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See Democratic Party

May 12, 1937.

9:18 a.m.

H.M.Jr: Hello

Operator: Senator Bulkley. Go ahead.

H.M.Jr: Hello

Bulkley: Hello

H.M.Jr: Good morning Senator.

B: Good morning, Mr. Secretary, how are you, sir?

H.M.Jr: Oh I'm fine, I had a good week and the only trouble with it is it makes me feel as though I want to go away again.

B: Well I suppose that gets us going, doesn't it?

H.M.Jr: Ah - last night - ah - I got the report from Cleveland - the agent just sent it in to me last night so my being away didn't delay the matter any.

B: Yes.

H.M.Jr: Now, at your convenience, I'd like to talk with you again.

B: All right - ah - let's see - I - I - sometime this afternoon would be good. How does that strike you?

H.M.Jr: Well, unfortunately, I've got the Brazilian Ambassador on for a big conference this afternoon.

B: Well maybe tomorrow morning would be the best.

H.M.Jr: Ah - the fact that he is coming is confidential but I tell it to you.

B: Oh I'm all

H.M.Jr: Now the only appointment I have tomorrow morning is 10:30 Press which lasts about 15 minutes.

B: Yes.

H.M.Jr: So anytime tomorrow morning except from 10:30 to 10:45.

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B: Well I think maybe this following night would be as good as anything.

H.M.Jr: All right.

B: Can you indicate in a general way what you've done?

H.M.Jr: Ah - well - ah it's kind of a long story.

B: Too much to tell me over the 'phone and give me an intimation?

H.M.Jr: A little bit too much.

B: All right, I'll wait till tomorrow morning.

H.M.Jr: If - if you don't mind.....

B: O.K.

H.M.Jr:and is 11 o'clock alright?

B: Yes, that's fine.

H.M.Jr: And - ah - .

B: O.K. that will be fine.

H.M.Jr: Thank you.

MEETING RE TAXATION AND "HOT" MONEY

May 12, 1937
9:30 A.M.

Present: Mrs Klotz
Mr. Magill
Mr. Oliphant
Mr. McReynolds
Mr. Gaston
Mr. Lochhead
Mr. Taylor
Dr. Viner
Mr. Haas
Mr. Bell

H.M.Jr: Wayne, what's the nearest dock to your place?

(Conversation with Taylor on this matter
written up separately) (p. 25)

The reason I've asked this particular group is I just want to sort of check - I mean back a few days, and I thought I'd want to let you know what's going through my mind and then - so we can all be more or less thinking about the same thing and working along the same lines.

Now, there are several things which I've got which I'm concentrating on, and I want to tell you we're back again on hot money, and I feel that once and for all we ought to decide whether we can or cannot solve that problem. And I'm very much encouraged on the work that's been going on; I think that we can. Now, Magill has worked out this idea that - taking the aliens....

(Bell comes in)

Hello, Dan.

Bell: Good morning.

H.M.Jr: I didn't know whether you were coming, but I asked particularly to have you come because I wanted you to know what I am doing.

Bell: I didn't; I intended going to the Secretary of War for a conference.

H.M.Jr: Well, walk out whenever you....

Well, let me just do this a minute while Bell is

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here. I'll switch. I'll come back to hot money. The rest of my brain - I made a discovery which everybody else may know but I didn't know it - we'll come back to hot money - and that is this: that the first four months of this year, out of the emergency expenditures, that is, all emergency agencies out of the 1935 and 1936 Act - the first four months of this year spent 856 million dollars as against last year spending one billion, 160, or a decrease of 26 percent. Now, that just hasn't registered, Herbert, with anybody. I mean if you ask anybody. Taking all of the emergency agencies, how much they've spent - they've spent 26 percent less the first four months of this year than last. Now, it just hasn't gotten across.

Oliphant: Everybody thinks it's the other way.

Bell: I'd be a little careful of....

H.M.Jr: Well, it's true, isn't it?

Lochhead: Wasn't the CCC swung to a regular appropriation?

Bell: CCC, yes; I'd check up on that.

H.M.Jr: All right, well how much? Can you give me how much?

Bell: Yes, sir.

H.M.Jr: The figure I got here, out of your book, is 856 for the first four months last - this year, and the other is 1,160. Now, how much of that has been shifted?

Bell: Well, CCC is about the only one, but it's been shifted.

H.M.Jr: What?

Bell: Had good roads and rivers and harbors running out of emergency money and going onto regular money too. That started in 1935.

H.M.Jr: Well, can you bring in a report at 9:30 tomorrow on that?

Bell: Yes, sir.

H.M.Jr: Here's the thing, Herbert (showing book of figures)

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Gaston: Yes, I have a copy of it.

H.M.Jr: Well, anyway, I'd like to know what that is, because - Dan - because the other thing which you get is this: that this first four months of the Hopkins expenditures - well, - well, I can't - well, anyway Hopkins spent in March 144 million as against last March 132.

Bell: Right.

H.M.Jr: Which all bears out - I want to just take a minute on this thing - that the Hopkins organization is the only organization in Washington which is cutting down expenditures at all and all the other "fat cats" are going stronger than ever.

Bell: That is probably true.

H.M.Jr: Well, I - I - it comes back, it just bears out what I have been saying right along and I say in this group here that I am not sure, Dan, that before we get through we may not have to do what Cliff Woodrum has asked us to do, and that is to reallocate on all these things, if we're really going to save some money. I know it's a terrific blow on you personally, and as I say, this isn't a regular 9:30 group, if you look around, and I'm just raising it here. Because if we're really going to balance this budget and not take it out of the hide of the unemployed, I think we've got to take it out of some of the regular departments.

Bell: Well, that is where your 418 will certainly come from.

H.M.Jr: Or out of some of the emergency agencies other than Hopkins'. What I'd like to do is talk to you when you have - want to make an appointment with me for Friday, just you and I go into the thing?

Bell: Be glad to.

H.M.Jr: That give you enough time?

Bell: Oh yes.

H.M.Jr: That gives us a chance before the President comes back. How would 10 o'clock Friday morning suit you?

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Bell: All right.

H.M.Jr: What? Half an hour?

Bell: It's all right.

H.M.Jr: You stay now as long as you feel you can. What time is your appointment?

Bell: 10 o'clock.

H.M.Jr: I wanted to get that over. What?

Bell: All right.

H.M.Jr: Because - well, you - everybody gets what I'm thinking about.

Oliphant: It's a swell attitude.

H.M.Jr: What?

Oliphant: It's a swell attitude.

Bell: President sent a message to Wallace to be thinking about flood control, so that he'll have a conference over the weekend. His message wasn't quite clear as to what it meant. They're having a conference this morning at 10 o'clock in the Secretary of War's office to try to determine whether or not he meant he could allow more than is in the Budget, so they asked me to come over, and I've told them that certainly I cannot go along with any more money for flood control.

H.M.Jr: Well, this is pure guess, but Upham sent in a letter that somebody saw the President.... Upham saw Hecht in New Orleans, who saw the President, and he said the President pounded the desk and got terribly excited about balancing the budget. Hecht rode with him for some distance and came back very enthusiastic about the prospects of balancing the budget. I just throw that in.

But if you and I can have a half hour Friday, just sort of see where we're at - huh?

Bell: All right.

H.M.Jr: O.K.

Now, on this hot money thing, coming back again, Magill is developing this thought - and listen, I want this extra-confidential - now, the idea that we'll slap on the alien a 35 percent withholding tax and then make him file a return showing just what his income is from the United States, and then we'd apply to this fellow - if I'm not explaining it correctly.... - the same taxes that any United States citizen has to pay; if it is less than 35 percent, he will immediately get a refund. And on this return he will also have to - both he and the American will have to put on who the lawyer was and who the accountant was who helped advise him. Huh?

Magill: (Nods yes)

H.M.Jr: But he's presented this thing - have I put the idea correctly, briefly?

Magill: Only one thing I'd add; we're going to also tie up his return in such a way that he will have to report his capital gains if he wants to get any refunds, and have to show brokers with whom he dealt and give transcripts of his account with the brokers.

H.M.Jr: Now, Mr. Hull has approved this, where he didn't approve the other thing. And you have seen - and I want to get this thing straight. I had a talk yesterday - I had a record made - with Mr. Hull. Mr. Hull has asked us to let the Canadian thing go through because MacKenzie King is supposedly - this is all very confidential - a mouthpiece of the United States Government at the Empire Conference and we need his vote, and he is ready to go to the front on the trade treaty representing the United States, the President, and Mr. Hull at London. Mr. Hull explained to the Canadian Minister that we would let the Canadian five percent tax thing go through, but with the definite understanding that our hands were not tied and that next week we may introduce a bill which will be for the whole world along these lines, and the Canadian Minister said, "That's all right, but our Parliament has ratified it, the President has given his word, you've got to go through," and, as much as to say, "if you don't, we won't go through

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for you at London."

But Mr. Hull has gone personally and assured me that we can introduce any legislation we want next week and that in no way are our hands tied. So on that basis I will - I have a call for Key Pittman; he's out of town; I'm going to tell him. But when I tell Key Pittman that I'm giving him the green light on this thing, I'm also going to tell him that any day the Treasury may have recommendations on aliens and I want him to know it. And I told Mr. Hull that I was going to tell that to Pittman. So we're all right on that. But I mean I want to bring everybody up-to-date.

O.K., Wayne?

Taylor: (Nods yes)

H.M.Jr: Now, there's two things in this thing. There's this one thing that Magill is working on. Then the other thing, which I thought that you (Taylor) want to carry the ball on, is this question of foreign balances. Have we the necessary power to license, see? Which I understand is Oliphant's brain child; at least that's what I understand, anyway. Have we the necessary power? Do we need any additional legislation or not, see? And how would we perform, see?

Now, what I'm - the people in here, I mean, so that everybody is working together - now, those are the two things, the way I see it, as of this morning.

Now, Jake Viner said, "Well, what's that got to do with gold?" I said, "Nothing. All it does is to give us a - six months to turn around in and think the gold thing through." And on that basis Jake is satisfied. Right?

Viner: Oh, I'm satisfied. I think it is a move in the right direction. But the question I really asked is, who would take the gold if we keep it out, what would happen then? And I don't think we can accurately foresee that. I don't think this is a fundamental solution of the problem, but it is a dam for the time being.

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Haas: Takes us off the spot.

H.M.Jr: What?

Haas: Takes us off the spot.

Viner: Yes.

Oliphant: Well, it puts somebody else on the spot, which is all to the good.

Viner: I think it's all right as preparing the way to a fundamental solution.

H.M.Jr: Now, Jake very much objected that we put anything in the hopper that would affect financial things for the time being, with our financing coming; and, fortunately, Mr. Magill advises me he can't possibly be ready until after the first of June.

Viner: I'd keep it awfully secret until then, because the market is sick and nervous and it's not the right time.

H.M.Jr: Well, you cautioned, didn't you - I cautioned Eccles, you cautioned....

Oliphant: May I ask one question?

H.M.Jr: You may ask one and a half.

Oliphant: Has it been talked over with Feis?

H.M.Jr: Yes.

Magill: Yes.

H.M.Jr: Am I right?

Magill: Right, yes. Twice.

Oliphant: Twice with Feis.

H.M.Jr: And I personally with Hull.

Oliphant: And Feis has agreed to it?

Magill: I talked it over with Feis and he said he couldn't

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see anything wrong with it, and he talked it over with Hull and Hull was satisfied.

H.M.Jr: And then after that conversation I talked to Hull and he said it's all right.

Haas: Is the rate on that a fixed proposition, or is it subject...

H.M.Jr: No, it's the principle - just the principle.

But I just.... Now, on top of that... Before I leave that, anybody want to raise any question?

Haas: Well, I've got just this one question. I don't think we should refer to this as a solution of hot money. I think it has become more now the question of this gold inflow.

H.M.Jr: Oh no, we just take the flag and wave it, you see, and say, "Why shouldn't an alien pay as much as a United States citizen?"

Haas: Oh, I think that's the way to present it, but within our own minds I think we should think in terms of the gold proposition.

Oliphant: (Asks question drowned out by Haas' last words)

H.M.Jr: No.

Oliphant: No?

H.M.Jr: I know; I want to explain something.

Magill: When he went up he brought back a lot of loopholes that are loopholes.

H.M.Jr: And I'm glad you raised that question. I mean I want to get it all out. I don't want to - for instance, today we could introduce legislation, we could take care of the so-called incorporated pocketbook which they use; but how can I say to Pat Harrison, "You make the corrections A, B, C, but I won't let you do D, E, and F"? And how can the President of the United States do what he said he was going to do, send up this message? He asked us to write a message when two weeks ago, in his budget message, he said we wouldn't be ready until November. Now, am I thinking straight?

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Therefore, I say we've got to do it on the basis of not loopholes or anything else, but on the basis of Americanism, and that we want to take care of that foreigner, see?

- Oliphant: Well, or that the loophole thing is coming - going to come in installments and this is the first installment.
- H.M.Jr: Herman, I can do no more - just as soon as I go beyond the foreigner, then Mr. Harrison has got to immediately introduce the thing - the question of incorporated pocketbook and a capital gains tax, and the fat's in the fire. Now, I'm willing to lose whatever revenue is involved in incorporated pocketbook and this other thing for this year, because I think it is more important that when we hit this thing in November we hit it right.
- Viner: Can you take this thing out of the income tax and call it an excise tax?
- H.M.Jr: Now just let me finish this. Let me - hold your thought.and hit this thing and confine it to this business.
- And, to answer George, what we're trying to do is in order to give ourselves a breathing spell to handle this gold thing, see? I mean with my own crowd I want to be entirely frank. But I've got to confine it to the alien who has investments here in the United States and the United States citizen who sends his money abroad. I think I can hold it down to that. If I go beyond that, we're going to have a 1937 tax bill, and how the heck can the President have that after his message? What?
- Bell: He can't.
- Gaston: They'll take this as your hot money plan and that's all right, because you've already said that - made that an exception.
- H.M.Jr: Well, also, the President announced last November....
- Oliphant: Well, if you handle it on that basis, I don't see that this action, if you handle it on the basis of

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secret executive session - just keep your meeting, say, stabilization - very confidential.

H.M.Jr: But I want to explain why I want to confine it to this; because otherwise we'll be here all summer, and we're not ready yet for a new tax bill; I'm not ready and I won't be ready 'til next fall.

(On phone) Hello? Pardon me? Yes.

I don't know whether you (Taylor) saw that thing in the cable, but the French would only buy Russian gold if the Russians would spend the money in France.

Taylor: (Nods yes)

H.M.Jr: That's a new kind of gold standard?

Bell: Good, isn't it?

Haas: Yes. Not so dumb either.

H.M.Jr: (On phone) Hello, Mr. Cochran. (Conversation with Cochran, recorded 9:50 A.M.)

No, I just wanted to give all of you a little chance - to tell you how I was thinking so we'd all be working together, and I think that that covers the thing.

Now, who wants to ask me questions?

Haas: I've got one other. I think you appreciate this, but I'm not sure that the.... On the estimates for '38, I have a suspicion that there's been a much greater use of old loopholes, not new ones, because of the terrific pressure on account of the increase in taxes, both as to rates and as to the amount because of the increase in business; and that the estimates, even though they are reduced on a current March collection basis, on a last March collection basis may not be met, because I think this pressure will continue and I think the loopholes will become wider. I'm referring to old loopholes, not to any new ones in particular.

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H.M.Jr: And so what?

Haas: Well, I just wanted you to understand that by not doing anything about them now we may be up against a difficulty on it with regard to collections in '38.

H.M.Jr: Well, you're - but all right, do you recommend that I introduce - recommend legislation at this time to correct these things, at this session?

Haas: Oh, I appreciate the difficulties.

H.M.Jr: No, do you? I mean which is more important? Don't put me on notice that your revenue is going to be less in March. I say to you, do you think it is more important to get the revenue and have a tax bill now?

Haas: No, I think I'd - well, I - I don't.....

H.M.Jr: Well, the answer is "yes" or "no".

Haas: I think it depends on how much importance you attach to balancing the budget; it may mean balancing the budget or not.

H.M.Jr: Listen, you're saying - you put me on notice that you told me on May 12 that my revenue in March is going to be less than it might be. Now, I say to you, do you think that that is sufficiently important that I should recommend to the President that he recommend to Congress that we should close those things, if you know what they are?

Haas: I'd say if you knew what they are I think you could put a bill in now on major loopholes.

H.M.Jr: Do you know what they are?

Haas: I know quite a list of the old ones, but I don't know the answer - I mean how to cure them.

Oliphant: Well, can I ask this....

H.M.Jr: Well, let me just get this. I mean after this.

Oliphant: All right.

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H.M.Jr: Then I tell you (Haas) what you do.

Haas: There's books written on it now; you can go right down the....

H.M.Jr: Now listen, I'm a practical fellow. You put in writing what those loopholes are and how much we're going to lose.

Haas: That's impossible. I can tell you what some of the loopholes are, but how much we're losing - well.....

H.M.Jr: Well, tell me what they are. I'd like to get a letter from you.

Haas: O.K. Be incomplete, but rather long list.

H.M.Jr: And - all right, you give me a letter.

Haas: Uh-huh.

H.M.Jr: But serving notice....

Haas: Oh no - oh, I'm not trying to serve notice; I just want to make sure that you are informed. In other words, I want you to have what is in my mind. I wasn't trying to make any record of this. In fact, I'd prefer to have the record torn off.

H.M.Jr: No, it's my - this is my record. But put it in writing.

Haas: Glad to. I didn't want to do that; I'd rather just give it orally.

H.M.Jr: I don't want it orally; I don't want it orally. Because if there is - if it's going to run, say, several hundred million dollars, then maybe we'll have to have.....

Haas: Crum feels very strongly about this same point.

H.M.Jr: All right. But give it to me very soon. If it is sufficiently important and it may run up to several hundred million dollars, maybe that is important; but if it is a matter of a few million dollars, I'd say no.

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- Haas: Oh, it's much more.
- H.M.Jr: I mean if it is something - if it happens there is a possibility of being much more than just a few millions. Because if it is big enough, then you ought to revise your next year's estimates.
- Haas: It's a type of thing that you can't measure.
- H.M.Jr: Well then, what good are your estimates for next year?
- Haas: Well, you can't - you have to make some assumptions with regard to estimates.
- H.M.Jr: Well, what it boils down to, George, is: are your estimates, the way you have given them to this office, for the year '38 - '37-'38 - do they stand or do you want to revise them? Now, we just sent up a new group of estimates.
- Haas: Well, I'd like to have a chance to talk that over with you.
- H.M.Jr: Well, you just gave us a new group.
- Haas: I know, but you can't guarantee those.
- H.M.Jr: Well, do you know something since that time - just two weeks?
- Haas: No, no, we don't. In fact, I didn't think we were justified in reducing them at this time any lower than the March experience. But we all know that if there are loopholes, they become wider as the pressure goes on.
- H.M.Jr: But I say if you want to revise your estimates that you gave Magill two or three weeks ago - I think that's a pretty important thing.
- Haas: I wouldn't want to revise them.
- H.M.Jr: Well then, what do you want to do? What's the point?
- Haas: Well, I -because the estimates were made up on certain assumptions, and I thought you were aware of them, and this was one of the assumptions which I

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wanted to lay out, so you'd understand the estimates. Each time we make estimates, we make them up on the basis of certain assumptions, and I'd be glad to go over with you the assumptions which we make at the time we are making the estimates.

I'm not alibiing; all I'm trying to do is protect you. I might as well explain it now as next March.

H.M.Jr: Well, the time to explain it was when you gave us the revised estimates.

Haas: I thought we did.

H.M.Jr: Well, if you did, there's nothing to worry about.

Haas: Well, I think it isn't a question of personal responsibility. I think the result is the most important thing. Even if I did explain and they were down, I - I don't think that's important.

Gaston: Isn't the question this, Mr. Secretary: Has Mr. Magill discovered some loopholes which resulted in, let us say, a trickle of loss of revenue this year, but promises next year to widen a great breach in the revenues?

H.M.Jr: Well, he can answer that for himself.

Magill: Well, I would - speaking generally, I'd say no; that, in so far as my investigation showed, there were comparatively few loopholes, if any, so far disclosed, that we didn't know about before. There are some.

H.M.Jr: Well, we've been all over this.

Magill: Yes, we've been all over this.

H.M.Jr: We've been all over this. I can answer that. These things - incorporated pocketbook - I asked Magill this very question and his answer is that it isn't important enough to recommend to me that I should recommend to the President we should have a new tax bill.

Haas: Well then, the estimates will hold up; but if he's wrong, well then, they won't; that's the thing.

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H.M.Jr: Well, we've been all over this thing. I've discussed this thing and that is one of the things I wanted to bring up this morning; and that is, as a matter of policy, after Magill's trip, he and I didn't feel there was anything which was sufficiently important to say to the President, "Go ahead with your idea, with a message to Congress at this time, and have a tax bill now."

Is that right?

Magill: That's right.

H.M.Jr: Is that right?

Magill: That's right.

H.M.Jr: And it was much more important to wait until the job could be done properly.

Magill: The items on which we are losing large amounts of revenue at the present time are not, in my opinion, those things that can properly be called loopholes, and they are clearly matters that you're going to - if you present them to Congress at this time, you're going to have a tax bill that will take you months.

H.M.Jr: But I just want to say that I'll give you (Haas) a chance - now the situation this year is different than last year - and if you've got something that's wrong - last year I didn't have Magill; he's here now - you go and tell him what's worrying you, see? Will you please?

Haas: Sure. I've already talked to Ros.

Magill: Well, if you present a new idea today of having a long list of loopholes on which you think we're going to lose large amounts - now, if you have, for heaven's sake give them to me, because that's what I've been wanting to know and what I've been working on.

Haas: Well, I...

H.M.Jr: Did you (Haas) hear what he said?

Haas: Yes.

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Haas: Yes

Magill: I mean don't.... Something you said a minute ago that bothers me, that you hang all this on me.

Haas: I'm not trying to hang it on, but I want everybody to...

Magill: What I am saying - let me say it now, once and for all - if anybody in this room has any idea about any loopholes or any matter of revenue loss, for good heaven's sake come in with them, and don't tell me three or four months from now that there were a couple things I overlooked that I would have known about if I was bright.

H.M.Jr: I want you (Haas) to write it up and I want a list of those for myself and for Magill.

Magill: Yes, I want that too.

Haas: I didn't want to hang it on to anyone. I'm always on the spot anyway, so I'm glad to stay on the spot.

H.M.Jr: No, George, don't say that, for God's sake, because I'm the one that is on the spot and you haven't been on the spot.

Haas: All right.

H.M.Jr: There's been no public criticism on.... What you talking about, being on the spot? You haven't been.

Haas: O.K.

H.M.Jr: Don't say that.

Haas: I didn't say.... I mean inside here.

H.M.Jr: Don't say you're on the spot. You're alibiing yourself.

Haas: No, I'm not; I'm willing to put it in writing, Mr. Secretary.

H.M.Jr: All right, put it in writing. But where have you been on the spot? Has there been anything written on it or anything in Washington that says George Haas.....

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- Haas: Ros said if anybody had any ideas - well, I've already told him about these things.
- H.M.Jr: My God, don't say that, because you haven't been. I mean everybody.....
- Haas: I know it and I appreciate it. I apologize for that. It wasn't.... I appreciate that.
- H.M.Jr: The President has been, I consider, most generous with the Treasury in his attitude, and certainly if he is generous nobody in this room can say I haven't been equally generous; and I make mistakes every day and I hope I continue to, and everybody does. But I never come around and say, "You made a mistake and it's your fault." I've never done that. Now, if you've got something, give it to all of us.
- Haas: But the reason I said - I hesitated bringing this up this morning, but I think I'm bringing it up for the good - for your information and Ros's information, for all the good of the group.
- H.M.Jr: Then for the good of the group, write it up.
- Haas: That's right, I'm glad to do it. But I'm not - I don't want - I know you don't want to sit back and take it easy just for fear we might hurt somebody's feelings or something.
- H.M.Jr: I don't know what you mean by that. I don't know what that means.
- Haas: Well, this matter - I'd be much better off if I kept my mouth shut, but I don't think the Treasury would be.
- H.M.Jr: I don't see why. I don't know whose feelings you refer to. I don't know whose feelings you're referring to.
- Haas: Oh, it's all right; I'll write it up as best I can.
- H.M.Jr: And why wait for a meeting like this? I mean if you've got something, why wait for a meeting like this?

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Haas: Well, you just were raising these questions, telling us how you thought about these things, and I wanted to be sure in your own mind that you had a full appreciation of this fact. Crum's been talking to me about this day after day, that these things - that these estimates - he's gone over them and he feels some responsibility for them, but he says, "I hope the Secretary appreciates that these old loopholes still exist and may be much wider in '38, and nobody can anticipate what might happen."

Magill: You come right back to where you started. What we very much need from both you and Crum is a list of what these loopholes are. I mean it doesn't do us any good to talk in general that there are some loopholes. Now, if you've got a list of them or Crum has a list or anybody else has a list, why, let's have them right away, so that we can make our calculations.

Haas: I don't say it will be complete, but I'll give you a list.

Magill: I don't care whether it's complete; I'd like to have it.

Haas: We haven't really been studying the returns. I didn't know that that was our responsibility on it. But nevertheless, we have.....

H.M.Jr: Well, let's - whatever you and Crum know that has to do with the next fiscal year's revenue, let's have it.

Haas: That's what I've been trying to give out today.

H.M.Jr: I know; let's have it in writing.

Haas: O.K.

H.M.Jr: O.K.?

Haas: Fine.

H.M.Jr: All right. Now.... (nodding to Oliphant)

Oliphant: Thank you.

H.M.Jr: You're welcome.

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Oliphant: I intended today to formally give you a report of a more formal, elaborate examination that I have been making of the 1936 Tax Act, which would show that there are no substantial loopholes in that, and that the general picture is this: We have some old - so-called old loopholes, and it's the pressure of higher rates against the old loopholes that is probably the one most important factor in what happened in March.

The second thing I wanted to point out was that, counterbalancing the possibility of those loopholes becoming wider is the fact that it will be of tremendous importance - I mean the country knows that the Treasury is embarking upon a much more vigorous program of tax collection - Magill's trips - those things are all to the good and that will largely counterbalance, Mr. Secretary, the tendency of old loopholes to become larger as a result of the pressure of higher rates.

H.M. Jr: Well now, what you say is in entire agreement with what Magill and I have been talking about. Magill spent Monday evening with me going over this thing.

