoslavian government had sent a delegation to meet with the Commission early in 1924. It had its sole meeting with the Commission on April 7 during which the Yugoslavs took the simple position that conditions then prevailing in their country were so difficult that it was not possible to consider any debt refunding.[291] It was not until late 1925 that the Yugoslavian government announced that it was sending a delegation to Washington to negotiate with the Commission.[292]

The Yugoslav delegation had prepared thoroughly for their negotiations with the Commission and would prove to be skillful bargainers. Prior to their first meeting they had provided the Commission with detailed statements of the financial and economic situation of their country.[293] At the meeting, on January 27, Dr. M. M. Stoyadinovitch, Finance Minister of Yugoslavia and leader of the delegation, elaborated on the challenges facing his country. Its territory had been thoroughly and continuously ravaged by the war, was virtually devoid of natural resources and industry, had a mostly unfavorable balance of trade, and its people's standard of living was the lowest of all of America's debtors. Nevertheless, Yugoslavia acknowledged her debts to the United States and desired to pay at the very least the principal.[294] Stoyadinovitch then presented Yugoslavia's proposal for refunding its debt. Carefully prepared to emulate the initial articles of the typical refunding agreement, it proposed to repay

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[291] *WWFDC Minutes,* 55.
[292] U.S. legation in Belgrade to State Department, Aide Memoire, December 29, 1925, *FRUS, 1925, I,* 188.
[293] *WWFDC Minutes,* 217.
[294] *WWFDC Minutes,* 218-223.

Yugoslavia's $56 million debt over 62 years. Initially, payments would be very low, starting at $100,000 in the first year. They would rise gradually each year until they reached $2,175,540 in the final year of the agreement. Unlike proposals submitted by other countries, the payments were also allocated between principal and interest. No interest was charged for the first fifteen years. For the following ten years interest at 1/8% was charged. In further ten-year increments the interest rate rose to ¼%, ½%, and 3/4%, respectively. For the final seven years of the agreement it was 1%.[295]

At its meeting the next day, January 28, the Commission discussed the Yugoslavian proposal and decided that it was not acceptable. It was felt that the Yugoslavs should agree to refund their debt "along lines similar to the settlements made with Poland or with Rumania and Czechoslovakia."[296] Refunding on either of these bases would not have been very favorable as the Polish agreement had been drafted on the British model while the others were similar except that they deferred a portion of the early years' interest payments but then capitalized them as additions to the outstanding principle.

The Yugoslav delegation, having been told of the Commission's view by Winston, demanded to argue for their proposal on the basis of capacity to pay, a principle accepted by the Americans in other refunding agreements.[297] They did so at the Commission's meeting on January 30. Dr. D. Diouritch of the Yugoslav delegation skillfully used the precedents of prior agreements as well as statements by members of the Commission to argue that the proposal should be acceptable to the Americans. In particular, he used Mellon's testimony of January 4, 1926, before the House Ways and Means Committee to bolster his case. Mellon had said that a cardinal principle of the refunding agreements required the full payment of principal. The

[295] *WWFDC Minutes,* 224-225.
[296] *WWFDC Minutes,* 226.
[297] *WWFDC Minutes,* 227.

Yugoslav proposal provided for this, said Diouritch. One of the reasons Mellon gave for granting Belgium special concessions on interest rates was that it had been occupied by the Germans for most of the war. Yugoslavia, Diouritch reminded the Commission, had been invaded and partially occupied on three separate occasions by differing combinations of Austro-Hungarian, Bulgarian, and German armies. Referring once again to Mellon's January 4 testimony, he drew attention to Mellon's description of the three "indicia" of capacity to pay that were considered in determining a debtor's capacity to pay. These were, he said, the country's total budget, its foreign trade and its national income. The burden that would be imposed on Yugoslavia by a settlement on the Polish basis would be comparatively far greater than the burden imposed on Belgium or Italy by their refunding agreements. In addition, the burden would be even greater given the substantially lower standard of living in Yugoslavia as compared to either Belgium or Italy.[298]