Don't you think that it would be a great personal satisfaction for me to be able to go after Mr. X, who forms a corporation with which - in order that he could put his yacht in there and run his yacht with the expenses out of his corporation and run his yacht and deduct the expenses; that I could go after an American heiress who lives abroad and instead of paying a tax of \$150,000, pays - well, that of course gets into the other thing. But this incorporated pocketbook....that it would give me great personal satisfaction. But the thing comes back: which is more important, to satisfy my personal satisfaction about maybe fifty people who are using this device to any great extent, or to wait until next November, when the Treasury can present to Congress a complete tax program? Now, which is more important? Now, it raises the point, if by giving up making recommendations other than the handling of alien funds - are we giving up too much? You (Oliphant) tell me, from what you say, you don't think so. Magill doesn't think so. Haas has something which none of us has seen and which we all want to evaluate.

But talking with me, from what you say, we all feel, from what we've got here, that it isn't enough.

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You (Magill) call it trickles. It isn't enough to put into the hopper at this time a half or a quarter or an incomplete tax bill. Now, that's the decision that I want to make and I want to recommend to the President on Monday. See?

Oliphant: I'd like, if I might.....

H.M.Jr: Well, that's the whole story, but the only thing which is set to one side is the question of alien funds.

I've been waiting - they're due at ten o'clock, but go ahead.

Oliphant: I would like to just take one minute to elaborate that last thing I said. We haven't begun, Mr. Secretary, to scratch the surface of the things that we can do in the way of more vigorous enforcement, and which we should do.

H.M.Jr: And which we have just started.

Oliphant: And which we have just started.

H.M.Jr: And Magill also - I've spent a lot of time on this thing in the few days that I've been here - he has told me that through vigorous enforcement we can many times make up the money that we may lose from loopholes which we now know exist. Is that right?

Magill: That's right.

Oliphant: I can give you one recommendation right now, to require lawyers and accountants to tell us all corporations they have organized for purposes of tax reduction, that type of thing. Or you take the Mitchell case, take an old case; the Mitchell case stopped conveyances to wives, you see.

H.M.Jr: Well, there is just one thing Magill has worked out. He's going to set up a bureau here in Washington where we are going to have a blueprint of the financial structure of rich people in America of which the United States Government is at least a fifty percent partner, and we're going to have a blueprint of these people; after all, we're fifty percent partner.

Oliphant: And if you pull off a Mellon trial in New York, you

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just can't calculate the effect.

H.M.Jr: But I've been all over this thing and this is a small group and if anybody's got anything which would make this important decision, which really - it isn't a decision; I mean I've got to tell the President that he can't go back on what he said a month ago, that he's going to have these recommendations in November, unless I have something startling to tell him. Now, if I knew something was going - we were going to lose several hundred million dollars, why then I'd say, "Yes."

Have I expressed it?

Magill: Exactly. That's just it.

H.M.Jr: Now, do you (Haas) get the picture?

Haas: I get it. I don't think that - I think we can get together very easily on the thing. I just wanted to make sure - I didn't know what - just what picture you had, but I just wanted to make sure that you were familiar with this possibility. And I think what Ros plans to do and so on will be very helpful in it. Now, whether or not your decision - whether you want to do something today or not - I think that is something that has more factors involved than what I am talking about. But nevertheless, I'll be glad to give you these.

H.M.Jr: Well, if I'm not mistaken, Magill has already asked you for a list of the things, which he's still waiting for.

Haas: No, I don't think so.

Magill: Well, I did. Sometime ago I asked both of you (Haas and Oliphant). I've had a memorandum from Oliphant on the subject.

Haas: Well, I talked to you about the matter, but I didn't know that you expected.... I thought you had a group in the Bureau working on the loopholes and so on, and....

Magill: Well, we have, George, but the point still is - I want you to get it; I guess you do by now, but I want

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to be sure you do, and that is this: I'm using all the intelligence that I've got and I've got a group using what they've got, to give us all the information they can with respect to loopholes, and so on. Now, it seems to me the worst thing that could happen would be for people around here in the Department, who are close associates and who are in a position to know anything about this, to stand back and not give us any information that they may have and then say, "This Magill conducted this investigation and he didn't find it, but here's some more things."

Haas: No, I venture to say when I give you these things you'll know all about them, and they are very common things.

Magill: Well, I imagine I do too, and I imagine I've gone over them with the Secretary.

Haas: That's right.

Magill: But at any rate let's have a list.

H.M.Jr: Because - and, as I say, the purpose of these meetings is I can find out what everybody is doing.

If I'm formulating an important recommendation to the President which is contrary to what he says - after all, he's asked us to have a tax message ready for him when he comes back, and I've got to say, "No, don't send a tax message." "Well, why?" "For the following reasons."

Well, when you tell the President - when I say, "No, don't send it" then "Why?" "For the following reasons."

And incidentally; I wish to have Monday for lunch an outline just as to the principle of what we're going to do on aliens here and United States citizens abroad. I can say, "Now, this is the thing, and in principle Mr. Hull and Mr. Eccles and Mr. Landis are in agreement." See?

Magill: Good.

H.M.Jr: "And this is our recommendation to you instead of a tax message." See?

Now, this is a good meeting. Anybody want the last word?

Oliphant: I think that is a good last word.

EXCERPT FROM MEETING of May 12, 1937, 9:30 A.M.

H.M.Jr: Wayne, what's the nearest dock to your place?

Taylor: Yorktown itself.

H.M.Jr: You come in from either side? You haven't got a chart of that, have you?

Taylor: You can only come in on the York River.

H.M.Jr: Only on the York River.

Taylor: Yes.

H.M.Jr: What?

Taylor: (nods yes)

H.M.Jr: (On phone) If Tollaksen is over at Coast Guard, ask him to be here at 10:15 with a chart of the waters adjacent to Yorktown. Of the waters adjacent. And tell him to figure how many miles it is by water from here to Yorktown. Here at 10:15.

May 12, 1937.
9:50 A. M.

H.M.Jr: Hello.

Operator: Mr. Cochran.

H.M.Jr: Thank you.

Operator: Go ahead.

H.M.Jr: Hello.

H. Merle

Cochran: Hello Mr. Morgenthau.

H.M.Jr: How are you?

C: All right, thank you.

H.M.Jr: I just wanted to find out whether you were doing business while they were getting coronated.

C: Oh yes - yes - oh, that doesn't stop us over here.

H.M.Jr: I see.

C: It looks pretty quiet today; there's not much going on.

H.M.Jr: What I'm calling you up about is in your cable 613

C: Yes.

H.M.Jr: you talked about your friends over there - ah - buying gold from a certain country.....

C: Yes.

H.M.Jr: provided that they would spend the proceeds within that country.

C: Yes.

H.M.Jr: Well that's so surprising that I'm calling you up.

C: I don't think they've got a definite arrangement on that because they - they're figuring to buy

H.M.Jr: Yes.

C: What they

- 2 -

H.M.Jr: I didn't get that.

C: yet today.

H.M.Jr: I didn't get that.

C: What's that?

H.M.Jr: Repeat please - repeat it.

C: The local people - they're afraid their allies might give them this metal and then sell the proceeds in another few days.....

H.M.Jr: Yes.

C: for sterling.....

H.M.Jr: Yes.

C: and - because they knew that they did not have enough opposition security sending through in this country.....

H.M.Jr: Yes.

C: to take the franc.

H.M.Jr: Well Cochran - I don't hear you - I don't hear you.

C: I say they did not, as I understand it, have any binding agreement with the sellers of the gold however,

H.M.Jr: Yes, well I wanted to let you know that I considered that new trend very important and I want to be advised.

C: That what?

H.M.Jr: I consider that - this information very important.

C: Well I shall go see my friend tomorrow, if possible.

H.M.Jr: All right.

C: He was at my house for lunch yesterday when we had Reifler, you see.

H.M.Jr: Good.

- 3 -

C: And so I'll - I'll go out and check up with him again tomorrow if I possibly can.

H.M.Jr: Yes, on that particular angle.

C: Yes, all right.

H.M.Jr: All right.

C: Ah - nothing else particularly?

H.M.Jr: No, thank you.

C: I had Reifler send some other cables today.

H.M.Jr: Good.

C: I had J up at the house last night, you know.

H.M.Jr: Good.

C: And he seems tonight but that he had - then I'm to see Reese on Monday and Reese said that he wanted to see me very - ah - ah - confidentially afterwards.....

H.M.Jr: All right.

C:; he's got something on his mind.

H.M.Jr: All right, but this particular angle - I want you to follow that.

C: Surely.

H.M.Jr: Thank you.

C: I'll get busy on it tomorrow.

H.M.Jr: Thank you.

C: All right, sir.

H.M.Jr: Goodbye.

C: Goodnight.

BC

Gray

Paris

Dated May 12, 1937

Received noon

Secretary of State,
Washington.

621 May 12, 5 p.m.

FROM COCHRAN.

Paris stock market exceptionally quiet on British Coronation day. Bank of France sold a few belgas presumably on some commercial order but apparently was not otherwise active on the market. Rentes practically unchanged. Statement of Netherlands Bank for May 9 showed gain of 20,000,000 florins in gold reserve due to transfer of gold from equalization fund which had been purchasing dollars. Statement of Swiss National Bank as of May 7 likewise showed gold gain of 120,000 francs.

BULLITT

WWC CSB

SECTION TWO of Telegram No. 621 from Paris, May 12, 5 p.m.

Last evening the Paris Morgan partner visited with myself and Riefler. The rise in costs due to the social legislation and related factors are, he considers, the serious element in the French economic situation. As yet, his bank is not witnessing any repatriation of capital other than that which returned for subscription to the national defense loan. He is sympathetic with much of the social work undertaken and greatly admires Blum's foreign policies. No opposition leader of the caliber of a Poincare available to displace Blum is seen by this partner who has too much faith in the common sense of the French people to believe that any basic change in the nature of their governmental system will come from the present difficult times. He sees, on the other hand, financial crises ahead for France within the next few months.

I spoke with a Paris Guaranty Trust official this afternoon. He told me that woolen manufacturing clients of the bank doing business in Northern France state that their forward order have suffered heavily and their mills are now barely operating to the forty-hour schedule, due to increased costs and foreign competition.

BULLITT

EA:DJW

PARAPHRASE OF SECTION THREE OF TELEGRAM NO. 621
of May 12, 1937, from the American Embassy, Paris.

A representative of the Bank of Italy with whom I spoke this afternoon considers the demoralization on the French security market an index to the unsatisfactory state there. On the contrary the foreign exchange market has eased a little more than was expected in the circumstances by my friend.

In one of my many conversations with Sir Otto Niemeyer last week when at Geneva with him attending the meetings of the International Loans Committee, a point of interest developed. I was given little encouragement by Sir Otto when I asked his personal opinion as to the outlook for a trade agreement between the United States and Great Britain. Runciman, the only free trader in the Government, he said had been unable to make any move forward, and it was difficult to think that any more favorable attitude will develop especially since Runciman is not likely to be in the Cabinet for very long. The most constructive step in Niemeyer's opinion would be for both Great Britain and the United States to announce definite cuts of a certain percentage in the tariff schedules of their own countries. Niemeyer believes this could be agreed upon much more easily than the terms of a direct bilateral treaty. In his opinion it would have a much more helpful influence in leading the rest of the world to commence genuine reduction of barriers to trade.

END MESSAGE

BULLITT.

EA:LWW

Regraded Unclassified

PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Paris, France

DATE: May 12, 1937, 6 p.m.

NO.: 623

FROM COCHRAN.

At 5:30 this evening I called upon my friend at the Bank of France. With London closed, he stated that today the French equalization fund had been obliged to do nothing. At present he added there is no repatriation of funds to France except a slight gain from the sale of foreign securities. I asked whether Frenchmen were still selling American stocks. He answered that if they were, they were holding in dollars the proceeds thereof. He said in answer to my further inquiry that the tourist traffic had not yet become sufficient to yield a noticeable supply of foreign exchange. Consequently, the unfavorable trade balance more than offsets the repatriation of capital and the influx of foreign exchange from the tourist traffic. Therefore there is a steady although at present not rapid drain America's gold and foreign exchange holdings of the French control fund [This sentence not paraphrased]. Today approximately three and one-half billion French francs are held in gold and foreign exchange by that fund.

I made reference to the Russian gold transaction which was mentioned in my telegram of May 11, No. 613. I was
told

- 2 -

told that even though the Soviet Government Bank had agreed when selling 2,349,000 pounds sterling of gold to the Bank of France that the franc proceeds would be left in France, just a few days after the sale of the gold the Soviets transferred to the Banque Commercial pour l'Europe du Nord (which acts as the Soviets' exchange agent in France) 50,000,000 francs from its deposit with the Bank of France. The Banque Commercial at once purchased sterling with the exact amount of francs withdrawn from the Bank of France by the Soviets.

No way was known to my friend of making a binding agreement that could restrain the Soviets from disposing of the proceeds of gold sales any way they wanted to. My contact said, in referring to what was believed to be a Soviet endeavor to sell gold indirectly to the Bank of France, that the Chase Bank in London had inquired of the Bank of France whether the Bank of France would consider Russian gold good delivery. The reply of the Bank of France had been that it was not prepared to answer hypothetical questions, and the actual problem had not arisen. According to my friend the published figures of gold transactions on the market in London are really not indicative to the full extent of how much gold is being dumped on that market by dehoarders, by South Africa, and by the Soviets in particular. The sales
of

- 3 -

of gold in London by the latter, my friend thinks, have for a considerable period been at least one-half million pounds a day.

END MESSAGE.

BULLITT.

EA:LWW

RECEIVED
MAY 13 1951
TREASURY DEPARTMENT
DIVISION OF THE SECRETARY
WASHINGTON, D. C. 20540



OFFICE OF DEPUTY COMMISSIONER
INVESTIGATIVE UNIT

NAR:JWB

TREASURY DEPARTMENT
BUREAU OF CUSTOMS
WASHINGTON

MAY 12 1937

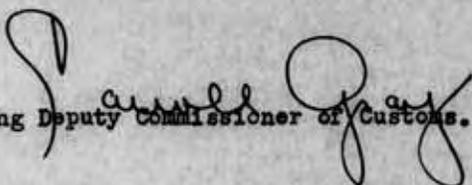
Memorandum for Mr. Graves:

Verbal information has been received from the Supervising Customs Agent at New York City to the effect that Customs officers at that port, on May 10th, seized 200 5-tael tins of smoking opium on the Danish S. S. ANNA MAERSEK, concealed in No. 5 hatch. The vessel left Hong Kong on March 27, 1937, and touched at Shanghai and San Pedro before arriving in New York. The boatswain on the vessel, one Kaj Moeller, is suspected of being the convoyer of this shipment. It has been learned that he purchased a new suitcase at Hong Kong on the outward trip from Hong Kong to Manila and brought aboard two suitcases allegedly containing soap.

In examining the suitcases at New York, Customs officers found in one of them a few minute scraps of paper which appeared to be of the same type as that appearing on the paper labels on the tins seized. These scraps of paper are now being given careful examination. The tins were rusted, indicating that they had been on board the ship a long time.

- 2 -

This information has been telegraphed to the Treasury At-
tache at Shanghai for appropriate investigation.


Acting Deputy Commissioner of Customs.

cc: Mr. Gibbons
Mr. Gaston
Mr. Moyle
Mr. Dow
Mr. Anslinger

Mr. Morgenthau: Mr. Commissioner, Gentlemen, I have no prepared speech. Since I know something about your work and your responsibilities, I think Commissioner Belvering's idea of bringing you all here for a get-together is excellent, and the idea will be just as good as you men make it while here.

I need not tell you we are collecting the largest amount of money. I guess, the Treasury Department has collected in a great many years. The responsibility falls on you men and the men under you to see that we get it. We have been through four very difficult years and we are now approaching the time when the President and the rest of us responsible to him are very anxious to balance the Budget. Now, there are just two ways to balance it, one to cut the expenses, and the other to collect the money. Fifty percent of the responsibility rests on your shoulders to get this money.

We don't want to be hardballed, we want to be fair. We are working for the taxpayers - - they are our bosses, they pay our salaries - - but on the other hand we want to make sure that they do pay the Government what they are supposed to under the laws. I can honestly say, and I know I can and look you in the face, that as long as I have been here nobody has pulled you off any case. As far as I know, you have been free from political pressure. If you haven't, it is your own fault. I have made the statement again and again that all you men have to do is to tell Mr. Belvering and he will tell me and I will take the pressure off. There is no reason in the world why you men can't go ahead

and do your work the way you would like to do it. That is the way I want you to do it, and that is the way Mr. Helvering wants you to do it. The only possible suggestion I have is that I don't feel we receive enough suggestions from the field. Perhaps this conference will result in increased suggestions from you men as to how we can improve the work.

I think the most important thing of all is the work that you have done in trying to get these returns examined within twelve months. The only bouquets I have been handed on our tax work are that the returns are examined within the year. There is nothing worse for the taxpayer than to worry about what happened two or three years ago. We should be on a current basis. That is up to you men. The prompt and just settlement of a man's taxes is what I would like.

Don't hesitate to tell us, if there is something you know is wrong, too much red tape, something impeding your work, some of your men being underpaid, or if you have some dead wood; don't be afraid to put it down. We want suggestions. That is why Mr. Helvering brought you here. Don't be fearful that if you make a suggestion it will redound to your injury. If there is anything which you know is not right in the internal revenue service, don't hesitate to say so. Mr. Helvering and Mr. McGill will more than appreciate it. The purpose of meeting you here is to find out from you fellows in the field what is going on. The country is too big. I can't go out myself, although I'd like to. Now that Mr. McGill is here as Under Secretary, taking this responsibility over, he wants to know. The trip he made to New York was very fruitful, the agent there was very helpful, but I say that if you don't give us the suggestions

- 3 -

and tell us what you need, it is your own fault.

I want to say that on the whole I think you men have done a fine job. I can't put my finger on any particular criticism, I haven't any. Just keep it up and I will be more than pleased. I am glad to have a chance to spend a few minutes with you.

S E A L

DEPARTMENT OF STATE
WASHINGTON

C
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Ex 68
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STRICTLY CONFIDENTIAL

May 12, 1937.

Dear Mr. Morgenthau:

Referring to our conversation of yesterday, I am attaching, for your confidential information, a copy of the gentlemen's agreement between the President and Mr. Litvinoff, and a summary of the negotiations which subsequently took place with the Soviet Government with regard to the settlement of American claims.

I would appreciate it if you would be good enough to return both of these documents to me as soon as you have had an opportunity to go over them. I may add that the original of the gentlemen's agreement was initialed by both the President and Mr. Litvinoff.

Sincerely yours,

(Signed) Robert F. Kelley

Enclosures:

Two, as above.

The Honorable

Henry Morgenthau, junior,
Secretary of the Treasury.

THE WHITE HOUSE

41

Washington

Mr. Litvinov, at a meeting with the President, the Acting Secretary of the Treasury, and Mr. Bullitt, made a "gentlemen's agreement" with the President that over and above all claims of the Soviet Government and its nationals against the Government of the United States and its nationals, the Soviet Government will pay to the Government of the United States on account of the Kerensky debt or otherwise a sum to be not less than \$75,000,000, in the form of a percentage above the ordinary rate of interest on a loan to be granted to it by the Government of the United States or its nationals, all other claims of the Government of the United States or its nationals and of the Government of the Union of Soviet Socialist Republics or its nationals to be regarded as eliminated.

The President said that he believed confidently that he could persuade Congress to accept a sum of \$150,000,000, but that he feared that Congress would not accept any smaller sum. Mr. Litvinov then said that he could not on his own authority accept any such minimum, as his Government had already stated that it considered this sum excessive.

Mr. Litvinov said that he had entire confidence in the fair-mindedness of the President and felt sure that when the President had looked into the facts he would not feel that a sum greater than \$75,000,000 was justified. So far as he personally was concerned, and without making

- 2 -

any commitment, he would be inclined to advise his Government to accept \$100,000,000 if the President should still consider such a sum fair.

Mr. Litvinov agreed to remain in Washington after resumption of relations and to discuss with Mr. Morgenthau and Mr. Bullitt the exact sum between the limits of \$75,000,000 and \$150,000,000 to be paid by the Soviet Government.

William C. Bullitt

DIGEST OF THE MORE IMPORTANT POINTS OF THE
AMERICAN-SOVIET DEBT NEGOTIATIONS OF
1934-5

In February 1934, the State Department prepared a draft note which it proposed that Mr. Litvinov or Mr. Troyanovski should address to the Secretary of State setting forth the manner in which the Soviet Government should settle American claims against it. This draft was approved by the President on February 10, 1934, and a copy was brought to Moscow by Mr. Bullitt. While Mr. Bullitt was in Warsaw en route to Moscow he received a telegram from the Department making an unimportant change in the original draft. The main points of the note as brought out in the draft as amended were as follows:

1. The Soviet Government agrees in settlement of all American claims against it to pay to the American Government the sum of \$150,000,000, together with interest in the manner set forth below, the payment to be completed within twenty years.

2. The Soviet Government will pay the amount mentioned in the following manner:

It will pay on all credits or loans to be extended to it or its agencies by the American Government, its nationals, or agencies of the American Government or nationals in addition to the regular interest an "additional interest" of 10 per cent per annum. This "additional interest" will be paid to the Export-Import Bank of Washington or to any agencies of the American Government

which

which that Government may designate for the account of the United States Treasury and applied first towards the interest on the sum of \$150,000,000 and thereafter to the reduction of the principal.

3. The sum of \$150,000,000 will bear interest at the rate of 5 per cent per annum, commencing July 1, 1934, payable semi-annually, on the first day of January and the first day of July of each succeeding year. Any interest remaining unpaid on the date due will be added to the principal and shall thereafter bear interest at the same rate per annum.

4. The sum of \$150,000,000 shall not include, but shall be in addition to, any assets that have been assigned or released to the United States.

5. The Soviet Government waives all demands and claims of every character by it or any of its nationals against the United States or any of its nationals.

On March 14, Mr. Litvinov and Mr. Bullitt discussed the proposal referred to above. Mr. Litvinov said that he objected to the note on the following grounds:*

1. It was worded in such a manner that if the Soviet Government adopted it, it would be compelled to make settlements with all other Governments which had claims against the Soviet Union.

2. The sum mentioned, namely, \$150,000,000 was too great. The amount of \$100,000,000 might be considered.

*See Embassy's telegram No. 12 of March 14, 1934.

3. He had never agreed to pay additional interest on credits but on loans to be given to the Soviet Government to be used for purchases anywhere.

4. The amount of additional interest requested, namely, 10%, was too great. Morgenthau had originally suggested 4% normal interest and 6% additional interest and he had replied that the normal interest should be no more than 3% and additional interest 4%.

During the conversation Mr. Bullitt stated that in his opinion the Government of the United States could not make any loan to any foreign country at the present time. Mr. Bullitt also pointed out that as the result of the decline of the dollar, \$150,000,000 had an exchange value of only about \$90,000,000.

On March 17, the Department sent Mr. Bullitt a telegram,* in which Mr. Bullitt was informed that the President had expressly stated that he had never thought of a direct loan and that there was not the slightest possibility of such a loan being made. The telegram added that the Board of Trustees of the Export-Import Bank with the President's approval had resolved to engage in no credit transaction which may have for its purpose the facilitating of Soviet purchases in the United States until a debt adjustment has been made.

On March 18, ** Mr. Litvinov told Mr. Bullitt that he

* See Department's telegram No. 11 of March 17, 1934.
** See Embassy's telegrams No. 20 of March 18, 1934, and No. 24 of March 21, 1934.

he would submit the whole matter to Stalin. On March 21 he said: "We shall never accept credits in place of a loan. We might agree to spend the entire proceeds of a loan in the U.S.A., but what we insist on is a straight loan like the one the Swedish Government has just granted us so that we can pay for all our American purchases in cash." He added that he had not as yet submitted the matter to Stalin. Mr. Bullitt expressed the hope in the telegram reporting the conversation that the Johnson Bill would be passed as soon as possible and that the Department would adopt a firm attitude with Troyanovski and bring to the latter's attention the revulsion of feeling which there would be in the United States if the Soviet Union should fail to continue its policy of cooperation with the United States.

On April 2, 1934, Mr. Litvinov made the following counter proposal to Mr. Bullitt:*

1. The Export-Import Bank would extend a 20-year credit to the Soviet Government in double the amount of the sum to be paid in settlement of the claims against the Soviet Government. If, for instance, the amount of the claims should be fixed at \$75,000,000, the credit would be for \$150,000,000. If the amount should be fixed at \$100,000,000, the credit would be for \$200,000,000.

2. This credit would be drawn upon by the Soviet Government when it needed cash with which to pay for purchases in the United States. The

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*See Embassy's telegram No. 33 of April 2, 1934.

Soviet Government desired to make all purchases in the United States for cash.

3. The interest on such a credit would be 4% during the first four years without any extra interest payment for the liquidation of debts, and after that the interest would be 4% plus 3% additional for retiring the claims during the subsequent 16 years; thus 96% of the recognized claims would be paid for at the end of the 20 years.

4. No interest would be payable on the amount of the claim.

Mr. Litvinov added that he was still willing to set the amount of the claim at \$100,000,000 if the President insisted. Nevertheless, it had been learned from documents turned over to the Soviet Embassy in Washington that the Kerensky Government had received almost none of the funds placed at its disposal in the United States. Most of the money lent had been used by the Russian Embassy in Washington to finance the fight against the Soviet Government.

The Department telegraphed Mr. Bullitt under date of April 5* that in the absence of the President it believed that Mr. Litvinov's offer would be unacceptable because:

(a) It substituted for a loan a credit which was equivalent to a loan. The Export-Import Bank,

it

* See Department's telegram No. 31 of April 5, 1934.

it was assumed, would not be able to extend such a credit and it was not believed that Congress would be willing to do so.

(b) If such a credit were extended, Soviet indebtedness would be twice as much at the end of the 20-year period as it was at the beginning of the period.

The telegram added that the proposal was therefore unreasonable, if not to say fantastic, and that the American Government was in no way responsible for the manner in which the Kerensky loan was spent. In the same telegram Mr. Hull said that he had discussed the matter with Mr. Troyanovski and had informed him that in view of Mr. Litvinov's new and unexpected contentions it would perhaps be best to keep all commercial and financial relations in suspense until the situation had clarified. Mr. Hull also stated that on the previous day the House had approved the Johnson Bill in the form previously passed by the Senate after there had been read to the House the resolution adopted by the Export-Import Bank which was as follows:

"It is the sense of the Board of Trustees of this Corporation that no actual credit transactions with the Soviet Government shall be undertaken unless and until that Government shall submit to the President of the United States an acceptable agreement respecting the payment of the Russian indebtedness to the Government of the United States and its nationals."