The Commission's initial response to Diouritch's presentation came in its meeting the following day. Winston was authorized to continue discussions with a subcommittee of the Yugoslavian delegation with a view to securing an agreement on the basis of applying the Romanian settlement to the first seven years of the Yugoslav agreement.[299] To a degree, Winston's efforts bore fruit a week later when the Yugoslavs submitted a revised proposal. It was presented to the Commission at a meeting held February 8. The payments in the early years would be higher, starting at $200,000 in the first year. Significant changes were made to the timing and amounts of interest. The number of years over which no interest would be paid was reduced from 15 to 12. Also, once interest began to be charged the rate would increase at a faster rate and the final rate would be higher. Starting in the thirteenth year interest would be

[298] *WWFDC Minutes,*227-232.
[299] *WWFDC Minutes,* 233.

charged at 1/8%. This would last for only three years when the rate would increase to ½%. Fourteen years later the rate would jump to 1% and three years after that to 2%. In another three years the rate would climb to its final level of 3½% for the remaining 27 years of the agreement.[300]

The Commission deferred consideration of this revised proposal until late April as it was also occupied with the French negotiations. On April 26, Winston reported to the Commission that Dr. Stoyadinovitch had returned to Yugoslavia shortly after the February 8 meeting. A change in government had resulted in him being replaced as Finance Minister. It appeared that the February 8 proposal represented the limit of the Yugoslav delegation's authority.[301] Accordingly, at its final official meeting, on May 1, 1926, the Commission agreed to accept this proposal as a basis for refunding the Yugoslav debt. It was likely, in Mellon's view, to be the best that could be obtained under the circumstances.[302] The agreement was executed two days later on May 3 and approved by the Yugoslav government on June 19, 1926.[303] It was approved by Congress and signed into law on March 30, 1928.[304]

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[300] *WWFDC Minutes,* 265.
[301] *WWFDC Minutes,* 246.
[302] *WWFDC Minutes,* 265.
[303] Moulton & Pavolsky, *World War Debt Settlements,* 374.
[304] Public Law 70-231, *U.S. Statutes at Large* 45 (1928): 399.

CHAPTER 14

DEPRESSION AND DEFAULT

During its tenure, the World War Foreign Debt Commission negotiated refunding agreements with thirteen governments. The Commission did not execute agreements with seven others for a variety of reasons. The short-lived country of Armenia had ceased to exist by the time the Commission began its meetings.[305] Payment of the Austrian debt had been deferred for twenty years by a 1922 joint resolution of Congress.[306] The Cuban, Liberian, and Nicaraguan debts either had been paid or satisfactory arrangements for their repayment were in place.[307] A Greek delegation had met with the Commission in January 1926 in an effort to negotiate a refunding agreement. However, the Greeks' insistence that any refunding agreement include the grant of additional credits made an accord impossible to reach. The Commission claimed it lacked the authority to grant such a request.[308] Greece and the United States continued negotiating through regular diplomatic channels and eventually concluded a refunding agreement in May 1929.[309] Finally, no debt negotiations took place with Russia because the United States had not extended diplomatic recognition to the new Soviet regime.[310]

By one measure, at least, the Commission had been quite successful in affirming American policy regarding the "sanctity" of contracts and the accountability of its debtors. The refunding agreements it negotiated accounted for more than 97% of the total principal amount of the war-related foreign debt held by the United States.[311]

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[305] *WWFDC Minutes,* 62.
[306] Public Resolution 67-46, *U.S. Statutes at Large* 42 (1922): 491.
[307] *WWFDC Minutes,* 49, 64, 65.
[308] *WWFDC Minutes,* 190-217.
[309] *Treasury Annual Report, 1928,* 53-55; for text of agreement, *Treasury Annual Report, 1929,* 50-52.
[310] *WWFDC Minutes,* 66.
[311] *Treasury Annual Report, 1926,* 58.