Mr.

Mr. Hull added that the Bill will prevent the purchase or sale of obligations given AMTORG for purchases.

On April 8* Mr. Bullitt and Mr. Litvinov had a most unsatisfactory conversation during the course of which Mr. Litvinov was angry and adamant. He stated that he would reject the State Department draft as a basis for discussion since it was in absolute contravention of his understanding with the President. He said that any fair-minded person could judge that the State Department draft contemplated not a loan or a credit but a taxation of Soviet trade. He asked Mr. Bullitt regarding the nature of the Department's reply to his proposal and was told that the proposal was entirely unacceptable even as a basis of discussion. When Mr. Bullitt asked if he had anything to add to his proposal Mr. Litvinov replied that he had nothing to add. Mr. Bullitt asked if the Soviet Government would be willing to put up actual metal security in addition to its promise to pay and was informed that the Soviet Government had never done so and would never do so. When Mr. Bullitt mentioned what the effects of the Johnson Bill would be Mr. Litvinov answered that the Johnson Bill presumably applied to England, France, and Italy as well as the Soviet Union and said "We shall be in very good company. This means that we shall buy nothing henceforth in the United States. We can cover all our needs in other countries and shall do so." When Mr. Bullitt asked Mr. Litvinov if he could not suggest a counter-proposal, Mr. Litvinov said that he had said his
last

* See Embassy's telegram No. 43 of April 8, 1934. Declassified

last word and that insofar as he was concerned the matter was closed.

During the conversation Mr. Litvinov referred to the resolution of the Export-Import Bank and said that the resolution was ill-advised since it was in the nature of a threat and the Soviet Union would never be moved by such a threat.

On May 9* Mr. Litvinov made a new proposal. It was in brief as follows:

The Export-Import Bank would undertake to discount for a period of two or three years bills of exchange issued by Amtorg or any other agency of the Soviet Government in payment of goods purchased in the United States for the Soviet Government to the amount of X million dollars at the rate of Y per cent, the bills of exchange to mature in Z years. All purchases to be covered by these credits should be made within a period of two or three years. The amount of credit should, however, be double the amount to be paid in settlement of debts, the interest rate would be 4% plus a 3% to retire claims, but in the conversation Mr. Litvinov made several remarks which indicated that he might consider 5% plus 5%. He insisted, however, that the maturity period should be for 20 years but indicated that he was ready to discuss X, Y, and Z if an agreement could be reached with regard to the form of the credit. The notes of the Soviet Government could be issued in

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* See Embassy's telegram No. 69 of May 9, 1934.

the form of readily saleable or negotiable obligations and the Bank would be at liberty dispose of such obligations as it might see fit.

Mr. Bullitt suggested to the Department that it might be possible to find a compromise somewhat as follows: The Export-Import Bank would discount notes only in cases of contracts which had been submitted to it in advance for approval and notes left in the hands of American exporters should be discountable only at the Export-Import Bank.

The Department replied to Mr. Bullitt under date of May 11, 1934,* somewhat as follows:

- (1) Suggest that as a compromise the lump sum considered as due might be set at \$125,000,000.
- (2) Any agreement should contain a stipulation that the amount of the claims must be liquidated within twenty years.
- (3) Unless a war should break out or other factors might cause the Soviet Government to be no longer a good credit risk the Export-Import Bank would be willing during the next twenty years to support specific trade transactions to an amount of not less than twice the amount of agreed indebtedness.
- (4) Specific transactions financed by the Export-Import Bank should be liquidated, however, within a period of five years so that funds would be released to finance new transactions. Thus, there would be created a revolving fund which would serve to promote Soviet purchases in the United States during the

full

* See Department's telegram No. 72 of May 11, 8 p.m. Regraded Unclassified

full twenty years. -10-

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(5) All credits should bear a normal rate of interest plus a rate to be applied to the debt.

(6) The Bank would make advances only to the American exporters; it would be prepared to discount Amtorg acceptances received by exporters in connection with specific transactions approved by the Bank for that part of the credit which the exporter would not be expected to carry.

(7) The maturities of such acceptances would vary according to different categories of goods with final maturity in no case exceeding five years.

Mr. Bullitt replied to this telegram on May 13,* pointing out that in his opinion Mr. Litvinov would not agree to pay a fixed amount of indebtedness unless he was promised a fixed amount of credits for a fixed period. Mr. Bullitt also asked the Department the following questions:

(1) Would the Bank be prepared to fix definitely the amount and duration of credits to be extended by it regardless of credits which may or may not be extended by American corporations or individuals and regardless of conditions in the Soviet Union?

(2) Would the Department be willing, in view of Mr. Litvinov's opposition to pay any interest whatever on the amount of acknowledged indebtedness, to reduce its demand for such interest to two or three percent?

(3) Would the Bank be willing, itself, to discount Amtorg obligations to an amount double the agreed indebtedness or would it merely assist in financing an indefinite

* See Embassy's telegram No. 81 of May 13, 1934.

indefinite proportion of credits to double the amount of indebtedness? 53

(4) Would the Bank be prepared to agree to relend immediately all repaid amounts and to keep outstanding a continuous line of credits for a fixed period to an amount double the total indebtedness?

(5) What amount of Amtorg obligations would the Bank be prepared to discount at once?

(6) Would it be satisfactory if Litvinov would agree to a 5% normal interest rate plus 5% to be applied to both principal and interest?

In the afternoon of May 13* the Ambassador discussed the Department's proposal tentatively with Mr. Litvinov and the latter stated that he was planning to be away from Moscow for a period of some weeks and would leave the negotiations in the hands of Mr. Krestinski and Mr. Rubinin, the Chief of the Third Western Political Division.

The Department replied to Mr. Bullitt's inquiries on May 15** that:

(1) The debt should be paid in twenty years if during that time additional interest on credits is sufficient for that purpose, if not the arrangement could be continued until it is paid in full.

(2) There should be a rate of three per cent and certainly not less than two per cent on the debt. The rate on credits should be five per cent, although this could be made a matter of negotiation; there should also be an additional interest of ten per cent and certainly not less than eight per cent to be applied

on

* See Embassy's telegram No. 82 of May 13, 1934.

** See Department's telegram No. 77 of May 13, 12 noon.

on principal and interest⁻¹¹⁻ of debt. It appears, therefore, that the minimum rate on credits would be 13%. 24

(3) The Bank could not be expected to specify in advance the total credits for any one year or the maximum or minimum of individual transactions. Credits would be negotiated between the Bank and the exporter on the basis of a general agreement with the Soviet Government covering the character and amount of exports and imports. The Bank of course should be able to approve any and all transactions; otherwise the placing of business in this country with the Soviet Union would be under the control and direction of the Soviet Government.

(4) It should be provided that in case of war the United States could suspend shipments.

The Ambassador on May 16* laid the original Department draft before Mr. Krestinski and Mr. Rubinin for discussion. Mr. Krestinski refused, however, to accept it as the basis for discussion, saying that there was no use discussing details such as total indebtedness so long as there was no agreement on the basic question of the form of credit. Mr. Krestinski added that the Soviet Government would have nothing to do with a scheme whereby it would have to negotiate with American corporations for credits in the granting of which the Export-Import Bank would participate. A sine qua non for a debt settlement would be a credit at the Bank for double the amount of the debt payment or a flat agreement on the part of the Bank to discount 100% Soviet

obligations

* See Embassy's telegram No. 85 of May 16, 1934.

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obligations in an amount equal to twice the amount of the debt payment. The conference broke up without having achieved any results.

On June 16,* Litvinov told the Ambassador that there had been no misunderstanding between the President and himself as to whether a credit or a loan should be given to the Soviet Government and added that the Government of the United States was attempting to back out of its original verbal agreement. He said that he and his Government were prepared to let the matter drop immediately and permanently; that the Soviet Government had not asked for any such agreement but had agreed to enter into such an agreement at the request of the President; that the agreement was clear; and that the Soviet Government would not change its position. Mr. Bullitt replied that such an attitude might in his opinion terminate any possibility of close collaboration between the two countries.

On July 16,** the Department asked the Ambassador to telegraph what he had understood to have been the substance of the conversations between the President and Mr. Litvinov while the latter was in the United States regarding the method of the payment of indebtedness.

Under date of July 17,*** the Ambassador informed the Department that he had been present at all conversations which had taken place between the President and Litvinov and at no time did Litvinov indicate that he would expect either a loan or an uncontrolled credit. There had never been in the mind of the President or of Mr.

Bullitt

* See Embassy's telegram No. 145 of June 16, 1934.

** See Department's telegram No. 160 of July 16, 1934.

*** See Embassy's telegram No. 195 of July 17, 1934.

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Bullitt the faintest idea of granting a straight loan or an uncontrolled credit. Furthermore, both the President and he had been convinced that Litvinov had agreed to pay extra interest on all loans or credits of whatever nature obtained from any American individual or corporation. During the course of the conversation the words "loan" and "credits" had been used synonymously by the President. It was possible that the word "loan" was even used in the one conversation of which a memorandum was made. However, the general tenor of all conversations was such and the American general position with regard to loans and credits was so well known that he could not understand how anyone could have derived the impression that the President had in mind the granting of a loan or uncontrolled credit.

In July the discussions were transferred to Washington and on July 25,* Troyanovski talked for more than two hours with officials of the Department. No progress was made, however.

On August 3 the Department placed a new proposal in the hands of Troyanovski. The details of this proposal are not to be found in the Embassy's files. On August 15, Troyanovski informed the Department that this proposal was even more unsatisfactory than the original proposal.** Among the points to which Troyanovski appeared to take exception were:

- (1) The fact that the Bank would be able to go into the details of each transaction and that if it was not satisfied with the terms it could refuse to guarantee the credits involved. He

was

* See Department's telegram No. 173 of July 25, 1934.
** See Department's telegram No. 203 of August 15, 1934.

was answered that such a ⁻¹⁰⁻right was reserved by all Governments that guarantee credits to the Soviet Government.

(2) The fact that the time limit of the credits was too short, particularly with respect to the purchase of machinery and industrial equipment. He considered the shortness of the term the most difficult question.

Mr. Troyanovski was told that the American Government had presented three different written proposals and had received no counter-proposal from the Soviet Government. Mr. Hull told Mr. Troyanovski at the same time that he expected a written proposal from him as to what terms the Soviet Government might be willing to consider.

On August 24,* Troyanovski left a memorandum with the Department in which it was proposed that:

(1) The American Government grant a credit of one hundred million dollars payable in twenty years and a revolving credit of one hundred million dollars payable in not less than five years with total interest rates of 7%.

(2) This proposal was made on the assumption that the amount of agreed indebtedness should be fixed at one hundred million dollars.

Mr. Troyanovski was informed that his proposal was entirely unacceptable and following the conversation the press was informed that the "Soviet Ambassador presented a counter-proposal in writing in view of which it is not possible to be optimistic that any agreement will be reached."

On

* See Department's telegram No. 214 of August 24, 1934.

On September 7,* the Department informed the Embassy that:

(1) The efforts to reach an agreement with Troyanovski had failed.

(2) There was no difficulty with respect to fixing the amount of the debt; but Troyanovski demanded an open credit of \$100,000,000 payable in twenty years, which is equivalent to a straight loan, and also a guarantee of a similar amount to be used in Export-Import Bank credit transactions, which would of course properly become a revolving fund.

(3) He also asked for a longer time on credit transactions, insisting that five years was not sufficiently long.

On September 13,** Mr. Bullitt advised the Department that Mr. Skvirski, the Soviet Counselor of Embassy, then on leave in Moscow, had informed him that:

(1) The Soviet Government could make no settlement with the United States which would cause a revival of the claims of England and France; he said that the payment of extra interest on credits from American exporters, even though the Government should carry a large part of the credit risk, would produce immediate revival of the claims of other nations. He said that he had advised his Government that the President could easily gain support in the United States for settling along the lines of Troyanovski's proposal.

On September 14,*** Mr. Rubinin, the Chief of Division
of

* See Department's telegram No. 233 of September 7, 1954.

** See Embassy's telegram No. 296 of September 13, 1954.

*** See Embassy's telegram No. 303 of September 15, 1954.

of the Commissariat for Foreign Affairs which handles American matters, informed Mr. Bullitt that the essential difficulty for the Soviet Government in accepting the American proposal was the necessity of making an agreement which would not possibly serve as the basis for an agreement with England and France. He said that any agreement based merely on extra interest on commercial credits would be immediately used by the British and the French to demand a settlement of claims by a similar mechanism. He said that the Soviet Union was endeavoring to bring about a rapprochement with Great Britain and France and could not afford to risk creating bad blood by refusing them a settlement on a basis similar to one on which a settlement with the United States had been reached.

In a telegram, dated September 15,* the Department informed the Embassy that it had no objection to Mr. Bullitt discussing the debt matter with Mr. Stalin as a last recourse. It pointed out that there appeared to be no really serious difficulty in agreeing with the Soviet Government regarding the amount of indebtedness, the time within which it should be paid, and the rate of interest. The main differences seemed to be as follows:

- (1) The American Government is willing until the debt is paid to support credit transactions to an amount equal to the amount of the debt through the Export-Import Bank, such credits to constitute a revolving fund. These credits should carry an interest rate of about $4\frac{1}{2}\%$ for the benefit of the Bank, which should include the Bank's expenses and in

addition

* See Department's telegram No. 246 of September 15,

addition interest at a rate which would guarantee the debt being paid off within the time specified. This added rate could not be less than 5%.

The proposal of the Soviet Government which is unacceptable is that it wants an open credit placed at its disposal in the amount of one hundred million dollars available for purchases independent of the bank, and even independent of available supplies of material in the country. Thus the Soviet Government could use the full amount immediately in order to purchase munitions of war. The Soviet counter-proposal also provides that the Bank support credit transactions up to another \$100,000,000.

(2) The American Government is willing to grant a maximum of five years for the repayment of Bank credits, the term to vary according to the categories of goods. Thus, for instance, credits for consumers' goods would be from one to two years; for light capital goods from two to three years; and for heavy capital goods from four to five years. The American Government would even be willing that the President be given the power to exceed the five-year limit in exceptional circumstances. In fact, if Stalin should insist upon flat five-year credits for all types of goods, the American Government might acquiesce.

The American Government also desires that any agreement should embody a provision affording it proper exemption from extending credits during the progress of a war.

On September 15,* Mr. Bullitt telegraphed the

Department

*See Embassy's despatch No. 304 of September 15, 1934.

Department that he had learned through a trustworthy source that Stalin, himself, had decided that French and British friendship was so important to the Soviet Union that the Soviet Government could not afford to run the risk of alienating France and Great Britain by making an arrangement to pay American claims unless it would be willing also to pay French and British claims on the same terms. French and British claims were so heavy that the Soviet Union could not afford to settle down by paying extra interest on commercial credits. Therefore no settlement could be reached with the United States whereby payment would be made by means of extra interest payments on extra credits.

On September 17,* the Department pointed out to Mr. Bullitt that when Mr. Litvinov was in Washington he had made no objection to the extra interest feature and that the United States cannot be responsible for the relations between the Soviet Union and Great Britain and France. It seemed therefore that it was up to the Soviet Government to work out some plan that might be acceptable in the United States, not including a loan or an open credit.

On September 27,** Mr. Krestinski told Mr. Bullitt that if it was impossible for the American Government to accept Mr. Troyanovski's offer, it might be better to allow the whole matter to drop. Mr. Bullitt replied that the failure of the negotiations might be a death blow to the development of really friendly and intimate relations between the two peoples. During the course of a personal conversation which ensued, Mr. Krestinski asked if it

would

* See Department's telegram No. 247 of September 17, 1934.

** See Embassy's telegram No. 328 of September 27, 1934.

would be possible for two entirely separate agreements to be drawn up: the one providing for the extension of commercial credits which would bear an interest rate sufficient to meet American demands for repayment of claims, and the other a separate agreement annulling all claims of both Government and/or their nationals. Mr. Bullitt replied that the President could not agree to annul debts without the consent of Congress and that in explaining to Congress why he wanted to enter into such agreements as those suggested he would be compelled to explain that a certain percent of the interest would be applicable to the debts and claims.

Krestinski pointed out that in case of a settlement via a commercial credit, his Government would have to deny that any extra interest had been paid in settlement of American indebtedness, that the position of his Government remained that a payment of indebtedness could be acknowledged only in return for a loan.

On September 27,* Mr. Bullitt telegraphed the Department that he had been informed by Mr. Krestinski that Mr. Troyanovski had been summoned to Moscow and would arrive between October 10 and 15. Mr. Krestinski suggested that Mr. Bullitt postpone his departure for the Far East, planned on October 5, until after Mr. Troyanovski's return. Mr. Bullitt replied that he could see no advantage in remaining in Moscow if the Soviet Government had no intention of changing its position, that is, if it continued to refuse to consider any settlement of the debts and claims which was not based on a loan. Mr. Bullitt requested the Department's instructions.

On

* See Embassy's telegram No. 330 of September 27, 1954. Regraded & Classified

On October 1,* the Department informed Mr. Bullitt
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that the President saw no reason which would require him
to await Mr. Troyanovski's return to Moscow since Troyan-
ovski apparently was making the trip of his own initiative
with the hope of persuading the Soviet Government to accept
the liberal offer made to him by the American Government.

On October 2,** the Department informed Mr. Bullitt
regarding the nature of the offer which it had made to
Troyanovski, and which Mr. Troyanovski was planning to
discuss while in the Soviet Union. The general character
of this offer is as follows:

(1) The Soviet debt to the United States was to
be fixed at \$100,000,000 to be paid in twenty years
and a small rate of interest was to be paid upon it.
In case the Soviet Government did not desire to pay
interest the amount should be set at \$125,000,000.

(2) Credits would be granted to cover Soviet pur-
chases in the United States to an extent of \$200,000,000.

(3) Extra interest to be applied to the payment of
the debt would be charged upon the credits, or if the
Soviet Union so desired, the debt could be paid in annual
instalments.

(4) Credits for various transactions carried out
within the framework of the agreement would be for
periods of five years regardless of the character of
the commodities purchased.

(5) There were of course a certain number of details
such as suspension of credit transactions in case of
default or at the option of the American Government

during

* See Department's telegram No. 264 of October 1, 1934.

** See Department's telegram No. 266 of October 2, 1934.

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during any possible war and a fair arrangement to be made as to the use of American ships and the method of insuring cargoes.

On October 5,* Mr. Litvinov asked Mr. Bullitt if he could not stay in Moscow pending the return of Mr. Troyanovski. Mr. Bullitt replied that it was the view of Mr. Hull and himself that there would be no purpose in his remaining unless there was some likelihood that Mr. Litvinov would agree that the matter of a loan or an unrestricted credit was out of the question. Mr. Litvinov replied that he could not make a statement to such an effect until he had had time to talk with Mr. Troyanovski. Mr. Bullitt then pointed out to Mr. Litvinov the serious effect which the failure of the Soviet Government to come to an agreement would have on Soviet-American relations. Mr. Litvinov said that the only obstacle was the difficulty of finding a formula which would not make trouble for the Soviet Union with England and France. Mr. Litvinov asked if it would not be possible that the formal agreement would contain no mention of the fact that extra interest was being paid in settlement of debts and claims. Mr. Bullitt replied that regardless of what might be in the agreement the President must be able to explain in detail to Congress that extra interest was being applied to the debt settlement. Mr. Bullitt told Mr. Litvinov that the minimum interest rate to be charged in any settlement along this line must be 9 1/2%. Mr. Litvinov replied that the Soviet Union had recently been offered credits by Germany at 7%.

On October 8,** the Department instructed Mr. Bullitt

to

* See Embassy's telegram No. 342 of October 5, 1934.

** See Department's telegram No. 273 of October 8, 1934.

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to give Mr. Litvinov to understand, without making any statement to the effect that diplomatic relations would be severed, that in case of the failure of the Soviet Government to agree to a debt settlement at the reasonable terms proposed, the relations between the two Governments would be inevitably less close and friendly than had been anticipated and that the reason for our Government doing many things contemplated would disappear.

On October 10,* Mr. Litvinov informed Mr. Bullitt that the Soviet Government was obtaining credits abroad at low rates. It was, for instance, receiving credits from the Chase National Bank at 4 1/2 percent and from large English banks at 4 percent.

Mr. Litvinov in great anger also stated that he understood that officials of the Department of State had been spreading the report that he had broken his agreement with the President. He said that his position was that the President had broken the agreement. Mr. Litvinov added that if he heard any more reports of such a nature he would publish the memorandum of his conversation with the President.

Mr. Bullitt replied that it seemed plain that Mr. Litvinov did not wish friendly relations with the United States; that if the negative attitude with regard to the settlement of debts should be followed by Comintern activities directed against the United States, relations would become almost impossible. Mr. Litvinov replied: "No nation ever starts talking about the activities of the Comintern unless it wishes to have as bad relations

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* See Embassy's telegram No. 353 of October 10, 1934. Regraded Unclassified

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as possible with us. The activities of the Comintern are merely an excuse for breaking diplomatic relations." Mr. Bullitt replied that Mr. Litvinov might expect the most drastic reaction in the United States in case the Comintern Congress should take place and there should be evidence of interference in the internal affairs of the United States.

Mr. Litvinov said that the final and definite Soviet proposal would not differ greatly from Mr. Troyanovski's recent proposal. Mr. Bullitt replied that "a loan was impossible, had always been impossible, and always would be impossible." Mr. Litvinov said that the Soviet Government had no desire for a loan except at a low interest rate, that it desired to let the matter drop, "that if the question of payments of debts and claims were settled in any way whatever, he would have grave difficulties with England and France." Mr. Litvinov said that he would make a final proposal with Troyanovski and then would refuse to discuss the matter further. Mr. Bullitt replied that he deeply regretted that Mr. Litvinov seemed determined to kill all possibility of really close and friendly relations between the two countries.

Mr. Bullitt departed for the United States by way of the Far East on October 11, 1934. His negotiations with Litvinov therefore terminated. Mr. Wiley was left in charge of the Mission and had a number of discussions with Mr. Litvinov during the course of which the matter of debts was mentioned. He also discussed the question of debts on several occasions with Mr. Troyanovski after the latter's return to the Soviet Union in October 1934. These

conversations

Regraded Unclassified

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conversations, however, had no real bearing on the negotiations and the information contained in them are so fragmentary that they are of little value in obtaining a picture of developments in Moscow with respect to the debt and claims question.

Mr. Troyanovski left for the United States by way of the Far East in the latter part of November.* It was understood that he was taking with him a reply to the proposal of the American Government. He loitered en route, however, in Japan and Honolulu and did not reach Washington until in the latter part of January. On January 31, 1935, he called upon Mr. Hull and informed him that the American proposal had been rejected.** He had no new proposal to make. The Department, therefore, decided that since there seemed to be little likelihood of important developments in American-Soviet relations, the staff at Moscow should be curtailed. The Naval and Air Attaches were ordered withdrawn, the Consulate General was abolished, and the staff of the Mission was reduced. The Charge d'Affaires was instructed in discussing these actions with the Soviet Government and others in Moscow to point out that the Government of the United States had desired and still desired most friendly cooperation with the Soviet Union but Litvinov had shown so little disposition to permit the development of friendly relations with the United States that the Government of the United States was convinced that no real friendship could be developed so long as he adhered to his present attitude.

* See Embassy's telegram No. 390 of November 19, 1934.

** See Department's telegram No. 24 of January 31, 1935.

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MEETING WITH EXECUTIVE COMMITTEE OF
FEDERAL RESERVE OPEN MARKET COMMITTEE

May 12, 1937
11:00 A.M.

Present: Mr. Taylor
Mr. Bell
Mr. Lochhead
Mr. Haas
Dr. Viner
Mr. Eccles
Mr. Goldenweiser
Mr. Piser
Mr. Sinclair
Mr. Harrison
Mr. Broderick
Mr. Williams
Mr. McKee

H.M.Jr: Well, Mr. Eccles, the floor is yours. That does not mean - I might also say the Treasury has been.

Eccles: I thought it would be helpful to the Open Market Committee if they could meet with the Treasury, and possibly helpful to the Treasury if they'd meet with the Open Market Committee. It's been several weeks since we've had a meeting, and the May first period has passed since that time, and in anticipation of the June financing and the financing that needs to be done between now and June, I thought that it would be helpful to both of us if.....

H.M.Jr: Excuse me. (To Kieley) Dr. Viner should be in here.

Eccles: ...if we could just simply talk about the situation generally. Now, we don't have anything specifically to - at least, I don't - to recommend at this time. If you could indicate to the Committee whether or not you think you'll need more than just a hundred million a week between now and June, and then the amount that you feel that we - you might like to get either at that time or beyond that period in a general way, so that we could be thinking about it, about the whole subject, that, I think, would be helpful.

H.M.Jr: George (Haas), get me my calendar off my desk, will you?

Eccles: The members of the Committee asked Mr. Morrill to notify them and he apparently misunderstood it. He thought the meeting was to be over there at 11 o'clock

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and he notified them there instead of here, so they're...

H.M.Jr: Well, we figured, Bell and I - Bell is over at the War Department; I guess he got shot; but I know what his figures are. We were planning to run through as is on the nine months stuff, just the way we are now.

(Broderick and Viner come in)

Hello.

.....to the second of June. That would give us 350 million falling due approximately September 15, 16, and 17. And with that we could just about get through by the skin of our teeth - I mean lets our balances run down very much lower than I like to see them, and I hope I'll never let them run down as low as we have. But I felt that we ought to, as part of the whole picture, and I think it's been helpful to do it; but I've taken a chance which I don't like to take by letting them run down as low as that. And.....

(Bell comes in)

Hello.

Bell: Hello. Sorry.

H.M.Jr: Just going to say - I said you might have got shot over at the War Department.

Bell: No, but I got held up.

H.M.Jr: I just said, Dan - they've asked us - I've simply said that we're planning 50 million a week for September - give you a chance to catch your breath - which gives us, going through the second of June - will give us 350 million falling due approximately September 15.

Bell: That is right.

H.M.Jr: And I say by figuring awfully, awfully close we can get just about - just about get by on that basis.

Bell: That's right. We'll have 406 million going into May, and going out of May we'll have 271 million. On June 2 we pick up 50 million, but we'll lose a total of about

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a hundred million so that our balances around the seventh or eighth of June will run down to 225, in that neighborhood. And planning 750 million dollars cash in June, of which 300 million will be used to pay off Treasury bills, 450 million net, gives us a balance going out of June of 831 million.