By another measure, the amount of money actually collected under the refunding agreements, the Commission was far less successful. The British and Finnish governments began making debt payments in 1923. The volume of payments increased throughout the 1920s as additional governments concluded their debt agreements and began to pay on their loans. France, the last country to ratify its debt agreement, was also the last to begin making payments. It made its first payment on December 26, 1929, two months after the Wall Street Crash had precipitated the Great Depression.[312] Despite deteriorating economic conditions, the debtor governments continued to make their scheduled payments through June, 1931, though the form of those payments changed. Because conditions in the money markets had driven up the price of United States bonds to the point where they were beginning to sell at a premium, a greater proportion of the payments were being made in cash than had been the case in previous years. During Fiscal Year 1929 (ending June 30, 1930), only 46% of the payments were made in the form of bonds.[313] During Fiscal Year 1931(ending June 30, 1931), the payments were made entirely in cash.[314] As of June 30, 1931, the debtor nations had made payments totaling $1,671,890,788. Of this amount, only $441,467,076 was applied against the principal balances of their respective debts.[315] This represented a mere 4% reduction of the total debt.

As the economic crisis deepened in 1931, former Commission member and now President, Herbert Hoover, called for a one-year moratorium on debt payments, both of reparations by Germany and of all inter-allied debts. This "Hoover Moratorium" was intended to restore confidence and increase international liquidity.[316] In a statement released June 20, 1931,

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[312] *Treasury Annual Report, 1930,* 76.
[313] *Treasury Annual Report, 1930,* 74-75.
[314] *Treasury Annual Report, 1931,* 79-80.
[315] *Treasury Annual Report, 1931,* 80.
[316] Costigliola, *Awkward Dominion,* 237-238; *Treasury Annual Report, 1931,* 82-83, for text of moratorium proposal by President, *Treasury Annual Report,* 1931, 359-361.

Hoover claimed the moratorium had "the cordial support of leading members of both parties in the Senate and the House." Its purpose was "to give the forthcoming year to the economic recovery of the world." Deteriorating economic and political conditions in Europe had led to "an abnormal movement of gold into the United States."[317] These developments, Hoover said, "diminish buying power for our exports and in a measure are the cause of our continued unemployment and continued lower prices to our farmers."

But while the moratorium would provide a temporary respite from debt payments it should not be construed to be anything more. Hoover went on to reaffirm long-standing American positions with regard to the debts and reparations. Reparations payments by Germany and debts owed the United States were not related. The latter "were settled upon a basis not contingent upon German reparations or related thereto." In addition, he would "not approve in any remote sense of the cancellation of the debts" to the United States. However, it was necessary to acknowledge current conditions. While the debt settlements were based on "the capacity under normal conditions of the debtor to pay, we should be consistent with our own policies and principles if we take into account the abnormal situation now existing in the world."[318]

By July 6, 1931, the Treasury was able to announce that all of the major creditor nations also indebted to the United States had accepted in principle the moratorium proposal. Eventually, all but Yugoslavia agreed to participate.[319] Under the provisions of the joint resolution of Congress that authorized the moratorium debtor nations would be permitted to

[317] According to a Treasury Department analysis of the need for a moratorium these "deteriorating economic and political conditions in Europe" included the failure of the largest bank in Austria, the Credit Anstalt, and an announcement by the German government that the drain on banking reserves threatened the national banking and credit structure, both of which occurred in June. In additional the Bank of England had suspended gold payments the following September, an action quickly followed by other national banks. *Treasury Annual Report, 1931,* 82.
[318] *Treasury Annual Report, 1931,* 359-361.
[319] *Treasury Annual Report, 1931,* 83.

defer any payments under their debt funding agreements that were due during the United States' fiscal year beginning July 1, 1931, that is, Fiscal Year 1932. In turn, they would agree to repay the deferred amounts over ten years at 4% interest with the first payment due during the fiscal year starting July 1, 1933, Fiscal Year 1934. In all, the moratorium allowed the debtor nations to make no payment on their debt during Fiscal Year 1932. During the following fiscal year, Fiscal Year 1933, they would be required to make the payments scheduled for that year under their original debt agreements. Starting in Fiscal Year 1934, they would be required to make not only the normal payments scheduled for that year but also the first of the ten annual payments on the amounts deferred under the moratorium.[320]

The first scheduled payment date following the end of the moratorium was December 15, 1932. As that date approached, many of the governments began to notify the United States that they would not immediately be resuming payments. Hungary, for instance, simply declared that it would not be making its payment of $40,729.35 scheduled for December 15. It lacked the necessary foreign exchange.[321] Others, like Lithuania, asked to postpone their payments.[322] Another group of governments, Britain, France, and Belgium most prominently, pursued a more ambitious goal, a general agreement between the United States and its debtors leading to modification if not outright cancellation of the existing debt agreements.