Then at the end of July we start Treasury bills again to commit to maturity of 250 million in December. That will be 50 million in July and 200 million in August. That will give us a balance going out of July of about 700 million and about 740 million going out of August.

And then in September we'd raise 500 million, of which 300 and about 80 million - 350 million bills and 30 million of the maturing notes - would be paid off out of that 500 million, leaving 120 million net cash, and giving us a 970 million balance going out of September.

Eccles: That's 500 new?

Bell: 500 new money, but you'd use about 380 million of it.

Eccles: 120 new, that would be. And then refund the notes.

Bell: That's right. Want to go on with that (to H.M.Jr)?

H.M.Jr: No, I think not.

Well, that is approximately the picture. I mean the 750 is still tentative. My own inclination would be, if the market would warrant it, I'd take all I could get comfortably up to a billion, and - I mean if the market was in that shape. Because I don't - I feel very uncomfortable when our balance is as low as this and it puts me in a position where I'm at the mercy of the Government bond dealers, and I don't like it, and I don't want to be there again as long as I am here. And, as I say - but depending upon the.....

The only other thing is, we thought that....

(McKee comes in)

How do you do?

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McKee: Sorry to be late.

H.M.Jr: We've distributed our \$20 gold pieces, so you're out of luck.

Roughly for you, what we have said so far is that we continue just as we are with a hundred million a week through the second of June. Bell's figures show that we need at least a minimum of 750 million dollars on the 15th of June; and we start July again selling into December. Now, that is approximately what we have said, and I was saying that I'd like to think in terms of financing this time - go back; I think what we used to do - do it two weeks before the 15th of June, do it March 31, rather than June 7. I know Burgess has always asked for extra time. I mean he never liked to have it so close.

Harrison: That's right.

H.M.Jr: What?

Harrison: That's right.

H.M.Jr: I mean we used to do it two weeks before and I feel - I may be wrong, but I simply feel that it gives them, everybody, a little bit more time to turn around. If you do it on the 7th of June, it makes it awfully close.

Harrison: On the other hand, this is one time when there may be some advantage in waiting as long as you can, to see which way this market is going to open up for you.

H.M.Jr: Well, we've got three more weeks.

Bell: You're just talking about the preliminary discussions; you're not talking about advancing the date, are you?

H.M.Jr: I'm talking about doing the financing on May 31.

Bell: Is that right?

Harrison: I say that I think this time, as long as the bond market and the note market have been through what they have been through, and have had the shock they have had, you may possibly decide that you will want to wait as long as you can in June to see which field

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of financing opens up for you.

H.M.Jr: True, but I thought for today I'd like to think in terms of the 31st, as a tentative date - I mean no announcement, just as a tentative date. Because you fellows have always been asking for more time. Now you don't want it?

Harrison: No, I think Burgess probably would want it. I'm just trying to figure out in your own behalf the advantages of your waiting as long as you can. Now, maybe May 31 will be quite adequate.

H.M.Jr: Well, we don't know how long you people can resist selling some bonds and we thought we better get it over with.

(Hearty laughter)

Harrison: But the important thing, I think, Mr. Secretary....

Sinclair: It's a nice day outside.

H.M.Jr: I mean just how long before you decide you're going to have a selling program, so....

Harrison: I think the important thing at the moment, from our standpoint, as the Chairman pointed out, is to ascertain from you what you have already told us, that between now and June your plan is to continue with the present bill financing.

H.M.Jr: We need 350 million dollars, due to the - we need every dollar of that.

Bell: Yes, sir.

H.M.Jr: I mean we can't get along with a dollar less.

Harrison: What I was interested in was whether you're going to ask for more.

H.M.Jr: No. I'm consciously taking a risk, which I don't like to do, by not asking for more, but I am willing to take the responsibility and the risk by going along this way. But I hope I'll never have to do it again, because - I mean I'm letting the working balances go

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down to less than 300 million dollars. I don't like it and I don't want to do it again.

Of course, you people may pass a resolution and ask me to de-sterilize some gold, but I don't want to have to meet a resolution like that.

But we can get along very, very carefully, as we are. I don't know, the market keeps talking about an extra hundred million dollars; we haven't got that in mind.

Harrison: Well, I think that is important to know. And I don't know whether it might be important for the market to know on these bills whether you contemplated any changes.

H.M.Jr: George, if you go back.... I've never said more than a week in advance. Supposing we suddenly had a bunch of gold dumped on us; we might have to ask for more. What?

Harrison: Yes, I see.

H.M.Jr: I mean if I commit myself for the rest of this month and then suddenly somebody dumps 50 million or a hundred million dollars worth of gold on us that we didn't expect, we'd have to change. But if it goes along as it is, we're all right.

Harrison: I see.

H.M.Jr: But if suddenly England dumps a lot of gold on us, then we might have to borrow some more money.

Harrison: Or somebody else.

H.M.Jr: Or somebody else. And that is why I told the newspapermen Monday that, as far as the bills were concerned, they were on a week-to-week basis. But you people are here and want to feel our pulse and look at our teeth, and we have no cavities. And that's the situation. Right?

Bell: (Nods yes)

H.M.Jr: Wayne?

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Taylor: (Nods yes)

H.M.Jr: Want to say something?

Taylor: I don't know whether you want to take advantage of the people being here - I mean to discuss maturities again, or do you?

H.M.Jr: Oh yes.

Taylor: Not for these next two - next three offerings, but...

H.M.Jr: You mean maturities at this stage.

Bell: You mean six months bills, three months bills.

Eccles: Well, wouldn't it be well, while we're here, not only to discuss maturities of bills, but to discuss the whole question of bonds and notes and - I don't mean that it's just the - the apparent merits, at least at the moment, of the various issues. I - I feel that unless the situation is very, very different than it is, that a bond issue would be a mistake. Bonds should pretty largely be taken by the investors, and I don't believe the investors would come in and take bonds....

H.M.Jr: Couldn't George Haas distribute this (charts) if that's what you're going to talk on?

(Haas distributes charts)

Eccles:to the extent necessary at this particular time. I think the short-term market is the market that can be depended upon. The banks are in easy position and there is a large supply of funds in the hands of investors and institution investors. But they will not go to a sufficient extent in the long-term field until they are certain - there are certain features, I think, the uncertainty that exists today, that they would want clarified.

If you need 750 million at the moment, it would be my thought that you might get 500 million in June, or 600, and then increase the bill issues; instead of starting July, suppose you might start immediately after the financing and merely increase the total supply of bills outstanding.

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- H.M.Jr: Well, I'm absolutely opposed to that, Marriner; I'm absolutely opposed to that.
- Eccles: You don't want to increase the amount of.....
- H.M.Jr: I just want to go..... We fellows absolutely bent ourselves double to go along and keep the money market easy and borrow the minimum, and I think we've done anything that the Board could possibly ask to cooperate with you fellows.
- Eccles: Well, of course.....
- H.M.Jr: Now, may I just finish? I look at this bill business as a thing, as a matter which we always wanted for an emergency, and I want that reserve borrowing power when something goes wrong. And to do what you suggest and to work that up to three billion dollars - I don't want to do it. I mean I don't - I'll pay whatever the traffic calls for, but I'm not - if anything, I want to go the other way, I want to let some of the bills run off, and keep that as an emergency thing. It is a nice device, but I'd like to use it the way we have up to now.
- And I haven't had any means of testing the market. I understand Burgess comes back on the 20th. Is that right, George?
- Harrison: Yes, although he didn't look very well this last week. I don't know whether he should come back.
- H.M.Jr: But I want to right now say that I don't want to increase the bills; if anything, I want to decrease them. And I don't care whether it's a note or a bond or what it is, but with prices sweet enough.... You fellows, I don't think you can convince me to increase the bills. And I don't think we are asking too much to ask the System to cooperate with us when you consider what we have gone through the last three months to cooperate with you fellows.
- Eccles: Well, we're not suggesting, or at least I'm not suggesting it from a standpoint of the System; I'm merely suggesting from the - from what I think would be in the interest of the Treasury.

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- H.M.Jr: Well, I can't see it at all. I mean you suggested it the other day - "Let us run up to three billion bills" - and I just can't see it. Now, if everybody disagrees with me, I'll begin to listen, but I'd like - but if everybody says I'm wrong and we should let the bills go up to three billion, O.K., I'd examine it this next week.
- Eccles: Well, you've got a market for bills. First you have - you take the banks, being closer to their reserve requirements, that is, the excess reserves not being as large and excessive as it was - the banks want to invest in the regular short-term paper. It isn't only an experience here but it is true all over the - particularly the British situation.
- I was in New York last week and talked to five of the money market bankers, and they are interested in the bill market. I know banks generally, so far as excess reserves, if they've got excess reserves, they're interested in using their funds in the bill market. Now, it will be to a certain extent in the note market, but less so possibly than in the bill market.
- The bond market, I think, is a field that you've got to look to investors for, largely outside of the banks, because I believe the banks have as many of the long-term issues as they possibly should have.
- H.M.Jr: Well, I - you told me the same thing when you were over here and I'm not prepared, and I haven't seen but one concern who dropped in, and I'm not really ready to talk. But I have always felt that.....
- (Williams comes in)
- Hello. - How do we address you, as President or Dean? Congratulations.
- Williams: Thank you.
- H.M.Jr: But I'm not really ready; it's useless to talk.
- Eccles: Well, maybe I'd change my views in a couple or three weeks, but I'm merely throwing this out for the purpose of a discussion, because it is only by discussion.....

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You don't want to - you don't want to - you may disagree, but you at least want our best judgment in this matter.

H.M.Jr: Well, I don't see how you can give it to me at this time.

Eccles: Well, based on the present situation, that's all.

H.M.Jr: Well, a couple weeks ago you fellows were all worried about the nine months stuff. You called this meeting, you told me, because you wanted to discuss giving up nine months and so on. Now for two weeks the nine months go all right and now you don't want to discuss it. I mean the thing changes so fast.

Broderick: Mr. Secretary, of course you realize there is really no market for nine months bills except New York. That maturity hasn't appealed to the rest of the market at all. And I believe the bill market will never be healthy until the banks elsewhere can be original bidders, and to do that they must have a maturity which will appeal.

H.M.Jr: Well, I think you fellows have been awful suckers the way you have taken those off the dealers' hands.

Broderick: Hasn't that helped the market?

H.M.Jr: Yes, but you've got them all educated wrong down there.

Broderick: well, let's educate them over. But I think if we had a wider distribution on the short-term bills throughout the country, you'd be surprised at the degree of health it would give to the market.

H.M.Jr: Listen, I don't - what I'd like not to do today is - I don't want to say how I really feel what's happened the last three montas, see? Now - and just leave - let it go.

Broderick: It's the present and the future we're interested in.

H.M.Jr: I'd much rather - and frankly, I don't think on a - from day to day we can decide whether it's going to be bills, notes or bonds, because the thing has changed

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so fast and the whole sentiment has changed so the last ten days; not only - the whole financial thing has changed so tremendously that I'm hoping that it will continue to change for the better between now and the first of June. And I frankly wasn't ready today to do anything other than give you people the picture of what our financial needs are.

But I just do want to say, and I want to - that we have just tied ourselves in a double knot by letting our working balance go below 300 million in order to cooperate on the policy of the Federal Reserve System in handling excess reserves and handling the bond market. And I feel on the 15th of June that we want to build up our balances and do it as well and as economically as we can.

But in three and a half to four years I've been here, I've always felt, and everybody that I've talked to has always agreed with me, that "don't overwork the bill device," that that is something you want to have to fall back on in times of emergency.

Broderick: That's right.

H.M.Jr: And I don't think - I think we have passed the emergency and I can't see at this stage - the little feel I have, which is very little - that at this time we want to increase the total number of bills outstanding. I mean I look on it as an emergency device. Now, if I - as I say, if everybody in the room is against me and as we get nearer, I'm not going to stand out alone.

But C. F. Childs walked in here with his New York bond market man, uninvited, and I never heard a more bullish man in my life. He practically said, "You can sell anything you want to; the country is lousy with money." And he said, "As long as you are moderately reasonable, they'll take anything that you offer." He said, "We've just made a complete check of the country." He said, "Don't worry about a thing. Your June 15 issue is a sure success."

I didn't ask to see him; he walked in here. He said, "Everybody, insurance companies - everybody's just lousy with money."

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Eccles: Well, we've known that. They've been that way all through this period, too - for the last two months; the situation hasn't changed any. You wouldn't think they were, though, if you could look at that market a month ago.

Harrison: Mr. Secretary, I didn't know anybody was coming here to talk about what you're going to do in June.

H.M.Jr: I'm not ready to discuss it.

Harrison: There's one thing I wanted to know; you told me. That is what we should plan about bills. Because my executive committee puts me on the spot every Monday morning - "Now, this bill thing has got to go this week. What you going to do about cleaning it up?" - and it's been rather a nerve-wracking performance for two or three weeks. It would become more so if you had advised us that it was likely you were going to increase the amount of bills you were going to ask for each Wednesday between now and June, and I'm glad you're not going to; but I didn't know whether you might not have to. But as long as you've answered that in the negative, much of the worry I've had about the bill market vanishes.

On the other hand, I do still think that whether we have been right or wrong in our guess about the nine months bill, some day, as a matter of caution and conservative policy, the Treasury will have to consider - that's all I think - the possible reduction of that maturity.

H.M.Jr: I won't argue about that.

I'd like to ask the Open Market Committee a definite question and then I'll answer you what I have in mind. Have you any worries at all if we say to you people that we'd like to continue just as we are to the second of June, 50 million of nine months and 50 million into the 15th of September? Have you any worry about that program from now until the second of June?

Eccles: I haven't any.

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McKee: Neither have I, if you're going to be satisfied with the rates as they come.

H.M.Jr: I'm satisfied.

Sinclair: We've had in Philadelphia more bidding this week than we have had in some time on both the longer and short bills.

H.M.Jr: I mean that - now, if anybody is worried about that program....

Broderick: Not at all, not at all.

H.M.Jr: George?

Harrison: No, I think it's going. I feel much more encouraged about it than I did a week ago, and still more encouraged than I did two weeks ago. Now we're over May first, we have more excess reserves than we originally figured we would have, and the bill market at the moment is pretty sound and carrying itself.

I do think we've got to face this one difficulty, and it comes up in view of a comment you just made: That outside of New York and outside of a few banks in New York, the nine months bill is quite unpopular and when the dealers get them, if we didn't take them off their hands, the very next Monday bidding you might have a flop in your nine months bills; and that's the only reason we're being suckers, as you explain it.

H.M.Jr: Well now, what I want to say to you, what I had in mind was this thing, that if we could get between 800 million and a billion dollars in June, I had even thought of the possibility of after that stopping our nine months for a while.

Harrison: I think that would be fine.

H.M.Jr: Letting our bills run down, and then start in with a six months bill.

Harrison: Six and possibly three.

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H.M.Jr: Or just going - of going to the quarterly. And then save that device again for a time that we need it.

I'd like to take all the traffic would bear; I'd like to get all the money I could in June, see?

Harrison: Mr. Secretary, would you consider this? You asked whether the present bill program is satisfactory or are we worried about it. I think that the records of the last two weeks show that the nine months bill is apt to go just because of New York. I think it won't go, frankly, on a given Monday if we fail to clean up the previous Monday's nine months bills, and that's too much of a risk to take, frankly, right now. I'm wondering whether you might not in the next few weeks consider - there may be some reason against it that I don't know of - but whether you wouldn't consider issuing nine months bills and three months bills rather than nine months and September bills. Because you don't need to put so many bills in September as you did in June for the reason that you have a good maturity in September anyway, and the purpose of putting bills into September, or at least the purpose of putting bills into June, doesn't exist to the same degree for September.

And what is running through my mind - with all this talk about, these fellows saying, "We want a nine months bill - I mean a ninety-day bill," couldn't you possibly consider now taking some of the maturities during the rest of this month out of September and giving them what they want for a while? That is, a choice between ninety-days that they say they want and the nine months which you want.

H.M.Jr: Well, may I answer you this way? What I'd like to do, if possible, for everybody concerned, is to continue as is until the second of June, so that we don't make any more headlines.

Harrison: Well, I'm against headlines.

H.M.Jr: If we can go just as we are with no change, no cause for newspaper comment, just run this show as is until the second of June, not having discussion "Why did they change, why don't they do it in September?".... If we don't do as much in September, they say, "They

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think they're going to get their income taxes reduced; they don't expect the money; therefore, they don't need the maturities." There's all kinds of people just looking around to write columns and stories and explanations, and so on. I'd like very, very much to - if possible, to run the thing as is until the second of June without any changes.

Harrison: If you do that, don't call us suckers for taking them off the dealers' hands.

Bell: What's the difference between three months and 120 days?

Harrison: Very little in fact; very little in fact.

Bell: That's what they're getting now.

Harrison: But we've been serving - both the banks and a lot of the corporations are trying to get interested in bills. I had a long talk with Walter Teagle of the Standard Oil about it, and he went back and surveyed it with his board and he says they are now buying your bills and they've been buying bills to mature before June 15, when I think they have a dividend. I asked him what he was going to do after June 15; I think they pay on a semi-annual basis and they'll be interested in something before December. There are other corporations, however, that have a quarterly payment and there is no doubt that the ninety-day bill will suit the corporate demand better than the nine months bill or even the six months bill, on the whole. I think that when you can, whether it is now, or for the reason that the Secretary says, you want to put it off to June - my recommendation would be to try two kinds of bills simultaneously; that is, the six months bills and the three months bills. And I understand from what the Secretary says, that that is not beyond consideration after June.

H.M.Jr: What I'd like to say to Chairman Eccles, if it is agreeable - today's the 12th; if you don't mind, I'd like to meet with you fellows again on the 19th, I'd like to meet with you again on the 26th.

Eccles: It's all right with me. What about you (Sinclair)?

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Sinclair: All right with me.

Eccles: All right with you, John?

Williams: Yes.

H.M.Jr: All right, we'll figure that the 19th and the 26th. And when you come in here on the 19th - today, the 12th, we'll send out the same notices again, the nine month and the bill in September - and then when you meet on the 19th, we'll give you another chance, we'll talk it over again, see how the thing is. See what I mean? I mean I'll keep this decision on a week-to-week basis.

Harrison: You won't be overloading September 15 by keeping up the September bills, will you, Mr. Bell?

Bell: 350 million.

Harrison: And how much your maturity - about 800 million?

Bell: 817 million of maturing notes. But if you want to use part of your notes, you'd have to confine your refunding to a certain percentage, see?

Harrison: Well, all I had in mind was that if, without causing other questions or headlines, you could lighten that maturity of September by having your three months bills for the remainder of this month, you might just be that much better off in September. Now, as against that, you raise the question of headlines, and that is...

H.M.Jr: Well, you can think it over, but all we can decide today would be, does anybody in the room see any objection to announcing - sending out the wires.... We do it on Wednesday, don't we?

Bell: Yes, Wednesday afternoon.

H.M.Jr: We make the decision Wednesday.send out that next Monday we'll offer 50 million dollars of nine months and 50 million of bills due September 15. Does anybody see any objection to that?

Harrison: No, I see no objection to that. The nine months

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bills were cleaned up this time for the first time out of the dealers' hands without our intervention. Be interested in that.

H.M.Jr: Yes, I know.

Harrison: Mostly due to the fact that the Bankers Trust Company took such a big wad of them.

H.M.Jr: As I say, we'll meet here a week from today; we'll have the same discussion over again.

Bell: But you're going to have an entirely differently situation in your nine months bill market after June second. See, when you've got 50 million just nine months, no shorter term bills, your rate ought to materially improve; and that will be after June second in your nine months bills.

H.M.Jr: George, get this thing. Since I have been here, I have never permitted myself the luxury of having any monetary hobbies. Now, the nine months isn't my hobby, see? And if it doesn't work out all right, I can change, because I'm not committed except from week to week. What?

Harrison: Well, I think your nine months bills look better today than they did two weeks ago.

H.M.Jr: But the only thing - I don't say - the difference - where Eccles and I may be thinking a little differently, and I may change next week and he may change next week - I reserve the right to change this afternoon... But my own feeling is that when I can get the money I'd like to get it and let the bill thing run off and save that for some other time when somebody else is going to do something which will upset the market.

Harrison: Mr. Secretary, may I just, as a matter of... I was a little upset at your statement about the fact that our administration of - our taking off the dealers' hands....

H.M.Jr: Do you mind referring to the Dean of the School of Administration when you talk about administration?

Harrison: Public Administration. This is private.

H.M.Jr: Oh.

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Harrison: I wonder, do you really feel strongly about our cleaning up the dealers each week?

H.M.Jr: No, I think....

Harrison: I thought you were very much in favor of that when we did it.

H.M.Jr: I tell you how I feel about it. (Laughing) You don't like the word "sucker."

Harrison: No, I never like that word particularly when it applies to me.

H.M.Jr: I think under the circumstances that you couldn't stop that overnight, see? Quite frankly, I wasn't aware of the fact that evidently it's been the policy for some time for you people to clean up the dealers' shelves when they got overloaded, see? I mean maybe you've done it before, but I didn't know you did it in any such large quantity. And therefore they go in there and if it's all right - as long as you've asked for this, I'll tell you - they take the profit, and if it isn't all right they dump it on the System. And that's why I use that word. Now, it is - it hedges you in.

Harrison: I would much prefer not to do it at all.

H.M.Jr: But in the middle of this I wouldn't - I certainly wouldn't want to start something new between now and the second of June by simply telling the dealers you're not going to stay behind them.

Eccles: Let me say something on this whole situation here.

H.M.Jr: I mean just - I mean to do it between now and the second of June and come back here Wednesday and say, "Just because you called me a sucker, I wouldn't stand back of them, and now see what happens," - please don't take that attitude.

Harrison: I just wanted to be sure.

H.M.Jr: But it's a system which has grown up.....

Eccles: The trouble is the excess reserves - if we had enough excess reserves into this picture so that they were in the super-abundancy in the New York area.... Now

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we got 800 million excess reserves, which, taking the System as a whole, is sufficient; it is more than we have ever had and should finance any necessary short-term financing. However, there's about 200 million of that in the New York market; the rest of it is throughout the country. The New York market is the bill market; the rest of the country are not educated and know very little about the purchase of bills. Now therefore, you have almost a monopoly of the bill market in the New York market. Our failure to get into that picture and do something about it means the management of that bill market by those dealers.

Now, where we are suckers is to have a law that prohibits the Federal Reserve System from purchasing directly from the Treasury and assuring the success of a bill financing. Now, we got in the law of '25 a prohibition to do that. And I'd like to say to the Treasury here that the sooner they correct that and put the Reserve System in a position to - if need be, like the Bank of England is..... Why do they get - why do they assure always the successful operation of the bill market in London?

H.M.Jr: Do you want the same system? We can also sell you a little gold?

Eccles: Well, if you'll give us the right to increase reserves and get a unification of the banking system - now, there is - in other words, a unification, that is, an enforced membership of the banks in the system, and then the right to further increase reserves, you could meet that problem without any trouble. But you can't increase reserves further where your banks can slip out from under you all the time. You see? And you can't do it without having the right to increase reserves further.

But I wanted - what I wanted to - I have no apologies to make whatever for the attitude I have taken with reference to this bill market. And I think that not only now but that as a continuous process, this Open Market Committee cannot assume a management of the domestic money picture without dealing and getting in that bill market constantly and currently, until you change the system; that if you want - if you're

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going to let five Government bond dealers run the money market, that is one thing, but as I conceive of this thing it is the business of this Open Market Committee to run that market. And I don't think that we are suckers at all when we purchase bills; that may be necessary in order to maintain a stable money market.

Broderick: You get a stable bill market when you get a wider distribution. That's what we need.

Eccles: That's right.

Broderick: Not run by the five dealers in New York. You'd have no market unless you'd have those five dealers. What's the substitute for that? A wider market.

Eccles: You haven't got that.

Broderick: By patient education you can get it.

And may I say also, so that the Secretary may not think we are.... I think that section of the law which forbids the Federal Reserve banks from dealing directly with the Treasury is a good section of the law. I don't agree with you (Eccles) on that point.

Eccles: Well, I don't expect to have a unanimous agreement on all these questions; but I'm merely giving what I see in this problem of Treasury financing.

H.M.Jr: Well, may I say this, that with the conditions as they have been this last month, and with the buying of the bills concentrated in New York, and with the lack of distribution and the fact that you couldn't buy, there isn't anything else that you could have done.

Eccles: No, and not anything I think we can do in the future for some time to come.

Broderick: And we're going to help all we can.

H.M.Jr: And I think it was highly important that you did do it, because - I mean as long as you fellows took the action you did take, with the result of what happened to the bond market, if you didn't step in in the bill

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market and do what you had done, why, the country would certainly have been gone. I mean there's no question about that; I mean the bond market was gone and the only thing left was the bill market, and the country and the dealers wanted some assurance that somebody still was interested in the - in a Treasury obligation. If you fellows hadn't stepped in there - well, we went all through that one night at our house and that was settled.

Eccles:

You have a concentrated money power in New York. Now, you can say what you want, but you've got those five dealers and a few very large banks and a few large insurance companies, and you have the concentration of the market there, pretty largely. And the - if you want to put enough excess reserves, pile them back into the System, and which - sometimes they'd have to be taken out again and then it would cause real difficulty. You can always - you can insure a market certainly for short-term securities. Now, there's an adequate supply of reserves today if that 800 million was all in New York, but inasmuch as it isn't and the bill market is in New York, it seems to me that it is the business of this Open Market Committee to - if they're going to assure an orderly market, a bill market at reasonable rates.... I don't say - I don't call rates above these present rates reasonable rates, in view of where they were. I think, looking at some time in the future, they may be advanced to some extent, but with the present excess reserves and the tremendous deposits and the advance we have had in rates, it seems to me that rates around the present level for short-term money could be considered a reasonable rate.

The New York bankers that I saw last week said that if we got higher rates, then the - no doubt the banks throughout the country - if the rates were high enough, that would attract those funds in. Well, it seems to me that if we're going to have an orderly money market, that means an orderly rate structure, and that at this stage of our recovery a substantial increase in the Government short-term rate would not be either wise or justifiable. That's - there may be a lot of disagreement, but I just wanted to get my point over and the problem that I see here, and where I may disagree very thoroughly with George or other members of the Committee; but at the same

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time that's your problem.

McKee: Mr. Secretary, may I make a statement about this bill situation?

H.M.Jr: Please.

McKee: I understand that is all we're talking about. Personally, I think your opportunity to continue to sell ninety-day bills is better now than it was two months ago.

H.M.Jr: You mean ninety-day or nine months?