The British opened their campaign on November 10, 1932. In a note to Secretary of State Henry L. Stimson, Ronald Lindsay, British ambassador to the United States, stated it was the position of his government that "the regime of intergovernmental financial obligations as now existing must be reviewed." Such a review was necessary, he maintained, not only because of

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[320] Public Resolution 72-5, *Statutes at Large* 47 (1931): 3.
[321] Aide Memoire of the Hungarian Minister to United States Government, November 1, 1932, *Treasury Annual Report, 1933,* 247.
[322] Baltius to Stimson, December 10, 1932, *Treasury Annual Report, 1933,* 253-257.

the continuing deterioration of economic conditions but also because of concessions Britain and other "European Creditor Powers" had made at the recently concluded Lausanne Conference. These concessions, aimed at the "ultimate termination of all reparation payments," represented the "maximum contribution in the field of intergovernmental finance which the governments concerned have so far been able to make." It was the "earnest hope" of the British Government, Lindsay continued, "that the United States Government will see its way to enter into an exchange of views at the earliest possible moment." However, the "immediate objective of the present note," he concluded, was "of a more limited nature." In light of the fact that a conference of the sort contemplated could not be conducted in the time remaining before December 15, Lindsay asked that the United States agree to a suspension of Britain's debt payments until its close.[323]

The French also delivered a note on November 10 in large part parroting the British one. The French government was also concerned "with the effect that the problems arising from the intergovernmental debts are having on the world-wide depression." The French government also emphasized the concessions it had made at Lausanne but gave a rather extraordinary explanation for its motive in doing so. It was because it was "certain of being in close accord with the views of the American Government" that the French government "voluntarily agreed to very heavy sacrifices." The French went on to ask the United States to join "in a further study of the debt question." The note closed, as did the British, with a request that France's debt payments be suspended until the requested consultations could be completed.[324]

The Belgians weighed in on November 15 with their request for a suspension of payments pending the convening of the conference sought by the British and the French. In agreeing to the provisions of the Hoover moratorium and the Lausanne Agreements the Belgian

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[323] Lindsay to Stimson, November 10, 1932, *Treasury Annual Report, 1933*, 232.
[324] French Government Memorandum to United States Government, November 10, 1932, *Treasury Annual Report, 1933,* 225-226.

government claimed that it had "consented to make sacrifices which were particularly heavy and which have profoundly affected the financial situation of Belgium."[325]

Stimson responded to all three notes on November 23. In virtually identical language he rejected the Europeans' requests for a general conference and for a suspension of the December 15 payments. Only Congress had the power to agree to such requests and they had shown no inclination to do so. He reminded them of the "historic position" of the United States that reparations were solely a European question. Accordingly, "no inference" could "be intended that the settlement of German reparations at Lausanne" were made "in reliance upon any commitments given by this Government." He also emphasized the unavoidable effect of granting the "concessions" the Europeans sought. "Every such concession'" he said, "would result in the inevitable transfer of a tax burden from the taxpayers of some other country to the taxpayers in our own without the possibility of recoupment from others." In closing, Stimson tried to assure the Europeans that the United States was sensitive to the effects of current conditions. It was "the attitude of the President," he said, that the United States would be willing to discuss the issue with each government separately, but there would be no general conference.[326]

The British and French responded to Stimson on December 1. In notes that were similar in tone and content the two governments repeated the essentials of their earlier arguments but in greater detail. The British attempted to distinguish the war debts from "commercial loans raised by foreign governments in the market for productive purposes." They were "self-liquidating" in the sense that their proceeds are invested in assets or enterprises which generate income out of

[325] *Treasury Annual Report, 1933,* 211.
[326] Stimson to Belgian Ambassador, November 23, 1932, *Treasury Annual Report, 1933,* 212; Stimson to French Ambassador, November 23, 1932, *Treasury Annual Report, 1933,* 226-227; Stimson to British Ambassador, November 23, 1932, *Treasury Annual Report, 1933,* 233.