McKee: Nine months. Now, when you realize that these corporations - that these corporate funds are not going to be employed to buy ahead for long-terms, that they're going to get what they can on their money and they're going to employ those loose funds in bills or anything else of short maturity... Now, I can't agree with some of them that you - that a nine months bill will not be popular for some time to come. Maybe there will be a time when you will have to change, but I think when that time comes then by changing you're going to affect the yield on all Government securities. Now, temporarily it might drop commensurate with a shorter maturity, but it will finally get up to the rate that you are paying on nine months bills.

H.M.Jr: You mean if you take a six months.

McKee: Yes.

H.M.Jr: Well, I don't know, and as I say, I simply feel we are in a period where things shift awfully fast. I mean two weeks ago the financial community seemed to have a bad attack of jitters; no one is calling me up any more asking about the price of gold, so temporarily they're not worried about it and things seem to be quieting down. Now, when you gentlemen come back next week I don't know what the conditions are going to be, and I can't make any commitments on this bill thing or how we will borrow more than a week in advance. And, as I say, as we come down, and only two more meetings, if we can put it through on the 31st - and that's tentative - I think maybe we'll arrive at how we can

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borrow the money; that's all I'd like to do. But....

Eccles: Well, certainly we can assure from now until June a successful operation of your bill financing of a hundred million a week in the three weeks. And it should be - and inasmuch as we have been able to do what we have over the past few weeks over a much more difficult period, much more difficult situation, there certainly should be no difficulty whatever in assuring the success of a bill market from now until June along the line you discussed.

H.M.Jr: And you fellows won't make any change in your Open Market Committee without letting us know, between now and June.

Eccles: What do you mean, change?

H.M.Jr: Any change in your policy.

Eccles: Oh no. We have - this is - this committee can't change the policy. It is a question of getting a meeting of the full Committee if we're going to change. We operate under the policy adopted by the full Committee.

H.M.Jr: Well, I meant - I'm talking - I'm talking about the System now.

Eccles: Yes.

H.M.Jr: I mean the System won't have any change between now and the 15th of June without at least giving us a chance to talk about it.

Eccles: We have a meeting the 7th of June of the full Committee.

Broderick: Heavy sale of our securities - that's what's in the Secretary's mind.

H.M.Jr: I mean any change of any....

Broderick: I think you'll find, Mr. Secretary, that there will be no material change in the policy without advising you fully before it happens.

Bell: Can't change the amount, can you, after you publish the statement, and.....

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- Eccles: Well, we can.
- Bell: That is, the...
- Eccles: Yes, the New York bank, which is our agent, couldn't change the amount.
- H.M.Jr: I address myself to the System.
- Eccles: The Executive Committee has power to increase or decrease the portfolio; we have that up to certain amounts. The Executive Committee adopted a program of not permitting a reduction in that amount from week to week without special action on the part of the Executive Committee.
- Broderick: You're not interested in minor changes, just material changes of two or three hundred million, something like that.
- H.M.Jr: Well now, I meant - I meant anything that would affect this picture that we are all working on.
- Broderick: You would be fully advised, Mr. Secretary.
- H.M.Jr: What?
- Broderick: You would be fully advised.
- H.M.Jr: I didn't mean two or three - I meant even 25 million. I meant anything that would materially affect.....
- Eccles: Would - what would be your opinion if there was any change at all between now and June?
- H.M.Jr: Oh, I think that that is a thing that you've got to watch from day to day. I'm on record, and have been for three years, that I thought you people made a mistake when you froze - froze the amount, and I'm going to be the last person to say that you can't let it run off if you got a very strong market.
- Eccles: You'd think, though, that that is a question of timing and - - the question of letting it run off.
- H.M.Jr: I think it is a question from day to day. I mean I don't - the thing - this thing that we have gone through isn't a question of a wound that can be healed in a day or two. It's going to take weeks

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or maybe months to heal what's happened here the last three months, and the thing's got to be watched just like a sick child; the child isn't well. I mean this is something it's going to take months to recover from.

Harrison: Mr. Secretary, you have said something to individual members of the Executive Committee from time to time about the influence or the dictation of the dealers in New York. Now, I'm not the counsel for the dealers, and I don't have to defend them, and I didn't create them; but the truth of the matter is that over a period of years the dealers have done a good job, and I don't know what we'd do without them right now, because I don't know what the other mechanism would be, and for a while I think we've got to live with them.

If, on the other hand, there is anything constructive that anyone has to suggest about what we can do in our relations with the dealers, or in their relations among themselves, or their relations with the banks, I'd like to know what it would be. I think it is a little unfortunate that there appears to be growing up here among the members of the Executive Committee - and I rather gather your own feeling - that the dealers are extralegally dictating the Treasury policy. I don't feel that that is true; and if it is true, what can we do about it, or what should we do about it, rather than just talk about it?

H.M.Jr: Who are you asking?

Harrison: What?

H.M.Jr: Who are you asking?

Harrison: Anybody that can answer it.

Eccles: I don't think you can do anything about it right now, except for the Open Market Committee to take an interest and an activity in this bill market. That's what I think. I think that you can't change this dealer picture overnight certainly, and I don't know that we'd want to change it, certainly, until you find a substitute for it. But the Open Market Committee, in their operation, it seems to me, have got to take that situation of the dealers into account; and inasmuch

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as we can't buy directly, such as is done in other places and such as we could do once before, then it does seem that we've got to exercise our influence in the management of the money market, which I conceive to be our job and our duty, through the security market. And you get along with the dealers under that kind of operation.

- Broderick: May I come back to another point in regard to our System portfolio? You said that it should not be a stated amount and I've never believed it should be a stated amount, and it's been a stated amount for too long. And I couldn't see much difference if that is flexible; it might be down a few million one week and might be up a few million the next week. But what's back in your mind is that we start off on a program of deliberately reducing that portfolio in substantial amounts; that's the type of operation you're thinking of when you ask to be advised.
- H.M.Jr: That's right, you understand it perfectly. I mean you stated just the way I feel - I mean it should be flexible.
- Golden.: Mr. Secretary, may I ask you a question about your balances with the Federal Reserve banks? They are at a rather unusually low level, and that's one reason that the reserves are higher than we expected. And I was wondering whether you were contemplating keeping it at that level of about a hundred million or is it likely to rise?
- Bell: I might say that they are down there because the Board asked me to let them run down so it would ease the situation on May first.
- Golden.: Yes, that's right.
- Bell: We can operate very well on 75 to a hundred million dollars balance, and I should say that it would not run over a hundred or 125 million. I don't see any reason for it to run over that.
- Eccles: The important point is to keep them within a range, to have a stabilizing influence, whether it's 150 or 100 or 200. The thing that upsets the market, of course, would be to have them go from a hundred up to 300 or 350 within a very short period.

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- Bell: Of course, that won't be done unless there is major financing paid in cash.
- Golden.: That's what I wanted to know.
- Bell: It will be within a range of 75 to 125 million.
- Golden.: Because that directly affects the volume of excess reserves immediately.
- H.M.Jr: Sure; I thought we were working on a plan here.
- Golden.: I just wondered whether that plan was continuous, that's all.
- H.M.Jr: Well, it's continuous, yes, but I again reiterate, nothing can be continuous in these times. But we certainly extend to you the same courtesy that I am asking, that we wouldn't change that without getting in touch with you people. And I think it's been demonstrated, as I have said a number of times, that the most important thing is that the two institutions work closely together; and I think that after we finally did get a meeting of minds it demonstrated we could handle the situation. As I said before, the only thing I was worried about during this whole period was that there should have been a break; and I feel if there had been a break, that would have been the most serious thing that could have happened, and I think there wasn't and the country benefited by it. I think we'll give just as much cooperation as....
- Harrison: ...you get.
- H.M.Jr: No.as we have in the past. No, we don't - on that basis, George, you wouldn't have got so much for a while.
- Bell: Those balances might run up a little, Dr. Goldenweiser, around the middle of June.
- Golden.: Temporarily in connection with your income tax.
- Bell: Particularly if we get a large payment in cash for the new issue. That we can't contemplate.
- Eccles: Your tax revenue, too.

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- Bell: Well, your Treasury bills will take care of a great deal of your tax revenue. But I can't see why we should get a large cash payment on the maturing issue, because we've got the special depositaries drawn down to bedrock this time, and they may want the credit.
- Eccles: Well, right there, of course, is where an open market operation would come into the picture, where you are taking substantial funds out of the money market through either financing or taxes, which would increase your balances temporarily, maybe for a week or two weeks.
- Bell: That's where you ought to let your bills run off.
- Eccles: Right there is where we should increase your holdings of bills and as the money goes back let them run off. See? I mean as you take the money out of the market we should put it back by the purchase of bills, to offset the decrease in reserves brought about by the increase in your balances, and then reverse it after that period. But that situation will only likely exist in your tax period and your financing periods.
- Bell: That's right.
- H.M.Jr: Well, if there is nothing else, shall we adjourn? From today 'til a week from today.
- Eccles: All right - 11 o'clock.

MEMORANDUM

May 12, 1937

To: Secretary Morgenthau
From: Dr. Burgess

Treasury bonds declined moderately today in a quiet market. An easier tendency was in evidence in the forenoon and quotations dropped further in the final hour, the long bonds closing $7/32$ to $8/32$ off from yesterday, with the exception of the $2\ 7/8s$, off $10/32$. The rest of the list was generally $1/32$ to $6/32$ down. Some offerings out of town were reported and there was little interest on the buy side. Treasury bond turnover on the stock exchange totaled \$1,038,000. In the guaranteed group the F.F.M.C.'s were $4/32$ to $10/32$ down on the day and the H.O.L.C.'s were $1/32$ to $4/32$ down. The note market was quiet and easier. The 1939 issues closed $1/32$ down, the 1940's were $1/32$ to $2/32$ down and the 1941's $3/32$ to $4/32$ down.

Both high and second grade domestic bonds were very dull and a somewhat easier tone prevailed. Quotations for both groups were down small fractions from yesterday, at the close.

Foreign bonds showed no changes of consequence.

No purchases for Treasury today.

May 12, 1937

3p.m.

Present:

Ambassador Oswaldo Aranha
Mr. Sumner Welles
Dr. Feis
Mr. Taylor
Mrs. Klotz

HM, Jr.: Well, I understand our respective Presidents talked over various things when they met on the trip down to South America.

Mr. Aranha: Yes.

HM, Jr.: And they worked out everything together for us, just leaving us the details.

Mr. Aranha: Yes. And I just want to know, because they talk only about general ideas, what are your ideas to send to my Secretary of the Treasury and decide about.

HM, Jr.: I see.

Mr. Aranha: Because you know money and also the ideas.

(Laughter by both the Ambassador and the Secretary.)

HM, Jr.: (to Mr. Welles) You were on the trip. Do you want to sum up?

Mr. Welles: Well, of course, I am a little embarrassed speaking in the presence of the Secretary of the Treasury and a former Secretary of Treasury on abstruse matters of high finance! But the basis of the conversations which the Presidents had and which I heard very briefly of down there and which I subsequently on our way back heard a little more extensively, was more or less along this line: the Brazilian Government is considering the creation of a central bank. The chief objective the Brazilian Government wishes to attain is a stability in Brazilian currency. It has occurred as a possibility, and I think that the suggestion emanated from the talk President Roosevelt had with President Vargas, that it might be possible to work out some arrangements with the Brazilian Government whereby some of the gold reserves of the

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United States could be made available to the central bank to be created by the Brazilian Government and could be obtained by the Brazilian Government, you might almost say, 'on the installment plan', over a period of years, gold that might be segregated for that purpose to be earmarked for account of the Brazilian Government and as installment payments were made over the course of years that each year the gold would be sent, the physical possession of the gold, to the Brazilian Government. That was the general basis of their discussions. Anything else that occurs to you, Dr. Feis?

Dr. Feis: Only the interest rate to be nominal. I think we talked 1/8%.

Mr. Welles: That was the President, President Roosevelt's idea.

HM, Jr: It doesn't leave me much, does it? I think he's charging too much interest! Too high interest! I think it's too much!

(Much laughter)

Mr. Aranha: We say in Portugese, I don't know in English (here the Ambassador spoke in Portugese.)

Mr. Welles (Translating): "When the charity is great, the poor man is worried."

HM, Jr: Which is another way of saying, "Beware of Greeks who come bearing gifts."

Mr. Aranha: Santa Claus! We once started (and I can send to you all we had that's in Brazil) -- Sir Otto Niemeyer went down and made a study of our central bank and all and we have that also in English and at this time his ideal was to make a loan of 18,000,000 pounds, but he left Brazil just in the moment in which England devalued the pound and that was impossible. After that we had all these troubles with the world.

HM, Jr: That was in 1931?

Mr. Aranha: Yes. And we did not think about these gold pounds for our money. After talking to the two Presidents we desire to start this possibility and to know what we can do. Our money, the value of our money, is improving every

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day. The Government is just working against that. We have gold, but only from our mines. We have now more or less 6,000,000 pounds in gold from our mines. We are every year buying. The gold is free -- the exportation of our gold -- but we are buying from people who want to sell to our banks and in three years we bought 6,000,000 pounds. We have this gold refined and no more; that is only gold we have. We have more or less 10,000,000 pounds, this is a probability, in foreign banks, from our commerce.

HM, Jr.: Now, Mr. Ambassador, I would like to take this attitude. Since I have been here I have never attempted to have any conversations with any country unless that country wishes it. Now I don't know just how much the Government of Brazil wants to go into this kind of a study, and it's an internal matter of Brazil. If they really want to do it, then my time is at your disposal.

Mr. Aranha: Thank you.

HM, Jr.: But

Mr. Aranha: If you allow me, I would suggest to you that if we could put two specialists together to talk and study our position and all our details and your representative will study with ours and they will arrive to some conclusions and, after, they will give to you this conclusion and to me, we could talk because I cannot take your time in these details and also these details are very important because we don't know; that depends; many details to know if that is possible. Naturally Brazil wants it because we will free our exchange and we will improve our economy through entering the Gentlemen's Agreement, for example, and we will have the gold here. We don't want the gold in Brazil. We will have our gold, but we want only to have that here, like a fund for our international commerce through your country through this fund, and the base of this fund we will create here.

HM, Jr.: Well, Mr. Taylor, who is Assistant Secretary, is ready to meet anybody whom your Government will send here.

Mr. Aranha: Yes.

HM, Jr.: And, as you say, just as they arrive at a conclusion (each Government has necessary information) I would like to follow it myself, because I am very much interested in it. I think it is a very interesting idea, but, as I say, it is

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only something that -- we would like to offer our services if they are asked for, but we feel it's nothing we want to push.

Mr. Aranha: Yes.

HM, Jr: If it's to the mutual advantage of both countries, fine! but if it is not, I am sure you do not want it.

Mr. Aranha: Our idea is not to deal only with this formation of this fund, of the gold basis for our money, but also the results of this agreement on our commerce because we have now money troubles with Germany because we are compelled -- Brazil is selling to many countries which don't pay us. They gave a keg of money which has no value.

HM, Jr: We went all through that, both before the war and since then.

Mr. Aranha: Yes, but you have a way to resist, but Brazil has not. We must have decision about this question about these other countries. They don't pay and we are compelled to sell them because we need this money to pay our debts and if we will have this solution we will not sell until we will be paid in this universal money which is in the market.

HM, Jr: I understand. I want to say one other thing, if I may. In other arrangements of this kind with other Governments which I have had to do with since I have been here, I confine myself purely to the Government. I am not interested in the private debts. I want to make that perfectly clear at the beginning.

Mr. Aranha: Yes, I know that.

HM, Jr: I want to confine it purely to Government affairs.

Mr. Aranha: Yes.

HM, Jr: And it means that private matters are of no concern ...

Mr. Aranha: I know. We will include all that as a result of a good financial position and a good money. All will be all right after that, not with you -- with all.

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HM, Jr: I understand. That follows. It's the same thing. If we could keep the pound and the franc and the dollar more or less even, then the man in private business can do business between the Governments, but first the Government has to establish that for them and then private business follows.

Mr. Aranha: That is our interest in the case.

HM, Jr: What would you do? Bring somebody up from your Treasury?

Mr. Aranha: Yes. I will call in five or six days. I will be here. Naturally, that is a matter for a specialist. I think that a diplomat cannot deal with money.

Mr. Taylor: Even if he is a good Secretary of the Treasury.

Mr. Aranha: Yes. But when I was Secretary, we had no gold and I do not understand about gold and this law about gold in Brazil, I made this law. And it's really something which is doing very good deal in favor of our financial position. Before, Brazil compelled all the miners to sell the gold to them, to the Government, by a special price, and gold could not be sold to the foreign countries and I freed the market and I set the price by the price of London and the mines improved their production I think ten times more and now we are producing much more gold and the Government is buying and we have in two years we bought 22 tons of gold and each ton is 250,000 pounds.

HM, Jr: And the production of the gold mines is growing?

Mr. Aranha: Yes. It is very well in Brazil.

HM, Jr: I think it would be very worth while, especially as we have established the practice, now that we do this thing as between Governments instead of as between central banks.

Mr. Aranha: Yes; we have no central bank.

HM, Jr: Our arrangement with England and France is between Governments.

Mr. Aranha: I know.

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HM, Jr: And not as between central banks, because we technically have no central bank here either.

Mr. Aranha: I know. And if we will not arrive to an agreement about that, I will sell to you our gold!

HM, Jr: We will give the same price that we do to everybody else.

(Mr. Aranha left the meeting at this point.)

HM, Jr: The only thing, the first embarrassing thing that happened, is this 1/8%. Did the boss really say that? He must have, otherwise you would not have said that.

Mr. Welles: He did; in Buenos Aires sitting with me.

HM, Jr: With Mexico on the money they actually use while it is earmarked, we don't charge them anything, but if they want to borrow dollars against it then it's 3%.

Dr. Feis: I don't think the way would be blocked to that.

HM, Jr: On earmarked gold we charge them nothing. I would rather charge them nothing. When gold comes in, it's 1/4% and when it goes out it's 1/4%, but if they want to borrow milreis or dollars against it then it's 3% against the money actually used.

Dr. Feis: The possibility of borrowing was not even discussed.

HM, Jr: It's not borrowing; it's an advance against their gold.

Dr. Feis: Even that was not discussed.

HM, Jr: Mexico deposited 12,000,000 ounces of silver and borrowed \$5,000,000 of foreign exchange and on that we charged them 3%, but on gold in vaults we charge them nothing.

Mr. Welles: I am perfectly sure that the understanding is within the limitations Dr. Feis had in mind.

HM, Jr: And then the other thing, when I said 'If you don't want to do it'.

Mr. Welles: I am very glad you made that clear. Absolutely.

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HM, Jr.: But his dropping that, I wanted to make it perfectly plain.

Mr. Welles: I am very glad you did.

HM, Jr.: Because I thought he was a little high-hat for the moment.

Mr. Welles: He did not mean to convey that impression. Both the President and the Secretary of Treasury of Brazil, in my judgment, are very anxious to do it.

HM, Jr.: Does he come from the same district as the President?

Mr. Welles: Yes; intimate friend.

oOo-oOo

May 12, 1937

My dear Mr. Secretary:

Supplementing the oral discussion between you and Under Secretary Magill on April 28, 1937, I should like to refer further to the interests of this Department in the subject of cooperation among nations in matters of administrative assistance directed at the prevention of tax evasion and the collection of taxes.

The revenue laws of this country require all persons subject to our jurisdiction making periodical payments to others, in excess of certain sums, to report such payments to the Commissioner of Internal Revenue. These reports are applicable to such items as dividends, interest, rents, royalties, premiums, and the various remunerations. Furthermore, information reports are required from security and commodity brokers on gross transactions of their customers in excess of certain amounts. This system affords an effective check against evasion by both the payee and the broker's customer in the case of periodical income arising within the United States. Where, however, such income arises abroad and the United States has no jurisdiction over the payer of the income, such information can only be obtained by international agreements.

A better understanding may be had of the benefits to be derived from administrative cooperation by referring to some of the principal cases or classes of cases in which tax avoidance is now possible.

Domestic brokers submit annually many information returns showing transactions in the names of foreign brokers, running into many millions of dollars for each account. Foreign brokers of practically all countries consistently refuse to disclose the customers bank of their accounts. This leaves our 400,000 citizens resident abroad, our resident citizens, and our domestic corporations with or without foreign branches or foreign subsidiaries, free to trade through foreign brokers without disclosure of their accounts by such brokers. Moreover, many American-owned personal holding companies have been organized abroad in the past few years for the purpose of dealing in securities and other properties, and of accumulating profits, free from the taxes applicable to American personal holding companies and present, it is extremely difficult to ascertain the stock ownership and earnings of such corporations; or to obtain information regarding their transactions through brokers.

Many foreign corporations, of the dummy variety, have been organized for other purposes of tax evasion. For example, such corporations have been availed of in the liquidation of large security accounts to prevent imposition of the United States tax on capital gains. If the enterprise engage in international business, dummy corporations have been frequently used for the double purpose of attempting to avoid the capital gains tax in this country and the tax on receipt of dividends in other countries. Successful prosecution of these cases is, in the main, greatly hampered for lack of complete information.

Tax disputes frequently arise in the adjustment of the accounts of a foreign corporation operating in this country through a branch or a domestic corporation. The Bureau of Internal Revenue is greatly handicapped in the prosecution of many cases through non-availability of records located in foreign countries. The common plea of the taxpayer is that records located in another country may not be removed for the purpose of examination in this country. Permission to send our agents abroad to examine the records is consistently denied on the plea that since the taxpayer has presented all pertinent information in connection with the tax dispute, no further investigation is necessary. At this point it is useless, in the absence of a treaty, to petition the foreign country for permission to examine the foreign taxpayer's records. Substantially the same situation obtains where an American corporation operates in foreign countries through foreign subsidiary corporations, and the books of the foreign branch are in the possession of that branch. There are many pending cases involving such considerations, in one of which the proposed tax deficiency is about \$25,000,000.

Difficulties in tax administration are not confined to lack of information necessary to a proper determination of the tax but also involve tax collection problems. There are many hundreds of cases pending in the Bureau of Internal Revenue where the foreign taxpayer has admitted that the tax is due, or where the Government has obtained a judgment against him, but where the Government is powerless to collect for want of jurisdiction over the taxpayer's assets located in other countries. These cases involve many millions of dollars. There are other cases where the nonresident alien or foreign corporation is contesting the case on the merits but where, pending final determination of the tax, the Government has no means of protecting its rights through taking conservatory measures against the property located abroad.

There has been a marked growth in the number of tax conventions since 1923. Prior to that time very few of such conventions existed whereas the number now exceeds 140. The conventions relate primarily to the prevention of double taxation, largely through agreements as to methods of allocation of income and capital and the elimination of discriminatory and extra-territorial taxes. There are, however, provisions in twenty-nine of these conventions pertaining to cooperation in preventing tax evasion through disclosure of information; and in the collection of taxes, through provisions for conservation of the taxpayer's assets by one country for the benefit of the other and the enforcement

The Secretary of State - 8/10/37 - 3.

of final tax determinations by one country for the other. The movement toward cooperation through disclosure of information and collection of taxes has gained momentum, particularly since 1934.

The most commonly accepted criterion in cooperation is that neither contracting state shall be required to go beyond its own laws in furnishing information. Measured by this test, the United States seems to be in a peculiarly favorable position to negotiate treaties for fiscal cooperation. Through our existing system of requiring information returns on mere phases of taxation than perhaps any other country, we have presently available the specific data in which foreign tax administrations would be interested. If we desire concessions on other points (such as those in the proposed addendum to the Franco-American Treaty, involving double taxation and extra-territorial taxes), we are in a position to make use of our greater ability to disclose.

The pending treaty with Canada provides for a mutual rate of tax on dividends and other items, under the circumstances specified in the treaty, of not to exceed 5 percent. The following example serves to illustrate the application of the proposed treaty: A, an American corporation, pays a dividend to B, a New York bank or a broker, the record owner, who pays it over to C, a Montreal banker or broker, who distributes one-half to D, a Canadian resident and actual owner of 50 percent of the stock, and one-half to E, a nonresident as to Canada, and actual owner of the other 50 percent. Various plans were considered which would give protection to the withholding agent, enable the Canadian resident to obtain promptly the benefit of the 5 percent rate, and enable the United States to obtain the 10 percent rate on dividends going to individuals nonresident as to Canada and corporations foreign as to Canada. The problem was finally met by the Canadian Government undertaking (upon only 5 percent of the dividend being withheld in the United States) to follow the dividend upon its receipt in Canada and secure payment to the United States of the other 5 percent where appropriate. In substance, the plan contemplated that the United States would furnish the Canadian Government with the names and addresses of persons in Canada receiving such dividends, together with the amount of dividends paid; and that Canada through a new system of tax returns would insure to the United States that any Canadian resident transmitting income from American sources to a person not resident in either country, would pay an additional 5 percent to the United States. There is attached hereto a memorandum setting forth the details of the plan which was tentatively accepted. It was mutually understood that this plan would be incorporated in the United States Treasury regulations pertaining to the treaty, upon its ratification.

Consideration was given to incorporating in the treaty provisions for cooperation in tax enforcement and collection in respect of the matters heretofore mentioned. It was finally determined to omit

The Secretary of State - 5/10/37 - 4.

provisions of this character in the interests of simplicity. The representatives of both countries, however, expressed a common interest in the desirability of a supplemental treaty on cooperation in preventing fiscal evasion and in facilitating tax collection.

The Department has previously expressed to you its interest in the negotiation of treaties directed at administrative cooperation between nations in the enforcement of their respective tax laws. As tax rates increase the problem of international tax avoidance becomes more and more acute. The informal administrative arrangement with the Canadian Government represents an initial step in fiscal cooperation, which in the opinion of this Department might properly be extended into more permanent treaty relationships, not only with Canada but with other nations as well. This Department will be glad to discuss with you at any time the initiation of negotiations looking toward treaties of this character with other countries.

Very truly yours,

Secretary of the Treasury.

The Honorable,
The Secretary of State,
Washington, D.C.

EM/mrl

**Tentative Proposals Submitted by Canadian Representatives
for the Practical Administration of the Reciprocal
Tax Convention of December 30, 1936**

1. That the withholding agents in the United States deduct 5 percent from all dividends going to Canadian addresses.
2. That the United States Bureau of Internal Revenue send annually to the Department of National Revenue at Ottawa the following:
 - a. The names and addresses of persons in Canada receiving dividends from sources within the United States;
 - b. The amount of the dividends paid;
 - c. The amount of the tax deducted under the 5 percent provisions as referred to in the United States Revenue Act and the Convention;
3. That Canada enter upon such enabling action as will require persons having an address in Canada annually to file an income tax return - whether they are taxable in Canada or not - simply because they receive dividends from United States sources, and in the annual tax return to certify: -
 - a. That a dividend was received from sources within the United States and the amount thereof;
 - b. The name of the company declaring the dividend;
 - c. That the dividend is held for the sole use and benefit of such resident, or if not, whether passed on to
 1. persons resident in Canada, or
 2. persons not resident in Canada, and in either case giving the names and address;
 - d. In respect to dividends transmitted to persons not resident in Canada, that 5 percent additional has been withheld or that percent which is equivalent to that originally withheld at the source in the United States.