which the loan is repaid. The war debts, conversely, represented "expenditures on destruction." They generated no income out of which they might have been repaid. The British note also challenged the United States to apply to current conditions the capacity to pay principle it advocated during the original debt negotiations. "The resumption of war debt payments in present circumstances" appeared "altogether inconsistent" with the basic concept of capacity to pay. Both notes closed with requests, once again, that the United States agree to a suspension of the payments due December 15 pending the outcome of a general conference dealing with the war debts issue.[327] A Belgian note of December 6 made similar points and a similar request for payment suspension.[328]

Stimson's replies to this round of notes demonstrated the extent to which the correspondence had degenerated into petty bickering. He replied to the British on December 7. To their complaint that payments on the war debts were creating serious foreign exchange problems he pointed out that between 1924 and 1930 American tourists had spent $3.9 billion in foreign countries and immigrants in the United States had sent some $1.5 billion to their home countries. These amounts, he claimed, far outweighed the $1.7 billion in war debt payments received by the United States during the same period. He also challenged the British assertion that all of the war debts had been made for purposes of destruction. Some of the loans made after the Armistice, he asserted, "were vital to the recovery, and indeed, to the very existence of the borrowing nations." While this statement was accurate in a general sense, it did not apply to the British. Their loans were all made during the war and indeed represented "expenditures for destruction." Nevertheless, Stimson closed on a conciliatory note. Recognizing the difficulties posed by current conditions, he was "confident" that the Congress, whose approval was required

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[327] British Ambassador to Stimson, December 1, 1932, *Treasury Annual, 1933,* 233-240; French Ambassador to Stimson, December 1, 1932, *Treasury Annual Report, 1933,* 227-230.
[328] Belgian Ambassador to Stimson, December 6, 1932, *Treasury Annual Report, 1933,* 213-215.

in such matters, would "be willing to consider any reasonable suggestion made by your Government which [would] facilitate payment of the sum due on December 15th."[329]

Stimson's reply to the French, sent December 8, largely ignored the points detailed in their December 1 note. He repeated assurances that the United States was sensitive to the difficulties with which the French government was contending and that there remained in Washington a willingness to explore any reasonable solution to the payment issue. However, the United States was not willing to conclude that the December 15 payment should be postponed. The amount due on that date, Stimson said, "would hardly seem to my Government to be of disturbing weight or difficulty in respect to world economy or the reestablishment of prosperity." Accordingly, he concluded, payment of the amount due December 15 still appeared "to us to outweigh any reasons presented for a delay."[330] Stimson's reply to the Belgians on December 13 was in much the same vein.[331]

As December 15 neared, various governments began to reveal their intentions with regard to payment. On December 11, the British announced that they would make their December 15 payment. They remained convinced, however, that the pre-moratorium debt structure could not "be revived without disaster" and that "the whole subject should be re-examined." Accordingly, they requested that their payment "not be regarded as a resumption of the annual payments contemplated by the existing [debt] agreement." Rather, it should be regarded as "a capital payment in which account should be taken in any final settlement" of the overall question of war debts.[332]

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[329] Stimson to British Ambassador, December 7, 1932,*Treasury Annual Report, 1933,* 240-242.
[330] Stimson to French Ambassador, December 8, 1932, *Treasury Annual Report, 1933,* 230.
[331] Stimson to Belgian Ambassador, December 13, 1932, *Treasury Annual Report, 1933,* 214-215.
[332] British Ambassador to Stimson, December 11, 1932, *Treasury Annual Report, 1933,* 242-243.

On December 14, the Belgian and French governments announced that they would not be making their December 15 payments. The Belgians cited a lack of capacity to pay under prevailing economic conditions.[333] The French ambassador informed Stimson that the French government had fallen that morning over a resolution in the Chamber of Deputies "inviting" the government not to make the December 15 payment on account of the United States's refusal to participate in a general conference on the war debts issue.[334] The Italian government, the last of America's four largest debtors, announced on December 15 that it would be making its regularly scheduled payment that day.[335]

Of the other debtor nations, Czechoslovakia, Finland, Latvia, and Lithuania made their December 15 payments; Estonia, Hungary, and Poland did not. Romania and Yugoslavia also made no payment but that was because none was due from them on that date. Of the $124,925,422.48 due December 15, 1932 from the thirteen governments with which the Debt Commission had negotiated refunding agreements, the Treasury actually received $98,685,910.68. Of this, Britain paid $95,550,000.00, Czechoslovakia $1,500,000.00, and Italy $1,245,437.50.[336]

Of the seven countries that made no payment on December 15, six, Belgium, Estonia, France, Poland, Romania, and Yugoslavia, would never make another. They would in future years continue to communicate with the United States regarding the debts and attribute their failure to resume payment to various causes such as continuing poor economic conditions or

[333] Belgian Ambassador to Stimson, December 14, 1932, *Treasury Annual Report, 1933,* 215.
[334] French Ambassador to Stimson, December 14, 1932, *Treasury Annual Report, 1933,* 230-231;for text of resolution, 231; for detail on the deliberations of the French government's decision not to pay, see Michael T. Florinsky, "France and the War Debts," *Political Science Quarterly,* Vol. 49, No. 3 (Sept., 1934), pp. 321-346.
[335] Italian Charge d' Affaires to Stimson, December 15, 1932, *Treasury Annual Report, 1933,* 247.
[336] *Treasury Annual Report, 1933,* 28.

their desire to convene a general conference to discuss the debts issue. In practical terms, however, they defaulted on their debts in December 1932.

As economic conditions continued to deteriorate in the first half of 1933 so did the willingness of the debtor governments still paying on their debts to continue doing so. Since the previous December, the British government had been attempting to secure an agreement with the United States for significant concessions on the overall debt situation. The British considered such an agreement an essential precondition to the success of the upcoming London Economic Conference. As of mid-June, the negotiations had yet to yield any positive results due in part to the change of administrations in Washington and the incoming Roosevelt Administration's unwillingness to grant concessions on the scale the British were seeking.[337] In a June 13 note to Acting Secretary of State William Phillips, the British cited these failed negotiations as the reason for their decision with regard to their payment due two days hence. "It is essential to the success of the Conference," the note contended, "that the delegates should not be hampered and harassed by doubts about the possibility of a satisfactory settlement of the war debts." If the British government were to make a full payment it "would inevitably be judged to mean that no progress whatever had been made towards such a settlement and would, therefore, deal a damaging blow at the confidence of the delegates." However, not wanting to be seen "as in any way prejudicing an ultimate settlement" of the debt issue, the British announced that they would make on June 15 a token payment of $10 million "as an acknowledgement of the debt pending a

[337] For details on the British perspective see Self, *Britain, America and the War Debt Controversy,* 161-177; for an American perspective see, Joan Hoff Wilson, *American Business and Foreign Policy 1920-193,* Boston, Beacon Press, 1973, 149-156.

final settlement."[338] Accordingly, on June 15 the British government paid $10,000,518.42 of the $75,950,000.00 actually due that date.[339]

The Italians followed suit in announcing on June 14 that they also would be making only a token payment on the 15th. Instead of the $13,545,437.50 actually due, they would pay $1,000,000.00 "in order to show the goodwill of the Italian Government and at the same time the limitations imposed upon it by the existing situation." Italy, the note concluded, "would be glad to enter upon negotiations" seeking a final settlement of the debt question "at the earliest date convenient to the United States."[340] Czechoslovakia, Latvia, and Lithuania also chose to make minimal token payments for the same reasons, difficult economic conditions and the lack of any progress toward a general settlement of the war debts issue.[341] Czechoslovakia paid $179,914,17 of $1,500,000.00 due, Latvia $6,000.00 of $119,609.00, and Lithuania $9,990.35 of $132,091.00.[342] Of the $143,631,816.85 due June 15, 1933, from the nations with which the Debt Commission had negotiated funding agreements, the U.S. Treasury received only $11,374,097.66. Finland was the only country which made its June 15 payment in full.[343]