4. That for brokers, trust companies, banks, and like organizations, in lieu of an annual income tax return to the Dominion Government, there should be a suitable form prepared, containing the names of persons, in or out of Canada, to whom a dividend was passed on either in whole or in part, and in respect of those resident out of Canada certifying that a deduction has in fact been made and sent to the Treasury of the United States.
5. That the Canadian income-tax administration will check the information from the source referred to in paragraph 2 above against the declarations of the residents and business in Canada. Where there is failure or omission, action designed to ensure the payment of such taxes as may be due to the Treasury of the United States will be provided for.
6. That the Canadian authorities will authorize Canadian residents to effect deductions as against non-residents of Canada.
7. That the foregoing may, with appropriate additions, be made applicable to other cases of analogous character which suffer a 5 percent tax at the source in the United States.

RM

RM

Speech given by Secretary on May 12, 1937
at opening of Conference of Int. Rev. Agents ¹¹⁰
held in Washington.

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Mr. Morgenthau: Mr. Commissioner, gentlemen. I have no prepared speech. Since I know something about your work and your responsibilities, I think Commissioner Helvering's idea of bringing you all here for a get-together is excellent, and the idea will be just as good as you men make it while here.

I need not tell you we are collecting the largest amount of money, I guess, the Treasury Department has collected in a great many years. The responsibility falls on you men and the men under you to see that we get it. We have been through four very difficult years and we are now approaching the time when the President and the rest of us responsible to him are very anxious to balance the Budget. Now, there are just two ways to balance it, one to cut the expenses, and the other to collect the money. Fifty percent of the responsibility rests on your shoulders to get this money.

We don't want to be hardboiled, we want to be fair. We are working for the taxpayers - - they are our bosses, they pay our salaries - - but on the other hand we want to make sure that they do pay the Government what they are supposed to under the laws. I can honestly say, and I know I can and look you in the face, that as long as I have been here nobody has pulled you off any case. As far as I know, you have been free from political pressure. If you haven't, it is your own fault. I have made the statement again and again that all you men have to do is to tell Mr. Helvering and he will tell me and I will take the pressure off. There is no reason in the world why you men can't go ahead

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and do your work the way you would like to do it. That is the way I want you to do it, and that is the way Mr. Helvering wants you to do it. The only possible suggestion I have is that I don't feel we receive enough suggestions from the field. Perhaps this conference will result in increased suggestions from you men as to how we can improve the work.

I think the most important thing of all is the work that you have done in trying to get these returns examined within twelve months. The only bouquets I have been handed on our tax work are that the returns are examined within the year. There is nothing worse for the taxpayer than to worry about what happened two or three years ago. We should be on a current basis. That is up to you men. The prompt and just settlement of a man's taxes is what I would like.

Don't hesitate to tell us, if there is something you know is wrong, too much red tape, something impeding your work, some of your men being underpaid, or if you have some dead wood; don't be afraid to put it down. We want suggestions. That is why Mr. Helvering brought you here. Don't be fearful that if you make a suggestion it will redound to your injury. If there is anything which you know is not right in the internal revenue service, don't hesitate to say so. Mr. Helvering and Mr. Magill will more than appreciate it. The purpose of meeting you here is to find out from you fellows in the field what is going on. The country is too big, I can't go out myself, although I'd like to. Now that Mr. Magill is here as Under Secretary, taking this responsibility over, he wants to know. The trip he made to New York was very fruitful, the agent there was very helpful, but I say that if you don't give us the suggestions

and tell us what you need, it is your own fault.

I want to say that on the whole I think you men have done a fine job. I can't put my finger on any particular criticism, I haven't any. Just keep it up and I will be more than pleased. I am glad to have a chance to spend a few minutes with you.

MEMORANDUM

May 13, 1937

To: Secretary Morgenthau
From: Dr. Burgess

Following a temporary easier tendency in the early part of the session when declines of up to 4/32 were shown, the Treasury bond market improved in tone and quotations gradually tended higher, ending the day at their highs. The long bonds closed unchanged to 2/32 up from yesterday, intermediates were generally unchanged to 3/32 better and the three short bonds were off slightly. Government guaranteed bonds improved with Treasuries, F.F.M.C.'s closing unchanged to 3/32 better and H.O.L.C.'s, unchanged to 4/32 better. Turnover of Treasury bonds on the stock exchange was \$810,000. The Treasury note market also improved after easing 1/32 to 2/32 early in the day. At the close, scattered middle and long maturities were off 1/32.

Domestic bonds were dull all day with quotations for both high and second grade bonds off small fractions from yesterday.

Foreign bonds were quiet and there were no price changes of consequence.

No purchases for Treasury today.

GROUP MEETING

May 13, 1937
9:30 A.M.

Present: Mr. Magill
Mr. Oliphant
Mr. Gaston
Mr. Taylor
Mr. Lochhead
Mr. Haas
Mr. Bell
Mr. McReynolds
Miss Chauncey

H.M.Jr: What do I do with this - Kit Williams, Acting General Counsel of Loans and Currency.

Taylor: That's that report on that Harriman Bank.

H.M.Jr: What do I do with it?

Taylor: You asked for an immediate report on it.

H.M.Jr: (Nods negatively)

Oliphant: About the lawyer fee or what?

H.M.Jr: I don't know a thing about it. One hundred eighty-eight dollars; I don't bother with anything under three hundred dollars.

Taylor: This fellow has been writing everybody, starting with the President and ending with you, or someone.

H.M.Jr: Well, what should I do, Wayne?

Taylor: You asked for a special report on it.

H.M.Jr: Would you mind looking at it? Where did I ask for it?

Taylor: You sent it in to me and asked for a special report on it.

H.M.Jr: Well, what will I do with it now that I got it?

Taylor: Tell the fellow "nuts."

H.M.Jr: Oh, I'll tell you why I don't know this. It came in May 10 and your answer is May 12. That's why.

Taylor: Oh, I see.

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Oliphant: No reasonable interval.

Bell: You had it lined way back in your mind a couple months.

H.M.Jr: This is a complaint against you.

Taylor: Among others.

H.M.Jr: All right, file it. - This is too sudden.
All right.

Taylor: While I'm on the rostrum, how about that left-handed pitcher.....

H.M.Jr: I don't know, what do you....

Taylor: Daiger.

H.M.Jr: What's his name? What's that fellow with the Federal Reserve?

Taylor: Daiger.

H.M.Jr: Marriner Eccles wants to sell us Daiger's services. He's through with him.

McR: Marriner talked to me about Daiger.

Bell: Talked to me too.

McR: And I told him I'd give it serious consideration. I haven't started to consider it yet.

H.M.Jr: Daiger is in Mr. McReynolds' hands. What does he do?

Taylor: He's Eccles' housing expert.

Bell: I told him I thought we might use him if he'd pay his salary for three months; we didn't have any money.

H.M.Jr: I went you one better. I suggested he give him leave with three months' pay and we'd use him for three months.

Bell: That's right.

H.M.Jr: What?

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- Bell: That's right. I said if he'd give him leave with three months' pay, we'd take him on.
- H.M.Jr: Well, everybody in favor of Mr. McReynolds' handling this situation signify by saying "Aye," those opposed by the contrary; motion carried.
- McR: Poor old Matt. Matt is the secretary to this racing association over here in Maryland.
- Oliphant: That's his father.
- Gaston: That isn't Matt himself.
- McR: Oh, is that his father? I supposed it was Matt, because he - Matt came to him and told him he was to be gone about two weeks, and the races opened right along there and I supposed that's what it was.
- H.M.Jr: If that's his training, we need.....
- Bell: Be good on housing.
- Oliphant: Paul Mallon said last night that a couple ^{came} near - pretty near balancing the budget in the fifth race at Pimlico last Saturday.
- McR: Just missed it.
- H.M.Jr: All right, what else?
- Magill: I have two things here that affect this revenue act situation that I'll just mention. One is a bill submitted to us by the Federal Housing Administration which is intended to give credit for reserves under the undistributed profits act to corporations organized under the National Housing Act. The extent of the reserve is apparently determined by the Federal Housing Administrator, so he says, in cases similar to that of some organizations, principally national mortgage associations, which are already given credit for such reserves. It doesn't look to me like they are identical, and of course I have....
- H.M.Jr: That's Taylor's baby.
- Magill: It is? Well, will I take it tenderly and lay it on his doorstep - well, of course, if he brings it back to me, which he probably will, I'll still have the

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question as to whether we should have let them drop the waters on the undistributed profits tax.

- H.M.Jr: Suppose you and Taylor agree and then let's.....
Taylor's - gosh, he's handling my mail - May 10.....
- Bell: He must be up-to-date.
- H.M.Jr: So I.....
- McR: You just raised hell, Wayne.
- Magill: I'll be glad to confer with him provided the agreement which we're going to reach is that the amendment shall not be pressed.
- Taylor: I'll go further than that with you. I'll say, no national mortgage association.
- H.M.Jr: Inasmuch as Taylor is current, we'll have this at 9:30 tomorrow morning. How's that?
- Magill: You mean have Taylor handle it between now and then?
- H.M.Jr: Anyway, the answer will be 9:30 tomorrow morning.
- Taylor: We're in complete agreement already, Ros.
- Magill: I just wanted to be sure we were before I started in.
Now, Mr. Haas was also - has just given me some estimates requested by Senator LaFollette. He wants to know with respect.....
- Haas: I'm working off the top, if he thinks I'm current.
- Magill: His proposal is to lower the exemptions and increase some of the rates. I presume we have no option but to go on and send the estimates forward to the Senator and see what happens.
- H.M.Jr: Well now, last year I insisted that all those letters clear my desk and this year I'll give you that privilege. I mean when these things begin to come in now on rates and that kind of stuff - I mean they used to send a different estimate up every split second; they'd

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come in with not only Estimate 64, but B - Estimate 64-B. So I think this year, if they begin calling for rates, so that - let them go across Magill's desk.

Haas: All right.

Oliphant: Didn't we have a rule of always sending it to the Chairman?

Haas: That is still in existence, but Ros thought we ought to make an exception on this, and I'm inclined to agree.

Magill: I think we better give in on these estimates. We're bound to have to give it to him.

H.M.Jr: Well, you better send copies to Pat Harrison. What?

Magill: That's right.

H.M.Jr: We broke the rule, remember, when the Senator from Texas - what's his name? -

Taylor: Connally.

H.M.Jr: - Connally raised such hell about it. He asked the Treasury... I think, if you remember, after that incident with Connally we said we would send them direct and sent them to Pat Harrison, and he....

Oliphant: We checked that with Harrison. We telephoned Harrison.

Magill: Wouldn't that be the thing, to call Harrison and tell him that LaFollette is after these estimates and how....

H.M.Jr: And how does he want it handled this time?

Magill: Yes. I don't know what as to Doughton.

H.M.Jr: You won't have any trouble with him.

Magill: We're sending up estimates.

H.M.Jr: No harm to speak to Doughton.

Magill: I think I'll speak to him, because they're feeling

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particularly tender up there at the present time.

H.M.Jr: All right, what else?

Magill: The only other thing - over the ticker the other day there came this statement respecting one of Van Sweringen's men who had made a lot of money, as it was stated, by defrauding the income tax out of the profits on the sale of properties out there. I asked Mr. Helvering to let me know whether they were in touch with the situation, and he reports that they have been from the beginning and gave Senator Wheeler the questions which he asked of the witness.

H.M.Jr: Helvering did?

Magill: Helvering did.

H.M.Jr: Fine.

Magill: In fact, there seems to be a good deal of legitimate doubt as to whether these people were taxable under the circumstances, but anyway they developed the case as best they could to show fraud.

H.M.Jr: Is that all?

Magill: That's all.

H.M.Jr: Now, my cousin, Professor Goodhart, is having lunch with me at one o'clock, and he'd like to see one of you (Magill and Oliphant) at two or two-thirty. Which would be good for....

Oliphant: I'm free at two.

Magill: Yes, I'm....

H.M.Jr: Well, which wants to make it two? One at two and one at two-thirty.

Magill: Mine is two-thirty if that's all right.

H.M.Jr: You (Oliphant) at two and you (Magill) at two-thirty.

Did you know his brother-in-law is the head of the something - tax thing in London?

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Magill: What's his name?

H.M.Jr: I don't know. You have been - visited with him at Cambridge, Oxford.

Magill: I saw Mr. Goodhart in London. He had me at tea or something.

H.M.Jr: Well, Oliphant at two. He said he's had a long heated discussion with you.

Oliphant: Uh-huh.

Magill: Is he coming by my office?

H.M.Jr: He's going to have lunch with me. He'll go to Oliphant at two and you at two-thirty. Right?

You know the famous LaGuardia story he tells about having lunch with me when we had lunch here. I can't tell it quite the way LaGuardia tells it, on account of Miss Chauncey being here, so I'll....
(Reporter instructed not to record)

Well, you're all right?

Magill: I have one other little thing, but I don't know.....

H.M.Jr: Well, you're staying after this meeting.

Magill: I can take it up then.

H.M.Jr: All right.

Herman?

Oliphant: Nothing new to report, except Joe called me up - Joe Keenan called me up yesterday - and I expected him to call about arranging a time to see Igoe; he called up very much outraged that we had lost a tax case up in Brooklyn, and thinking that... I don't think that we lost it - the Sullivan case.

H.M.Jr: Who was excited?

Oliphant: What?

H.M.Jr: Who was excited ?

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Oliphant: Joe Keenan said that we were trying to settle, we oughtn't to settle it, and as long as he was acting Attorney General we weren't going to settle the case out....

H.M.Jr: Now wait a minute. Who tried the case?

Oliphant: Well, it was some time ago. I'm getting a report on it from Ireys.

H.M.Jr: I mean civil or criminal?

Oliphant: Criminal; it's their case.

H.M.Jr: It's their case.

Oliphant: I think what happened is Joe Keenan read this 44-page document.....

McR: Is that the reason why he was excited, Herman?

Oliphant:on the other side. Frankly, I think - I think he was currying favor with us. I think he's read that document and he's just sort of - it's just overwhelming so far as Igoe....

H.M.Jr: That's the document which we....

Oliphant: We sent him. I said, "Well, are you ready to talk?" He said, "No, I'll get in touch with you later."

H.M.Jr: Who signed that document?

McR: You (H.M.Jr) signed the letter that transmitted it. The document was not signed. Oh yes, it was; Helvering and I signed it.

H.M.Jr: He's acting Attorney General? Where are all the other boys?

Oliphant: That's what he said to me.

Taylor: At White Sulphur.

H.M.Jr: All right. What else?

Oliphant: Nothing.

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H.M.Jr: Huh?

Oliphant: No, nothing.

H.M.Jr: And you and Mac are coming in a quarter of eleven - 15 minutes - with Helvering on this Cleveland - liquor. It's not very difficult.

Oliphant: No, I think not.

H.M.Jr: Herbert?

Gaston: I talked to Duffield again last night and I told him he better lay off that Russian thing until today.

H.M.Jr: Yes

Gaston: But the only thing I know to tell him is that, of course, they can ship gold here if they want to - anybody's guess is as good as anybody else's whether they are likely to or not.

H.M.Jr: Duffield's got an idea that the Russians will send some gold. Let me simmer on that. Ask me afterwards when you come into press conference, will you?

Gaston: O.K.

H.M.Jr: Yes

Gaston: I just held it for the time being. I talked to Ray Tucker about that. He agreed it is perfectly damnable, but he says it's just another instance of the stuff this fellow McMullin writes about Washington, and he kicks so much about it that he - he doesn't feel that he can complain, that he can say anything. He said, "Anyway, it's in the hands of all the editors now and the damage is done."

H.M.Jr: Did Steve Early see that?

Gaston: I haven't talked to Steve Early.

H.M.Jr: (Takes White House phone) He most likely isn't in yet. (To W.H. Operator:) Is Mr. Early in? - Please. - Hello. -- Yes. - No, let it go.

Gaston: Is he in?

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H.M.Jr: He's out for half an hour. You might call him.

Gaston: I'll try and get him before the press conference.

H.M.Jr: Not before mine; I don't want to... See whether they've seen him, huh?

Gaston: Yes. He probably has a press conference of his own the same time - 10:30.

H.M.Jr: Anything else, Herbert?

Gaston: Nothing.

Oliphant: Ray Tucker printed a perfectly irresponsible story that the Treasury allowed the liquor industry to draw the statute to enforce the 21st Amendment, and it was so constructed it couldn't be enforced in the dry states; the dry states weren't protected.

H.M.Jr: What did you.....

Oliphant: Well, it came in my last abstract. I'm getting a memorandum on it for Gaston's. It is grossly inaccurate.

H.M.Jr: You handle it, Herbert.

Gaston: Yes.

H.M.Jr: Wayne?

Taylor: (Nods no)

H.M.Jr: (Nods to Lochhead)

Lochhead: (Nods no)

H.M.Jr: (Nods to Haas) I'll see you today sometime. I've got you on my mind.

Haas: O.K. A couple of these investment trust people have been in to see me the last couple days, and I ought to tell you what they're worrying about.

H.M.Jr: Well, I'll just take time now.

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Haas:

O.K. They feel that everything is - long-term is O.K., but what disturbs them is they have an apprehension that something may be done down here to control the boom or regulate this gold flow, and they think we might use an axe on it. Mentioned the excess reserve requirement increase was too severe, just upset things. And they had some apprehension that all this publicity on the tax revision and so on, and then - although nothing was said from the Treasury about it. Secretary Wallace put out a statement you must use the taxing power to control booms, and their apprehension is that some tax law, maybe like the British, on corporations will be put in, you see - that we had it in the back of our head. And these two fellows felt that that sort of thing was engendering the jitters up there, because they've just gone through this last experience on this reserve situation, the bond market, etc. They thought it was just overdone. One of them told me that he thought the source of the origination of the rumor on the thing - the basis for it started with the Fortune article.

And then they - a fellow named Wilson who was Director of Research at Scudder, Stevens & Clark, said he thought there was a possibility of some recession in the summer, but that a good many of the other people in New York, Boston, and Philadelphia, engaged in the same type of business as they are, felt that the summer recession, as they anticipate some recession, might be rather severe; they felt the Federal Reserve Board index might go down as low as 100; it is now about 121. But he thought - he didn't look toward any recession of that sort.

Then Edgar - what's his name? - I forgot about this - this man with the General Motors, in to see.....

H.M.Jr: Smith.

Taylor: Smith.

Haas: ...he thinks we ought to have a free gold market - the same stuff he had before.

H.M.Jr: If White hasn't seen these last cables coming from Switzerland, of Cochran, tell him to be sure and read

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them.

- Haas: I think he has; he sees them as soon as they come; but I'll call his attention to it.
- H.M.Jr: But nothing - I mean special?
- Haas: No, he told...
- H.M.Jr: I mean just give me anything that we don't know that they've got.
- Haas: No. Smith had some of his own ideas about sterling, where he thought it could go without hurting them - 450.
- H.M.Jr: 450. What would it do to us?
- Haas: Well, he says it's a difference of opinion on the thing, but as far as the automobile industry, as far as General Motors' exports, etc., he said it wouldn't hurt them at all. But we've got to analyze that one.
- H.M.Jr: O.K.
- Haas: All right.
- H.M.Jr: Is that all?
- Haas: That's all.
- H.M.Jr: Dan?
- Bell: The Agriculture report wasn't printed yesterday. It was - there was a statement given out by the Chairman, I think. But it will be out today. Sixty million was cut off the 500 million.
- H.M.Jr: And that is a net saving?
- Bell: It is a net saving in appropriations. It will not be a full saving in expenditures, because we had anticipated that they couldn't spend the full 500 million and put in the Budget an estimate of 460 million, so that this is about 18 million dollars less on an appropriation basis than our expenditure basis. So we'd save somewhere between 30 and 40 million dollars of the 60. And it is a question whether they can hold that in confidence; and it is a

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question, a further question, if they do hold it, whether or not the Agriculture Department will be obligated - certain moral obligation - to pay more than the 440 and go to Congress for the deficiency if the obligations total more than that figure. There is no direction in the Act for the Secretary of Agriculture to reduce the obligations proportionately if they should aggregate more than that figure.

H.M.Jr: Well, what about this dam?

Bell: Of course, that's a long pull. Didn't appropriate any money, and the thing has been up for - this is the third year, I think, and they finally got it in.

H.M.Jr: But doesn't mean anything on the Budget?

Bell: Not this year, no, sir. They appropriated no additional money for it. Probably take several months to determine just exactly where it's going to be. I think they were a little confused in the two Committees by Morgan's testimony. He came before me and there was quite a difference of opinion in the Board of Directors of Tennessee Valley as to the advisability of building Gilbertsville, and Morgan was very much opposed to building it at all at that time; and three months later, when he had his hearing, why, he turned around and said that he could determine in thirty days where the location should be. Well, it's all a confused matter now. There's a little politics in it.

H.M.Jr: No bills pending that should be vetoed?

Bell: Not at the moment. There's one coming down on the New York affair which has the five million in it, but wording changed, so that I don't know yet whether the President would veto it. Apparently they have played up to the foreign countries.

H.M.Jr: How about the Interior bill? Is that passed?

Bell: No, that isn't passed yet. They added three million dollars to the vocational education - three million six.

H.M.Jr: But they cut something else?

Bell: They - yes, they've taken care of it in other places. And I think there's a feeling in the Committee that

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they prefer the President's approval rather than veto on it, because they have an awful hard time, and will have a further hard time, holding that figure at that level.

H.M.Jr: Ickes get fixed up with a car?

Bell: Beg pardon?

H.M.Jr: Ickes get fixed up with his car?

Bell: No.

H.M.Jr: Didn't get any? Didn't give it to him?

Bell: No, they didn't.

H.M.Jr: Not even a \$2500 car?

Bell: They offered him a \$750 car, I think; he turned it down.

H.M.Jr: Well, how about the Chrysler?

McR: As far as I know, he's still got that Chrysler.

H.M.Jr: Now....

McR: I haven't heard of it coming back.

H.M.Jr: Just inquire, will you?

McR: Yes, I'll find out.

H.M.Jr: Well, what about that Packard that he was after?

McR: That hasn't been released yet.

H.M.Jr: But he still has one of our Chryslers.

McR: As far as I know he still has it.

H.M.Jr: Well - I mean do it - can you do it kind of - you know...

McR: Yes, no trouble. I can find out very easily without his knowing of it.

Gaston: They build cars to order in Germany. They could get

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him one cheap with aski marks.

H.M.Jr: Anything else, Dan?

Bell: I have this statement of expenditures - '35, '36, '37.

(Bell explains figures to H.M.Jr at desk)

H.M.Jr: Anything else?

Bell: That's all.

H.M.Jr: McReynolds?

McR: (Nods no)

H.M.Jr: Dan, did you get to look at those two new Coast Guard boats? 70-footer and 80-footer; one does 30 and the other 35.

Bell: Very nice.

Oliphant: Take you out for a spin?

H.M.Jr: No.

All right, thank you, gentlemen.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE May 13, 1937.

TO MR. McREYNOLDS.
FROM MR. GRAVES

good report.
Graves

I hand you herewith a progress report which has been furnished me by Mr. Palmer, who has been on duty in Chicago as special representative of the Secretary in connection with law-enforcement work since April 15.

You will note that, while maintaining contact with all our agencies at Chicago, Mr. Palmer for the present is confining his intensive work to the Alcohol Tax Unit.

I have canvassed personally with Mr. Palmer the various steps which he has taken, as outlined in the attached report, and it is my opinion that they are all well calculated to insure full compliance with the special instructions given me by the Secretary with reference to the Chicago situation.

From my conversations with Mr. Palmer, it is evident that he now has a complete grasp of our problems in the Chicago District, and can be relied upon to see to it that the work of our enforcement branches there is efficiently done.



INTELLIGENCE UNIT

TREASURY DEPARTMENT

INTERNAL REVENUE SERVICE

CHICAGO
(Name of Division)Chicago, Illinois,
May 12, 1937.

ECP RH

Mr. Harold N. Graves,
Assistant to the Secretary,
Washington, D. C.

In re: Treasury Investigative Agencies,
Chicago, Illinois.

Dear Mr. Graves:

A. I wish to advise you of the action taken with regard to the Treasury Investigative Agencies at Chicago since my arrival there on April 15, 1937. The initial objectives of my assignment, as outlined by you, were to ascertain the present condition of the several agencies and to accelerate the enforcement program in such degree as seemed warranted.

B. Contacts with the five agencies at Chicago have been made and will be maintained by me. I expect in due time to suggest some workable arrangement looking to an effective coordination of their activities. The matters of more immediate concern relate to the Alcohol Tax Unit, and all of our detail work to date has been within that agency. The steps so far taken which affect alcohol tax enforcement work are as follows:

(1) Two additional special investigators have been permanently assigned to this district and three special investigators from other districts are on temporary detail to work on jacketed cases in the Northern Judicial District of Illinois, which comprises the city of Chicago and adjoining counties.

(2) Six investigators from other districts and four investigators from other divisions of this district have been assigned to Chicago to supplement the investigative force regularly employed there.

(3) Thirty-two investigators now available for strictly enforcement work in the city of Chicago and environs have been segregated into eight groups of four men each. The most capable investigator of each group has been designated as a group leader and is held immediately responsible for the activities of his group.

(4) Each group, for general purposes, has been assigned to a specific area within the city of Chicago, although they are not restricted to that area if their investigations lead into other sections. The general purpose of the area assignments is to encourage the men to exercise resourcefulness in developing real sources of information within a particular area. Certain known and persistent violators are believed to operate in each of the designated areas. Each group has been furnished with the names of the violators who are believed to operate within their territory, and the respective groups will be responsible for keeping informed relative to the whereabouts and activities of those violators.

(5) Emphasis is being directed to the detection of illicit stills, and in addition to the above general assignments, each group has been furnished with definite material for immediate attention which is calculated to result in the apprehension of illicit manufacturers.

(6) A joint meeting of the eight group leaders will be held each Monday morning for an interchange of views and a discussion of current enforcement problems. These meetings will be attended by Investigator in Charge G. J. Simons, Mr. R. B. Ritter and myself.