The United States's responses to these massive defalcations were generally muted. The State Department acknowledged receipt of the Czech and Latvian announcements of partial payment, informed them the reasons they gave for their actions "have been noted" and repeated the United States's willingness to negotiate with each over the debt issue.[344] The response to Italy was a little sharper in its caution to the Italian government that the relatively small amount

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338 British Ambassador to Phillips, June 13, 1933, *Treasury Annual Report, 1993,* 245-246.
339 *Treasury Annual Report, 1933,* 28.
340 Italian Ambassador to Phillips, June 14, 1933, *Treasury Annual Report, 1933,* 248.
341 Minister of Czechoslovakia to Phillips, June 15, 1933, *Treasury Annual Report, 1933,* 219-220; Consul General of Latvia in New York to Phillips, June 15, 1933, *Treasury Annual Report, 1933,* 252.
342 *Treasury Annual Report, 1933,* 28.
343 *Treasury Annual Report, 1933,* 28.
344 Phillips to Minister of Czechoslovakia, June 21, 1933, *Treasury Annual Report, 1933,* 220; Phillips to Consul General of Latvia in New York, June 21, 1933, *Treasury Annual Report, 1933,* 252.

of its June 15 payment compared to that actually due "may be regarded in the United States as unsubstantial, and may occasion disappointment on the part of Congress and the American people."[345] The response to the British note of June 13 also required something more than mere acknowledgement. Speaking for President Roosevelt, Acting Secretary of State Phillips said that while the President noted the British "characterization" of the circumstances surrounding its partial payment "he, by no means, concedes some of the statements concerning the worldwide economic cause and effect contained in His Majesty's Government's communication." Phillips also included a reminder that Congress controlled matters relating to the renegotiation of debt terms.[346]

The British continued to try to bring the Americans around to their view of the need for a general revision if not outright cancellation of the war debts. The two sides negotiated through the fall of 1933 with little success. Willing neither to openly default nor to make the full payment due December 15, the British secured the assent of President Roosevelt to make another token payment, this time of $7.5 million. This decision was announced in a joint statement of the President and the Chancellor of the Exchequer released November 7.[347]

Within a few days, other countries began to announce their intentions regarding their December 15 payments. On November 22, Latvia advised the State Department that it would be making a token payment of $8,500, which was somewhat higher than the $6,000 it had paid the previous June.[348] Italy followed on December 7 with the announcement that it would replicate its June payment of $1 million.[349] Two days later, Czechoslovakia announced that it would pay

[345] Phillips to Italian Ambassador, June 17, 1933, *Treasury Annual Report, 1933,* 248.
[346] Phillips to British Ambassador, June 14, 1933, *Treasury Annual Report, 1933,* 246.
[347] *Treasury Annual Report, 1933,* 246-247.
[348] Latvian Minister of Foreign Affairs to American Charge d' Affaires in Riga, November 22, 1933, *Treasury Annual Report, 1934,* 234.
[349] Italian Ambassador to Phillips, December 7, 1933, *Treasury Annual Report, 1934,* 233.

$150,000, an amount smaller than the $180,000 it had paid in June.[350] In a twist, Hungary, which had made no payments in a year, announced that it would resume payments in a manner of speaking. It would on December 15, it said, "deposit to the foreign creditors' account at the Hungarian National Bank, a Hungarian Treasury Certificate in the pegno equivalent of the dollar amount due." That certificate would pay interest at 2% per year. In effect, Hungary was converting the currency in which its debt to the United States was payable from dollars to its own currency, the pegno.[351] Finally, Finland reported that it would be making its December payment in full.[352]

In April 1934, the Congress of the United States acted in a manner to ensure that the debtor nations would never pay any of the amounts remaining due on their debts. Prodded by Senator Hiram Johnson of California, it passed an act "to prohibit financial transactions with any foreign government in default on its obligations to the United States." Under the provisions of this capital embargo it became illegal to buy or sell the securities of nations not current on their debts or to extend them loans. Violations were punishable by fines of up to $10,000 and imprisonment not to exceed five years.[353] The debtor nations were now deprived of the one significant benefit that had been promised them when they had signed their debt agreements, access to American capital markets. Johnson's legislation effectively denied this access not only immediately but for any foreseeable time to come. The debtor nations, many of which had not made a payment on their debts since June, 1931, would have to make all of those back payments before they could borrow in the United States again. Under the prevailing conditions, that was an impossible task.