(7) Special Investigator R. B. Ritter, of the Alcohol Tax Unit at Detroit, has been assigned to cooperate in this program. Mr. Ritter is an attorney and has made a thorough study of the laws and decisions relating to searches and seizures. Search warrants are now being obtained in all cases involving still seizures.

(8) Mr. Ritter has been placed in the office of the Investigator in Charge, and the group leaders are required to report to him daily with regard to the progress made in investigations. The purpose of that arrangement is to exhaust the investigative possibilities before a seizure is made and to have the assurance that adequate probable cause is in hand before application for a search warrant is made.

(9) Mr. Ritter has established cordial relations with the United States Commissioner at Chicago, with the result that the Commissioner will now issue night warrants when the facts justify such action. The Commissioner has also manifested a sympathetic interest in our plans to make all cases factually complete and technically sound. I think the present program will assure that result.

(10) When the investigators encounter a situation involving large illicit operations, arrangements will be made to assign a special investigator to the case, before seizure, in order that he may have the vital benefit of being on the scene at the time of seizure.

(11) Complaints involving violations of such minor nature that they cannot be sustained in Federal court are being carefully scrutinized to avoid the dissipation of enforcement energy on that type of work. Necessary support will be given, however, to the retail inspection group in cases of minor wilful violations detected by them.

(12) Special Agents J. A. Conwell and F. C. Pond of the Intelligence Unit are making a survey of the case records of the Alcohol Tax Unit for the period January 1, 1936, to February 28, 1937. When that work is completed, I will submit a review of the findings, coupled with a discussion of the policy of the United States Attorney in the disposition of strong cases in which principal operators have been implicated.

(13) Other matters which will be made the subject of subsequent reports will relate to (1) the need of a more capable Investigator in Charge at Chicago, and (2) a proposal to transfer the raw materials group from the office of the Assistant District Supervisor, Enforcement, to the office of the Investigator in Charge.

Respectfully,



E. C. Palmer,
Special Agent in Charge.
(Atlanta Division)

-COPY-

Paris, May 13, 1937.

MEMORANDUM FOR THE SECRETARY.Subject: European Narcotic Smuggling.

In the interval between Mr. Wait's return from his month's treatment at Bad Nauheim, Germany, and Anslinger's arrival in Paris, I make a quick trip to Athens and Istanbul to gear up Christides. En route going I took a quick look at Bulgaria, and returning, the same with regard to Yugoslavia. I wrote you from Athens about the first part of the trip. The attached special memorandum covers the result of study on the trip as a whole. The information contained therein has been furnished to Mr. Wait. I think the lead I obtained on the stock in the warehouse at Hamburg may be of considerable value.

We are hitting the ball here as best we can. Since an important feature of the mission was to get informers, we have gotten them. Our list now numbers 50, a considerable increase over the few the office had when I brought Scharff and the boys over from the States. Scharff has proved to be very good at getting informers, just as you figured he would. It is true that a number we have taken on have proved to be washouts, but that must be expected in some cases. We have been much disappointed that the information we have sent home from time to time regarding narcotics on ships or in cargo has not resulted in seizures, as most of this information looked good. We have just gotten a new informer who apparently is in the know. He came to us very guardedly, voluntarily, in a peculiar way. He was in a narcotic trafficker's hangout (he is in the business himself), when a telephone call came in from

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Havre from a big-shot smuggler there, warning his Paris associates to be on their guard, because the Treasury men (Beers and Delagrave) were very active around Havre and had lots of money to pay for rewards and information. Our informer then decided to get in on this money by coming with us. He is very cagey and afraid of his life, but we expect him to produce. His first information of interest was that the smuggling to America was being diverted to a new channel, namely over Italian ports instead of French and German. His next information was rather disquieting to us. He told us that Sahib (Nick's man) had shown up in town and that he had the "mark." We asked him what he meant by the "mark" and he explained that it is a peculiar scar left by a cut on the side of the face, made by narcotic gangsters on one of their associates who they decide has turned "stool pigeon." We expected that Sahib would be spotted as appearing in town, but the mark was interesting to us because we had noticed the scar of recent appearance, but Sahib told us he got it in an automobile accident. The next thing that happened was that Albayes, our contact man with the French Surete, told us that Sahib was in town and that he had the "mark". I learned this as soon as I got back from Istanbul. I told Scharff to get Sahib so I could talk to him (Sahib had not given us anything since his arrival two weeks before) and we could not locate him. Our informer then tells us the next day that Sahib had gone to Yugoslavia, and had planted a dummy in his room at the hotel. This came to us as part of the general information as to prominent narcotic traffickers in town, from this informer. The above gave Scharff and myself considerable room for thought, because we had counted heavily on Sahib. We are inclined to

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discount the "mark" story, as there has recently been a gangster movie shown here in which this incident (the "marking") figured. However, we will find out as soon as we get in touch with Sahib.

As I study the narcotic-smuggling situation progressively, I become more and more convinced that our problem lies in detection of cargo smuggling. The in-transit shipment is important, say over New York to Chicago, with the "bonded truck switch" or the "warehouse switch" methods of substituting legitimate cases for the ones containing narcotics. "To order" shipments, of course, are a natural set-up for the smuggler, particularly since the real consignee does not have to come forward with the bill of lading to claim the freight until he feels everything is safe (it would of course usually be done through a customs broker). Also, the fact that the absence of a consular certificate on the invoice merely entails the posting of a bond (\$5 a thousand at any bonding company) for the production of said invoice within a year. If the real importer feels that the shipment is "hot", all he has to do is to remain incognito and let the shipment go to the storage warehouse, where it remains a year before it is opened as unclaimed. Within that year there will be plenty of opportunity to fix the "warehouse switch" and get the narcotics out.

A good guess as to what part of the 10 tons of narcotics estimated smuggled into our country per year is cargo and what is not, would be eight tons in cargo and two tons by personal carriers, including their baggage.

We must keep up the fight on the personal carriers, sailors, passengers, and others, necessarily, in order to keep it down, but our big problem is "cargo", meaning "freight", and the fight on this, of course, has the two important angles, (1) tightening the customs procedure in the United States,

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and (2) obtaining information at home and abroad as to illegitimate endeavor.

We are endeavoring to get in on the "cargo" angle of the information business here all possible. It is much harder than the other. We uncovered one thing of interest in that regard in Istanbul. An exporter of sausage casings there, one S. Feldman (previously mentioned from the Czecho-Slovakian end of our investigation of his activities) has for several years been sending an average of around 30 barrels of casings to New York and Philadelphia per month. Most of these barrels are returned unopened to Istanbul. This means that the American importer apparently did not consider it necessary to open the barrels in New York for the reason that the narcotics had already been secretly removed en route and the openings in the barrels made at this time cleverly concealed. The name of the consignee in New York is the Harry Levi Co., Inc., 625 Greenwich Street.

I talked with Anslinger after his arrival. He thinks I should go to Geneva. Accordingly, I will do so, since he had talked the matter over with Mr. Graves before he left Washington. This will delay my return home, but it may be worth it to the cause. No credentials through the State Department will be necessary for me, the way it looks at present. Wait's instructions for Geneva mention only the meetings of the Seizure Committee, but Anslinger thinks Wait should attend the succeeding sessions also, which Wait is preparing to do.

Best regards,

Respectfully,

THOMPSON.

CONFERENCE IN SECRETARY MORGENTHAU'S OFFICE

May 15, 1937

Present: Secretary Morgenthau
Senator Bulkley
Commissioner Helvering

Subject: Status of Collector Moore
of the Cleveland Division.

The Secretary opened the conference by advising Senator Bulkley that it was his desire to reach a final conclusion in this case which has been hanging for many months. He therefore had requested the Senator to come in at this time to see him on this subject. Senator Bulkley had at previous conferences asked for additional information as to the charges against Mr. Moore. The Secretary stated to Senator Bulkley that more than a year had elapsed since settlement of this case was supposed to have been finally agreed upon and that Mr. Moore had not made a move to carry out the agreed settlement. Senator Bulkley then stated that Mr. Moore's wife had been sick and that Mr. Moore himself had undergone a serious operation, and so forth.

The Secretary called attention to the agreement as to the disposal of the stock of Famous Brands, Inc. He further stated that the records showed a transfer of this stock by Mrs. Moore to her father, Dr. Wells, and that the dividends received from this stock had been endorsed by Dr. Wells to Mrs. Moore. Discussion was then had as to the two conflicting statements Dr. Wells had made concerning this transaction and as to Dr. Wells' first statement in which he said that he had purchased this stock from his daughter, the consideration for which was cancellation of an indebtedness by Mrs. Moore to her father of advances previously made to her. The second investigation revealed that Dr. Wells retracted the previous statement and filed with the investigator a statement in writing to the effect that his daughter had given him the stock and that there was no cancellation of indebtedness.

Senator Bulkley stated that he did not like the idea of the change in this statement but further stated that it was a perfectly natural thing for a daughter to do as he understood there was no sale for the stock and that she could not just hand it to anyone on the street. Senator Bulkley then inquired of the Commissioner if an examination had been made of the returns for the year 1936 of Mr. and Mrs. Moore and Dr. Wells. The Commissioner stated that the returns were a part of the current report which had just been filed with the Secretary. These income tax reports were then examined and it was found that Dr. Wells had reported as income for the year 1936 the entire amount of dividends received by him for that year from Famous Brands, Inc.

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Mrs. Moore's return showed one dividend of \$900 from Famous Brands, Inc. and a further entry without explanation of \$1200 from Mr. Abbott, Mr. Abbott being the attorney in charge of Famous Brands, Inc.

Senator Bulkley demurred about reaching a final conclusion on the case until he had had an opportunity to further investigate the entry made on Mrs. Moore's return as coming from Mr. Abbott and the dividend from Famous Brands as listed on her 1956 return. The Secretary stated that all these side issues as to income tax returns did not go to the main point of the controversy, which was that Moore had entered into an agreement, as suggested by the Senator himself, to clear this case up and had taken no action to carry it out. Senator Bulkley requested further time to make inquiries so that he may have a clear understanding as to the meaning of the items in the income tax reports. The Secretary then stated he would not take final action on the case until the Senator had that opportunity, but that it would of necessity have to be within a reasonable time.

The conference was then adjourned.

May 13, 1937.
2:10 p. m.

H.M.Jr: Hello.

Operator: Mr. Rentschler.

H.M.Jr: Hello.
Gordon

Rentschler: Hello there, how are you?

H.M.Jr: Oh I'm fine.

R: Gone back to work, have you?

H.M.Jr: Absolutely.

R: Ah - I called you because it seemed to me that, from our advices, there's a little more nervousness on the continent in Europe today in relation to gold.....

H.M.Jr: Yes.

R: and - ah - they were offering during the day and we've had - some of our fellows asking about the prices they'd like to have at the opening tomorrow morning.

H.M.Jr: I see.

R: And

H.M.Jr: Are you talking foreign exchange or stocks?

R: No, this is gold.

H.M.Jr: Oh.

R: This is gold.

H.M.Jr: Yes.

R: Now - ah - we've been buying a little just to keep our fingers in the market. We bought 800 thousand dollars worth today

H.M.Jr: Yes.

R: Yes. And there was one of our continental banks that we've only loaned to on the basis that security's security and gold in London.

H.M.Jr: Yes.

R: in our own vault.

H.M.Jr: Yes.

R: And to secure their American acceptances.....

H.M.Jr: Yes.

R: have asked us to give them a price on gold tomorrow morning because they want to sell and get their acceptances against dollars that we'd have here in New York.

H.M.Jr: Yes.

R: Now they've held that gold for six or seven years and they're rather - it's only a half million dollars worth.

H.M.Jr: Yes.

R: But they have - ah - other amounts with both British and other American banks, I think, and they're a pretty shrewd outfit.

H.M.Jr: Yes.

R: So it just occurred to me with putting all the things together I've gotten in the course of the day that their rumor factory was working overtime again. One of our brokers over in London described it as - ah - "further continental gold liquidation."

H.M.Jr: Yes.

R: Ah - coming in from a good many places. I don't know what it amounted to in volume; whether there is a sizable volume offered in London or not.

H.M.Jr: Yes.

R: But it just happened that we got it from enough responsible places to feel that there was again a degree of uneasiness.

H.M.Jr: Ah-ha.

R: Now I've told our boys just to keep on buying small amount.....

H.M.Jr: Yes.

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R: ... and see what they have to say about it but - ah.....

H.M.Jr: Well - ah - I - there's nothing to what I can add to what I've been saying

R: Well I realize

H.M.Jr: for the last two months and I can't change human nature.....

R: No, you can't but

H.M.Jr: and I know there's a - you see there's a small group - I needn't tell you - who make their living out of foreign exchange.

R: Exactly.

H.M.Jr: And when it's steady there's no money in it.

R: Yep, and they want to ruffle it.

H.M.Jr: And they want to - they want to jiggle it.

R: Yes, they want to tickle it. Now they're not getting much help in tickling it. We've got, for instance, in our own things we're staying as square as we can based upon the absolute - ah - requirements that we have to meet for our customers.

H.M.Jr: Yes, and I - I - I, as I say, - ah - there's nothing that I can do to make these people stop talking.

R: Nope, not a darned thing.

H.M.Jr: And - ah

R: Not a thing.

H.M.Jr: Of course, - ah - I knew the thing was a little heavy but there's nothing that's happened - I mean - ah -

R: No, it's

H.M.Jr: there's absolutely nothing - I mean - ah - as a matter of fact - ah - I suppose that normally with the stock market off the way it is - ah - if anything, that - that there shouldn't be any movement here with a - with a large foreign interest.....

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R: Well, of course, there's a little dribble of liquidation coming in from over there but the big end of the liquidation in this present market is staying here at home.

H.M.Jr: It's here.

R: Yes, they're all fearful; they don't know what it means; they think the stock market has come into sterling;

H.M.Jr: Yes.

R: ah - that - ah - they can't understand and nobody is able to add anything to it so that the nimble fellows say, "Well, we'll sell and think about it afterwards."

H.M.Jr: Well, Gordon, the only thing we can do - you - your responsibility and mine is just to keep sawing wood and keep asking these fellows to give you - the way I do - a concrete evidence of something that's wrong and when I try to pin them down they can't tell me anything.

R: No, there's no concrete evidence that anybody that comes in here can give us.

H.M.Jr: And - now as long as there's nothing fundamentally wrong - there's lots of things they don't like but there's nothing fundamentally wrong - ah - I think the thing has just got to wear itself out.

R: I'm quite sure that's the only answer.

H.M.Jr: And - ah - I don't know of anything else.

R: I don't think there is any other answer. Now there's a whole string of fellows that come through this week, particularly business men from the back country and from the south.

H.M.Jr: Yes.

R: They're all doing a very excellent business.....

H.M.Jr: Well.....

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- R: and they're fearful of the full effects of the labor situation;
- H.M.Jr: Yes.
- R: they can't quite appraise that but thus far they haven't been hurt by it.
- H.M.Jr: Yes.
- R: They don't know what the future of it is going to be and they don't know how cockey some of these fellows may be and how hard it will be to control them. That's about the only concrete thing they put their fingers on.
- H.M.Jr: Yes.
- R: Volume is good and profits are remaining good.
- H.M.Jr: Well.....
- R: But the big end of this fear apparently, as far as gold is concerned, is better than Europe.
- H.M.Jr: Ah-ha, well I - of course, I've felt right along it was centered right in London.
- R: Yes, I think you're right.
- H.M.Jr: Yes.
- R: Now this is the first time we saw it reach over in the continent; I don't know how big it might be over there; it might be only these very few people.....
- H.M.Jr: Yes.
- R: but this one bank is - ah - such an intelligent crowd and very careful, it's rather interesting to see them make this move.
- H.M.Jr: I see. Well I
- R: It very well might be that they're making the move on the basis confidence but rather than anticipating that gold will go lower.
- H.M.Jr: Yes.

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- R: It may be that they figured that this thing has run its full course and they better have dollars from which they might get some interest on their money.....
- H.M.Jr: Yes.
- R: rather than to continue to hold gold in our vaults in London.
- H.M.Jr: Well, of course, - and then the other thing today - needn't call your attention to the fact that we had a steady bond market.
- R; Yes.
- H.M.Jr: Now - ah - which ought to reassure some of these people.
- R: Ed Deeds is just back from Japan today and - ah - he was - ah - quite - ah - well satisfied with what he found.
- H.M.Jr: Who?
- R: Colonel Deeds, one of our Directors and the head of the National Cash Register.
- H.M.Jr: Oh yes.
- R: He seemed to think that these - the Finance Department over there and the heads of the big banks have their heads together in a pretty constructive way.
- H.M.Jr: Well, that's interesting.
- R: He felt rather more at ease about the Japanese situation than he did when he came back a year ago.
- H.M.Jr: Well that's interesting.
- R: He seemed to feel that there might be a disposition to build one less battleship and a couple less guns and a couple less this and keep their exchange on the right basis.....
- H.M.Jr: Yes.

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R: which - ah

H.M.Jr: Would be helpful.

R: is a rather interesting reaction because he's been a pretty shrewd observer.

H.M.Jr: Well that's

R: His feel was that there was some progress as compared with last year.

H.M.Jr: Ah-ha. Well thanks very much for calling.

R: Fine.

H.M.Jr: And - ah - it's never been so peaceful here at any time in ten - we've never had ten days so quiet as the last ten ones - dead days.

R: Well maybe that's just the quiet and peace that comes before the thunderstorm.

H.M.Jr: Ah - I don't think you're right.

R: I think you're right. I think you ought to have some bright days.

H.M.Jr: I think we've got them.

R: All right fellow.

H.M.Jr: O. K.

R: Good luck.

H.M.Jr: Thank you.

May 13, 1937.
2:21 p. m.

H.M.Jr: Hello.

Operator: Mr. Knoke is in a Director's meeting. Do you want me to call him out?

H.M.Jr: Yes.

Operator: All right. And Mr. Taylor hasn't returned from lunch.

H.M.Jr: Thank you.

Operator: Right.

H.M.Jr: Hello.

Operator: Mr. Knoke. Go ahead.

L. W.

Knoke: Hello.

H.M.Jr: Hello Knoke.

K: Yes, Mr. Secretary.

H.M.Jr: I'm sorry to pull you out of your meeting.....

K: That's perfectly all right.

H.M.Jr: but I don't know how exciting it was. Ah - anything particular other than the usual line of gossip about gold this week?

K: No, not usual - no different but I think it's becoming accelerated - aggravated.

H.M.Jr: Yes.

K: Ah - as the Bankers Trust said this morning the gold scare is again in full vigor.....

H.M.Jr: I see.

K: and the prices seem to bear it out. Gold sold at below the fixing - below the fixed price after fixing

K: Yes.

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- K: although the fixed price was pretty low already and the amount we have today - well the last I heard, before I went into the meeting, was 9 million dollars engaged in London so the problem will again be with us in somewhat accentuated form.
- H.M.Jr: I see. Well - ah - we'll just have to sit through it I guess - that's all.
- K: I just listened to a very interesting talk that Williams gave on that.
- H.M.Jr: Yes, what did Williams have to say?
- K: Well he - he simply stated the problem. He has no suggestion either. (Laughs).
- H.M.Jr: Well how did - what did he think the problem is?
- K: Well the problem, of course, is the - ah - the - ah - ah - increased arrivals of gold will - ah - will - ah - bring up the question of whether or not the - ah - the - ah - sterilization of gold should continue and then the - he thinks - and Congress may take it up and the pressure on the Treasury may increase and - ah - ah - ah -.....
- H.M.Jr: Well he isn't much better than some of those New York bankers, is he?
- K: (Laughs) Well at - at least he has this advantage that he hasn't been in New York for a long while so he can't be (laughs).....
- H.M.Jr: Yes.
- K: he can't suffer from the atmosphere.
- H.M.Jr: Well you understand German, don't you?
- K: Yes.
- H.M.Jr: You know what a watched wife is?
- K: Watched wife - Oh yes. (Laughs)
- H.M.Jr: All right.
- K: (Laughs more.)

H.M.Jr: What?

K: Yes I know.

H.M.Jr: Well - ah - all right. Well it's very nice down here; it's real summer and we're all having a good time.

K: Terribly close here; like a July day.

H.M.Jr: Well come down here - it's spring down here. All right, Knoke.

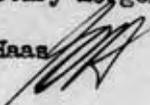
K: Thank you, sir.

H.M.Jr: Goodbye.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE May 13, 1937.

TO Secretary Morgenthau
FROM Mr. Haas 

Mr. White and his staff prepared the attached memorandum on Brazil prior to your request that I supply you with an economic analysis of Brazil, including its trade position, etc. A more comprehensive memorandum on Brazil is now in preparation which will include an analysis along the lines you suggested.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE May 11, 1937.

TO Secretary ~~M~~rgenthau
 FROM Mr. Haas *[Signature]*
 Subject: Evaluation of the Brazilian proposal to borrow \$50 million with which to purchase gold from the United States.

I. The proposal.

Brazil to borrow \$50 million from the Export-Import Bank, using the proceeds of the loan to buy \$50 million of gold from the United States Treasury. The gold will be held in the United States as security against the loan and will be released to Brazil only to the extent that the loan is repaid.

II. The acquisition of gold will strengthen her currency position and help attract foreign capital.

(a) Specie reserves behind the currency would be increased from approximately 6 percent to approximately 20 percent.

The approximate volume of currency outstanding on December 31, 1936, was 4 million contos (\$350,000,000 at the official rate of exchange). Reports indicate that the Bank of Brazil held about \$24,000,000 in gold at the end of 1936. This was acquired through the purchase since December 1933, for the account of the National Treasury, of gold produced in Brazil. Domestic production is officially reported at approximately \$4,000,000 per year, but is probably considerably more as the statistics do not include placer mining. There are rumors and surmises, which cannot be verified, that Brazil has recently acquired large unreported holdings of foreign exchange and gold.

On the basis of the reported gold holdings of \$24,000,000, the specie reserve at the end of 1936 amounted to only 6 percent of the outstanding currency. The addition of \$50,000,000 of gold would raise the specie reserve to 20 percent -- if the currency is not expanded.

(A description of Brazil's monetary system is contained in the attached appendix.)

There is no legal limitation upon the volume of currency which can be issued. Therefore there is no certainty that the ratio

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of reserves to note issue will remain so high.

With a specie reserve of only 20 percent, plus whatever unreported holdings of foreign exchange Brazil may have, it is extremely doubtful if Brazil would be able to, or would be wise to, restore convertibility of the currency. With the exception of the period 1927-29, the Brazilian currency has been inconvertible since before the World War. The advantage that convertibility has in the way of stimulating confidence and checking note expansion is offset by the disadvantage introduced by the possibility of internal drain of gold. Gold is far too expensive to be used as a circulating medium, and Brazil particularly would have far too little gold to run the risk of any internal drains.

(b) The gold loan would help clear up Brazil's exchange difficulties.

The important thing for Brazil is to develop sufficient gold reserves to make possible the liquidation of blocked accounts, the elimination of all exchange restrictions, and to provide a generous range within which her balance of payments may shift without danger of further depreciation of her currency.

Two crops - coffee and cotton - constitute so important a part of her exports (coffee about 60 percent and cotton about 12 percent) that her exchange position is very vulnerable. Her export excess varies greatly. For example, in 1934 it was 956,000 contos; the next year it dropped to 248,000 contos, and last year it rose to 626,000 contos. Unless there is a thick cushion of gold to absorb the shock of one or two years of low coffee prices, Brazil will never be able to stabilize her exchange. The \$50 million will help considerably in that direction. However, in view of her small gold holdings and the large possible fluctuations in her balance of trade, it would seem to be prudent for Brazil to lighten exchange restrictions as her gold (or foreign exchange) accumulates, but to postpone the removal of exchange controls until she acquired enough gold to take care of at least one year of low coffee prices.

I don't know on what grounds the figure of \$50 million was arrived at. It seems to me that a country whose balance of payments is so dependent upon the price of one or two crops should aim at a larger gold reserve. Serious consideration should be given to raising the loan to \$100 million, instead of \$50 million. That would force Brazil to save a large sum during the coming good years of good coffee and cotton prices so that when poor years come again she will be able to meet her foreign obligations and maintain stable exchange rates.

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(c) Foreign capital would be attracted to Brazil. Confidence would be restored and the security of foreign capital would be increased.

III. A gold loan has several advantages for both Brazil and the United States.

Advantages to Brazil:

(a) The contract to purchase \$50,000,000 of gold would have an important psychological effect on confidence. Capital imports would probably react as soon as public announcement of the loan was made.

(b) The whole amount may be included in the gold assets of the Bank of Brazil at once without waiting for full repayment (i.e., purchase) of the loan.

Advantages to the United States:

(a) The announcement of the sale to Brazil of \$50 millions of gold by the United States will have a beneficial effect upon a public opinion which, in view of the unprecedented size of our gold holdings, is increasingly apprehensive over the future demand for monetary gold. Such a loan would strengthen the prestige of gold as a monetary metal. Right now the psychological effect of such an extension in the use of gold is greatly to be desired. The effect on public opinion of a loan of \$100 millions would, of course, be greater.

(b) The Treasury would be immediately relieved of the cost of sterilizing \$50,000,000 of gold since the gold would be taken out of the inactive fund. The Export-Import Bank would receive interest on its loan in excess of the cost of borrowing the money in its own name.

(c) The fact that the gold is obtained in the United States and that we have consented to make a large loan to Brazil (even though with such good security) may be expected to have highly important effects on the good will of Brazil, even of Latin America, toward the United States. Such renewed and increased good will may have a beneficial effect on American trade.

(d) The gold loan would constitute a precedent which Latin American - and possibly other - countries would be encouraged to follow.

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IV. Will Brazil be able to repay its obligations to the
Export-Import Bank? Present trends indicate that it will.

(a) The balance of trade is increasingly favorable, and present indications point to a continuing large surplus of foreign exchange.

In 1936 Brazil had a reported favorable balance of trade of \$75 millions. The actual favorable balance was probably higher, since Brazilian foreign trade statistics tend to over-value imports and under-value exports. It has been estimated that the reported figure of the balance of trade should be increased by \$15 millions.

The increase in the reported favorable balance of trade in 1936, compared with 1935, was \$35 millions. The character of the increase is significant in interpreting the trend of Brazilian exports, for it indicates the successful diversification of Brazilian agriculture. Raw cotton exports increased \$11 millions in 1936, compared with 1935; cocoa increased \$6½ millions; wax increased \$3 millions; hides, vegetable oil and meat increased \$2 millions each. Coffee, the most important export commodity, was responsible for only \$3 millions of the increase in exports.