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[350] Minister of Czechoslovakia to Phillips, December 9, 1933, *Treasury Annual Report, 1934,* 224.
[351] Hungarian Minister to Phillips, December 12, 1933, *Treasury Annual Report, 1934,* 232.
[352] Department of State press release, December 14, 1933, *Treasury Annual Report, 1934,* 226.
[353] Public Law 73-151, *Statutes at Large* 48 (1934): 574.

British default was now inevitable, and it came quickly. In a lengthy note of June 4 to Secretary of State Cordell Hull, the British government reprised all of its well-oiled arguments supporting a call for a general conference on the war debts question, to which it now added a criticism of the capital embargo legislation. Reaching all the way back to the Balfour Note of 1922, the British government argued that requiring it to bring its payments up to date and to continue them "would necessitate a corresponding demand by His Majesty's Government from their own war debtors." Such action "would be a re-creation of the conditions which existed prior to the world crisis and were in a large measure responsible for it." The result would be "a bombshell [thrown] into the European arena which would have financial and economic repercussions over all five continents and would postpone indefinitely the chances of world recovery." Accordingly, the note concluded, the British Government would suspend further payments until it was "possible to discuss an ultimate settlement of intergovernmental war debts with a reasonable prospect of agreement."[354] The other nations that had been making token payments on their debts, Czechoslovakia, Italy, and Latvia, quickly followed Britain in announcing that they would no longer do so. In their notes, Italy and Latvia pointed specifically to the capital embargo legislation as the factor that rendered pointless any further partial payments.[355]

The American debt policy and the agreements it had engendered now lay in ruins. The embargo legislation had forced the debtor nations into default and none of them that had stopped paying by June 1934 would ever pay another dime toward their debts. But the cost suffered by the United States ran to more than money lost to the Treasury. The lingering animosity among the Europeans, particularly the French and the British, toward the American insistence on the

[354] British Ambassador to Secretary of State Cordell Hull, June 4, 1934, *Treasury Annual Report, 1934,* 227-230.
[355] Italian Ambassador to Hull, June 14, 1934, *Treasury Annual Report, 1934,* 233-234; Consul General of Latvia in New York to Hull, June 13, 1934, *Treasury Annual Report, 1934,* 235.

"sanctity" of contracts and refusal to modify those contracts in the light of deteriorating economic conditions often hindered the ability of the various countries to work together in the years leading up to World War Two.[356] The debtor nations, on the other hand, achieved their long-sought objective of cancellation by the simple expedient of voting with their financial feet.

After June 1934, only two countries continued to make any effort to comply with their debt agreements. For a time, Hungary continued to deposit its pegno-denominated Hungarian Treasury Certificates in the foreign creditors' account at the Hungarian National Bank. In December, 1937, it changed to making a partial payment of about $9,800.[357] These payments continued until Hungary entered World War II as a member of the Axis. Finland, unique among the governments with which the Debt Commission had executed agreements, continued to make its scheduled semi-annual payments throughout the 1930s and ultimately achieved a measure of notoriety as the only country to retire its entire debt.[358] And it is instructive to note the reaction of the United States when the Europeans once again needed massive assistance to defend themselves against German aggression. Instead of issuing credits requiring later repayment, the United States, through the artifice of Lend-Lease, committed its resources to a common effort to defeat a common foe.[359]

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[356] See, e.g., Dyer "The British War Debts and the Anglo-Japanese Alliance," 594-595; Self, *Britain, America and the War Debt Settlements,* 197-214.
[357] Hungarian Minister to Hull, December 15, 1937, *Treasury Annual Report, 1938,* 288.
[358] Charles P. Kindleberger, *A Financial History of Western Europe, Second Edition,* New York, Oxford University Press, 1993, 299.
[359] For a contemporary view of Lend-Lease see Edward R. Stettinius, Jr., *Lend-Lease, Weapon for Victory,* New York, Macmillan Company, 1944.

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