During the current year, coffee and cotton prices are one-fourth higher than in 1936, whereas an index of prices of Brazilian imports would show no such increase (in terms of foreign exchange). Furthermore, continued world recovery and rearmament will increase the volume of coffee and cotton consumed in the world. If the increase in the favorable balance of trade between 1935 and 1936 is any indication, it is not unlikely that the 1937 favorable balance of trade will increase as much again as did the 1936 balance.

(b) It is unlikely that the forthcoming revision of the Aranha Plan will obligate Brazil to increase greatly its payments on debt service, especially in view of its obligation to the Export-Import Bank.

(c) The volume of capital imports into Brazil has been increasing during the past year, according to unverified comments in the financial press. The acquisition of the \$50 millions in gold will no doubt accelerate the volume of investment, and provide Brazil with additional quantities of foreign exchange.

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V. The negotiations with Brazil may be broadened to include a discussion of the reorganization of the Brazilian monetary system and suggestions for the improvement of our trade relations.

(a) This opportunity may be utilized to discuss a reorganization of the Brazilian monetary system, suggesting the incorporation of silver and gold in the monetary reserves. The Treasury may be in a position to suggest a loan of a larger amount than is now contemplated, a stated proportion of which will be used to purchase silver from the U. S. Treasury.

The reorganization of the monetary system is an essential step in moving towards stability in the Brazilian economic system. At the present time there is no legal restriction upon the volume of currency to be issued. The effectiveness of gold acquisitions may be dissipated through uncontrolled expansion of the volume of currency. This fear is particularly pertinent since the Brazilian Government has incurred deficits in the National budget continuously since 1908.

The use of silver in the specie reserves will have distinct advantages to Brazil if the monetary system is reorganized at this time.

- (1) The existing gold holdings of Brazil, including the amount to be acquired if the loan is granted, is inadequate to provide adequate specie reserves for the stability and control of the currency system. The inclusion of silver will help to make up the deficiency.
- (2) The inclusion of silver in the specie reserve will permit a higher specie reserve -- at monetary value -- ratio behind the currency, than would be the case if gold alone composed the reserve.
- (3) A large seigniorage profit may accrue to the Government if the silver were valued at monetary value.

(b) Another possibility in the negotiations may be to obtain some concessions from Brazil in return for the loan with respect to trading arrangements with Germany in the use of ASKI marks. The State Department is now engaged in some conversations with Brazil

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with respect to that matter and it may be desirable to examine the situation and see if some arrangement can be made that would reduce Brazil's use of special barter transactions with Germany. The State Department appears to be eager to have Brazil abandon the use of special marks in her trade with Germany.

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APPENDIX

Brazilian monetary system.

I. Currency unit.

1 Conto = 1000 milreis = 1,000,000 reis.

"Milreis" is the usual unit of account; "contos" is the unit in large sums.

(Current price of milreis -- official rate, 8.7 cents; free rate, 6.1 cents.)

II. Circulating media.

A. Paper currency. The paper currency of Brazil consists of:

	<u>Approximate amount outstanding December 1936</u>
(1) Treasury notes	(about 3,112,000 contos)
(2) Bank of Brazil notes	" 10,000 "
(3) Rediscounting Department notes	" 870,000 "
(4) Stabilization Bureau notes	" <u>23,000</u> "
Total	" 4,015,000 "

None of the paper currency is convertible.

Conditions of note issue:

1. Treasury notes. There appears to be no legal limit to the amount of notes the Treasury can issue, though before the revolution of 1930 a legal limit had been established and had been reached.

Since 1929 about 1 million contos have been issued, bringing the total outstanding to about 3.1 million.

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2. Bank of Brazil notes. The Bank of Brazil obtained the issue privilege in 1923 when it was authorized to issue 600,000 contos against a gold reserve of 200,000 contos. In 1930 the Government assumed responsibility for the 592,000 contos of these notes then outstanding and the Bank was authorized to make a new issue of 170,000 contos. All but 10,000 contos of this new issue have now been retired.

3. Rediscounting Department notes. We can find no detailed information as to exactly what these notes are and in what way they differ from Bank of Brazil notes. The total of these Rediscounting notes outstanding has increased from 100,000 contos in 1931 to 870,000 by December 1936.

4. Stabilization Bureau notes. A Stabilization Bureau established in 1926 issued fully convertible certificates in exchange for gold. During the critical year of 1930 a large portion of the 850,000 notes then outstanding were presented for redemption. Most of them were redeemed in gold and when the Stabilization Bureau was abolished in November 1930 only 129,000 remained in circulation. These notes were made inconvertible but were to be paid eventually by sight drafts on London. The gold reserves left in the Stabilization Bureau were sent to London. The amount of these notes outstanding has diminished to 23 thousand contos.

It is believed that most of the notes of the Stabilization Bureau were held by the Treasury, the Bank of Brazil, and large private banks, and that the gold received from their redemption in 1930 was mostly sent abroad in official support of the exchanges.

(During the revolution in 1930 several states, notably Sao Paulo, issued state notes or "bonus", but a substantial proportion of these have been withdrawn.)

B. Coins. Subsidiary coins, consisting of silver 5/10ths fine - about 42,000 contos - and aluminum and copper coins circulate. On June 30, 1935, the total coins in circulation are estimated at 172,000 contos.

III. Gold holdings.

The only gold holdings of Brazil recorded are those reported by the Bank of Brazil. The Bank statement of September 30, 1936, showed an asset of 243,485 contos (about \$21 millions if computed at the official rate) in the gold purchase account. This would represent a reserve ratio against note liabilities of the Government of about 5 percent. (A consular despatch of January 1, 1937, however, states that the Government has acquired by the end of 1936

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21.7 million grams of gold equal to approximately 24 million dollars.)

Since October 19, 1933, the exportation of gold was prohibited, and on December 4, 1933, it was decreed that all gold extracted in the country be sold to the Bank of Brazil or its authorized agency. Both decrees are currently in effect. Inasmuch as the gold is paid for with milreis, and since there are restrictions upon the acquisition of foreign exchange, there is a motive for smuggling if the price paid for gold in terms of milreis is less than the foreign market price converted at the official rate of exchange.

It appears that the producers of gold do get less for it at home than they could abroad because according to the Department of Commerce it is generally believed that the Government receives not more than one-half of the country's total gold production, the remainder being smuggled out of the country.

IV. Foreign value of the milreis.

The exchange value of the milreis began to fall in 1920 from its 1919 average of 26 U. S. cents and fell steadily until 1923 when the average rate stood at 10 U. S. cents. Recovery lasted until 1926 when the average rate was 14 U. S. cents; however, in the next year the value began again to fall, reaching a low of \$.07 in 1931. Since that time there has been some improvement and exchange control has held the official rate at or near \$.085 cents since 1934.

V. Exchange control.

Exchange control was first imposed in October 1930 and has been administered by the Bank of Brazil since April 1931. The exchange rate, though reputed to have been tied to sterling, fluctuated substantially both in terms of sterling and dollars until the middle of 1932. From the summer of 1932 to the summer of 1933 milreis were kept pegged to the dollar. Since the fall of 1933 the official rate has followed fairly closely both sterling and the dollar. (Though it has been stated that the milreis was tied to sterling in July 1933, the rates indicate that it fluctuated both in terms of dollars and sterling until October 1933, and from then on followed sterling fairly closely - though from 1934 on it has, if anything, been more stable in terms of the dollar than in terms of sterling.) The above refers to the official rate of sterling. The free market rate established at the beginning of 1934 fluctuated about equally in terms of both sterling and dollars. Since the middle of 1935 it has been fairly stable at about 6 cents.

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Regulations governing Brazilian exchange control have been numerous and of varying degrees of strictness. From September 1933 until May 1934 was a period of very strict control. The free exchange market was made legal in May 1934, and after September 1934 all export bills were sold in the free market, with the exception of 17 percent of coffee bills; 60 percent of imports were paid for with official exchange, the rest being obtained in the free market; a system of import permits and priorities was established.

Despite the restriction on imports, pressure on the exchange increased, and in December it was announced that official exchange would be allocated to countries only in proportion to the amount of Brazilian coffee they imported (United States received 46 percent, France 13 percent). In January 1935, distribution of official exchange market was freed of all restrictions except the requirement that 35 percent of the value of export bills be sold to the Bank of Brazil at the official rate; all new imports were to be paid for with exchange purchased in the free market; and free market exchange could only be used for imports, without special permission. However, imports increased and the free rate continued to depreciate, and on June 29, 1935, the exchange restrictions of May 1934 were re-established.

VI. The banking system.

The Bank of Brazil is virtually a central bank, though it does not perform all the functions performed by central banks in leading countries. It is a private corporation, but the Federal Government owns more than half the stock and presumably exercises complete control over its policies. The Bank acts as fiscal agent of the Government especially in the administration of the foreign exchange control and, as noted above, issues rediscounting department notes.

In 1933 there were 53 banking organizations in Brazil, having capital of more than 5,000 contos. Of these, 37 were native and 16 foreign enterprises. In addition, there were 439 native banks and 70 foreign banks having capital of less than 5,000 contos. There appear to be no legal requirements for reserves, although currency kept on hand appears to vary between 3 percent and 25 percent of total deposits.

An extensive system of Federal Savings Banks had a total of over one million depositors, at the end of 1934, with deposits of 946,648 contos.

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Bank loans are at a substantially higher level now than they were before the depression. However, it is the native banks that are expanding and not the foreign banks. Loans and discount of native banks rose from 4,923,000 contos in 1932 to 6,293,000 in 1936, while those of foreign banks increased from 1,345,000 contos to 1,425,000. Total deposits in foreign banks decreased from 1,595,000 to 1,466,000 contos while those in native banks increased from 5,012,000 to 5,991,000 contos.

The cash reserve ratio of the native banks dropped sharply in the past seven years. In 1928 and 1929 their cash holdings were 21 percent of their total deposits; by 1932 the ratio had dropped to 14 percent, and on May 1936 it was only 8.7 percent.

VII. Blocked accounts.

Although the revolution in October 1930 was followed by a bank suspension and moratorium, from October 6, 1930, to January 31, 1931, and another moratorium from October 8 to December 8, 1931, transfer of funds to abroad, as distinct from transfer of funds within the country, was not blocked until July 11, 1932. At first the blocking of transfer took the form of a moratorium for 60 days, then in August it was announced that transfer of blocked funds would be made in four installments over a 4 months period. Finally, as the total of blocked accounts continued to mount, separate agreements were made in June 1933 with representatives of American and English creditors providing for the transfer of blocked accounts. (The agreement with American creditors, who had an estimated total of \$25,000,000 blocked in Brazil, provided that blocked accounts of more than \$50,000, but less than \$65,000, would be paid in 90 days at 13.3 milreis to the dollar, and that accounts of more than \$65,000 would be paid with 72 monthly guaranteed drafts bearing 4 percent interest with transfer into dollars at the rate of 13.965 milreis to the dollar.) Similar agreements were negotiated with representatives of English, Swedish, Danish, Portuguese, French, Swiss, Norwegian, Finnish, and German commercial creditors.

The Department of Commerce has estimated that American deferred credits in Brazil in the process of liquidation under the June 10, 1933, agreement had been reduced to \$10,900,000 by January 1, 1935, but that an additional \$10,000,000 had been blocked since that agreement. In November 1935 the Export Import Bank announced a plan by which it would help American exporters liquidate their accounts blocked in Brazil, and on February 1, 1936, an agreement was signed by American commercial creditors providing for the release of \$30,000,000 of exchange frozen before February 1935.

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Most Brazilian commercial debts, incurred since February 1935, have been currently liquidated.

VIII. External debt service.

The total external debt of the Brazilian Government, including States and Municipalities, was reported to be roughly £260,000,000 on January 1, 1936, of which £160,000,000 was debt of the Federal Government and £100,000,000 was debt of State and Municipal governments (the total internal debt on January 1, 1934, was reported to be roughly 8,000,000 contos). Of the total external debt, including States and Municipalities, about £160,000,000 was represented by sterling obligations, about £70,000,000 was represented by dollar obligations, and about £16,000,000 was represented by franc obligations.

Full service of interest and sinking fund on the Federal Government debt was in force from 1927 to 1930. Sinking fund payments were suspended in 1931 and interest due from November 1, 1931, to November 1, 1933, was funded in the 5 percent Funding Loan of 1931.

A Presidential decree of February 5, 1934, authorized a unilateral debt adjustment plan affecting all Brazilian external debt, including State and Municipal debt. This plan, the so-called Aranha payment scheme, operates from April 1, 1934, to March 31, 1938. In rough outline the plan divides the external debt into eight grades and provides for a different percentage payment of interest and sinking fund within each grade. Payments vary from 100 percent of interest and sinking fund for grade 1, to 17½-32½ (1935 to 1938) of original interest payment and no sinking fund payment in grade 7, and no interest or sinking fund payments in grade 8. The plan provides that its renewal will be announced by September 1937.

IX. Balance of trade and the balance of payments. (See Table VI)

Brazil has had a substantial export excess every year of the past 25 except 1920 and 1921, but the amount of that excess varies greatly. In the past 6 years it has been as low as 240,000 contos (1935) and as high as 1,517,000 contos (1931). The large fluctuations in her trade balance are due to the fact that a single crop - coffee - constitutes over 60 percent of her total exports. Cotton is next with 12 percent. These two items along account for three-fourths or more of Brazil's export business, and therefore the prices of these two commodities virtually determine the total value of Brazilian exports.

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In contrast, her imports contain no single item which constitutes an important percentage of the total and hence the total value of her imports is less influenced by price changes of any particular commodity.

The role played by the price of coffee in her balance of payments is evident from a comparison of her trade balance in the low year of 1935, and high year of 1931. In 1931 the f.o.b. price of Brazilian coffee was triple the 1934-35 price, and in 1935 the export excess was less than one-fifth that of 1931 in terms of milreis and less than one-half in terms of dollars.

The only other item of importance in Brazil's balance of payments is the outpayment each year required on her external debt and on the other foreign investments in Brazil. Foreign investments in Brazil were estimated in 1930 to aggregate 3½ billion dollars, more than one-third of which was British, and one-sixth American.

If interest and sinking fund payments were made on the external debt alone it would amount to over 100 million dollars a year. Even with partial payments, the sum was substantial. (In 1936 payments totaling \$40,000,000 were called for by the Aranha scheme.)

The London Economist estimates the total amount of Brazil's annual "invisible" commitments at \$70,000,000 to \$75,000,000 but the secretary of the Brazilian Financial and Survey Commission estimated them, on March 21, 1937, at about \$110,000,000. The importance her debt payments play in her economy may be judged from the fact that the total value of Brazil's exports for the year 1936 was only \$320,000,000.

X. Deficits in the National Government's budgets:

The National Government has been operating at a deficit in every year since 1908. From 1890 to 1907, a period of 17 years, only seven years showed surpluses, while 10 years showed deficits.

The amount of the deficits for each of the years since 1931, with the estimated deficit for 1936 and 1937, were as follows:

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	<u>Amount of deficit, in Contos</u>	
1931	281,000	
1932	1,164,000	
1933	296,000	
1934	571,000	
1935	149,000	
1936	356,000	
1937	<u>678,000</u>	
Total 1931-1937	3,495,000	(\$300,000,000 at the current official rate of exchange.)

Table I.

BRAZIL

Note Circulation and Gold Reserves, 1915 to 1936

(In 000's of Contos)

Year (Dec. 31)	Notes					Gold reserves		
	State and : Treasury	Bank of : Brazil	Redis- : counting : dept.	Stabili- : zation : Bureau	Total	Bank of : Brazil	Stabili- : zation : Bureau	
1915	897				897	747		
1920	1,848				1,848	275		
1921	2,049				2,049	354		
1922	2,233				2,233	384		
1923	2,260	389			2,649	407		
1924	2,237	727			2,964	450		
1925	2,115	592			2,707	454		
1926	1,977	592			2,569	471		
1927	1,977	592		435	3,004	407	435	
1928	1,952	592		835	3,379	407	835	
1929	1,952	592		851	3,395	407	851	
1930	2,543	170		129	2,842	-	-	
1931	2,563	170	100	89	2,942	-	-	
1932	2,604	170	400	64	3,238	-	-	
1933	2,978	20		39	3,037	-	-	
1934	2,908	20	200	30	3,158	-	-	
1935	2,867	20	700	25	3,612	-	-	
1936*	2,836	10	760	23	3,629	-	-	

*May 30, 1936

Table II.

BRAZIL

Value of the Milreis in
terms of United States currency

1917 to 1936

Year	Cents per milreis	Year	Cents per milreis	
			official	free market
1917	.2501	1927	.1184	
1918	.2534	1928	.1197	
1919	.2674	1929	.1181	
1920	.2251	1930	.1071	
1921	.1312	1931	.0703	
1922	.1295	1932	.0712	
1923	.1023	1933	.0796	
1924	.1094	1934	.0843	.06312*
1925	.1220	1935	.0829	.05748
1926	.1444	1936	.0857	.0588

* May 24--December 31, 1934.

Table III.
Bank of Brazil
Principal items of assets and liabilities
(Contos)

Year	Loans and discounts	Currency on hand	Total deposits	Currency as a percentage of total deposits
1928-1929 (average)	1,129,000	613,000	1,934,000	42.7%
1930	1,331,000	432,000	1,369,000	31.5%
1935	2,939,000	277,000	2,704,000	10.2%
1936, (May 30)	2,852,000	212,000	2,970,000	7.1%

Table IV.
Brazil
Banking statistics: all commercial banks; native and foreign
(Contos)

	March 31, 1936	March 31, 1934	1928-1929 average
<u>Assets</u>			
Loans & discounts	7,596,200	7,006,603	5,861,556
Other	23,964,420	21,456,746	
Cash	773,098	926,002	1,131,832
Total	32,333,718	29,389,351	
<u>Liabilities</u>			
Deposits	7,893,469	6,985,417	5,830,924
Other	23,424,786	21,409,654	
Capital	1,015,463	994,280	953,896
Total	32,333,718	29,389,351	
Cash as a percentage of total deposits	9.8%	13.3%	19.4%

Table V

BRAZIL

Banking statistics, all commercial banks
native and foreign banks compared

(Contos)

	: Loans : and : discounts	: Currency : on : hand	: Total : deposits	: Currency or a : percentage of : total deposits
1928 - 29				
Foreign banks	1,419,586	190,249	1,384,208	13.7%
Native banks	4,441,970	941,583	4,446,715	21.3%
1932				
Foreign banks	1,345,336	376,033	1,595,744	23.6%
Native banks	4,923,215	716,224	5,012,853	14.3%
1936 - May 30th				
Foreign banks	1,425,748	199,205	1,466,711	13.6%
Native banks	6,293,925	522,693	5,991,693	8.7%

Table VI
BRAZIL
Foreign Trade
1932 - 1936

Year	Imports			Exports			Trade balance		Annual average exchange rates (Federal Reserve Bulletin)		
	000's of milreis (contos)	Dollars	Rate (cents per milreis)	000's of milreis (contos)	Dollars	Rate (cents per milreis)	000's of mil- reis	Dollars	Official	"Free market"	Weighted rate*
1936	4,268,667	\$246,717,567	5.78	4,895,435	\$320,043,320	6.54	+ 626,768	+ \$ 73,325,753	8.57	5.88	6.82
1935	3,855,917	224,795,657	5.83	4,104,008	269,374,615	6.56	+ 248,091	+ 44,578,958	8.29	5.75	6.64 x
1934	2,502,785	207,737,755	8.30	3,459,006	286,607,114	8.29	+ 956,221	+ 78,869,359	8.43	6.31 #	-
1933	2,165,254	169,861,596	7.85	2,820,271	223,126,808	7.91	+ 655,017	+ 53,265,212	7.96	-	-
1932	1,518,694	105,818,626	6.97	2,536,765	178,255,293	7.03	+1,018,071	+ 72,436,667	7.12	-	-
1931	1,880,934	139,508,695	7.42	3,398,164	240,590,783	7.08	+1,517,230	+ 101,082,088	7.03	-	-
1930	2,343,705	-	-	2,907,354	-	-	+ 563,649	-	10.71	-	-
1929	3,527,738	-	-	3,860,486	-	-	+ 332,744	-	11.81	-	-

* Free market rate times 65; official rate times 35.

May 24 to December 31, 1934.

x Applicable to period February 11, to December 31, 1935.

TABLE VII

Brazil: Balance of Payments

	: 1936	: 1937
	: Millions of \$	
	: Estimated	
For debts	8.0	8.8
Diplomatic	.7	.7
Frozen credits (U.S., Brit., and Fr.)	5.1	4.0
" " (oil cos.-1/2 at open mar- ket)	-	.8
" " (others)	.4	.4
Earnings on foreign investments	3.0	3.0
Tourists	1.0	1.5
Immigrant remittances	.5	.5
Travel, insurance, etc.	.9	1.0
Imports	49.7	54.7
Residual	<u>1.9</u>	<u>1.7</u>
	71.2	77.1
Exports	64.5	71.0
Overvaluation of German imports	2.6	2.8
Tourists	.8	1.0
Diplomatic, etc.	.3	.3
New investments	2.0	2.0
Loan from Britain	<u>1.0</u>	-
	71.2	77.1

EDA

GRAY

PARIS

Dated May 13, 1937

Received 5:37 p.m.

~~170~~

Secretary of State

Washington

627, May 13, 6 p.m. (SECTION ONE)

FROM COCHRAN.

Exchange market very quiet. Only operation of interest was further purchase of sterling by Soviet which required some release of sterling by the French control. Belga seemed particularly weak today. Guaranty Trust not willing to operate from Brussels to New York. Presumption is that if Belgians ship gold to New York the National Bank at Brussels will attend thereto. French rentes unchanged to down 45 centimes. Stock market not good and market operators inclined to be unhappy. People are frightened somewhat by the recurrent lowering of the gold purchase price by the Bank of the Netherlands which continues to have to absorb large quantities. Bank of France statement as of May 7, showed no significant changes except that Treasury deposit has been reduced to 1,436,000,000 francs. Percentage 55.08 versus 54.71.

French Government is working on a scheme for financing public works in the Paris district which appears to involve borrowing

EDA - 2 - #627, May 13, 6 p.m. from Paris Section one.

borrowing through the "national fund for state contracts and public bodies" whose notes and those of the contractors will be discountable at the Bank of France and whose capital is being subscribed by "Treasury agencies" from "special reserves".

French financial press gives certain amount of attention to Dies' proposal for a monetary conference. There is, however, little enthusiasm evident for bimetallicism and slight hope expressed that advancement along the monetary line can go very far unless the economic situation is also improved through increasing foreign trade.

BULLITT

SMS:EMB

PARAPHRASE OF SECTIONS TWO, THREE, AND FOUR OF NO. 627
of May 13, 1937, from the American Embassy, Paris

Today I was visited by Jacobson of the BIS who was on his way to Dublin from Basel. Jacobson made reference to the wide-spread interest aroused in the press, especially in London and Europe, by the annual report of his institution, and particularly by the references to the outlook for gold contained therein. The Bank was being requested, my friend said, to provide many more copies of the annual report than customarily, and the fact that the report has attracted so much comment has pleased the resident officers. Presenting a statistical review each year is not at all the idea of the officers of the Bank; they want to give the most authoritative data available from central banks and related sources in the annual report and analyze the current elements in the financial and monetary sphere sufficiently to provoke study and discussion.

The following quotation from the STATIST pleased Jacobson -

"The fundamental factors behind the gold issue are very clearly and impartially discussed in the latest report of the BIS in the comments on the effect of the abundant gold supply on the monetary system".

The report, the STATIST and the FRANKFURTER ZEITUNG believed, is more of a warning to Great Britain than to any other country.

Jacobson feels that the criticism of the BIS by

Einsig

- 2 -

Kinsig in the LONDON FINANCIAL NEWS for touching upon so delicate a subject as that of gold revaluation is not fair to the BIS. The FINANCIAL NEWS reporter has sought to emphasize that Jacobsson's views were represented in the report, but Jacobsson thinks that Kinsig has not given enough attention to a fair analysis of such views. The reference which Jacobsson made to changing the price of gold, he said, was unduly stressed by Kinsig, whereas this was merely mentioned along with other alternatives in the report of the President of the BIS. Jacobsson is convinced that Kinsig is so indebted for support to the gold mining interests with headquarters in London that he is acting as spokesman for them in condemning any suggestion that might favor less profit for this industry. Jacobsson said he was glad that the President of the BIS had the courage to include in his reports statements which would risk refutation by those with an interest in gold mining. When economic professors shall have had more time to study the report he expects that further arguments will be heard. He expressed the opinion that the BIS, as the joint institution of central banks, is properly serving its purpose when it endeavors to check undue speculation, as it has in this last report.

Any suggestion that the part of the report on the possibility of lowering the gold price was inspired by

British

- 3 -

British influence is bitterly resented by my contact; this particular part of the report is the subject of the most comment. As early as last November, he said, he gave an address on this subject before an economic society at Zurich wherein he expressed his ideas. It was his purpose to try out the ideas on the Swiss, whose principal reaction was that hypothetical questions were being discussed. The appreciation of gold has now become a most real question, he believes, and world-wide discussion of the subject would be welcomed by him. Research work on the gold question has been undertaken by my friend and his assistants at Basel. They are giving particular attention in the beginning to collecting all available statistics regarding allotment and production.

END MESSAGE.

BULLITT.

EA:LNW

RECEIVED
MAY 14 1937
TREASURY DEPARTMENT
Office of the Secretary
Department of the Treasury

WWC

Gray,

London,

Dated May 13, 1937,

Received 1:30 P.M.

175
~~U~~

Secretary of State,
Washington D.C.

203. May 13, 7 P.M.

FOR TREASURY FROM BUTTERWORTH.

Nervousness in the gold market continues which was somewhat increased today due to the reduction of the price of gold in Amsterdam even though it was a normal result of the reduction in Holland's price for dollars.

This week's Bank of England return shows the note circulation at a new high record of pounds 479,000,000 principal and charges against the expansion being pounds 4,751,000. This increase is due mainly to coronation expenditure and preparations for the Whitsun holidays. Inasmuch as the Bank of England's stock of gold was increased on Tuesday by pounds 5,000,000 taken over from the equalization fund the reserve has not been adversely affected by the increase in the note circulation. This addition to the bank's gold stock is the first important acquisition since pounds 65,000,000 was transferred from the equalization fund against a pound 60,000,000 reduction in the fiduciary issue of December last. Prior to that the bank had purchased no gold since September but some pounds 50,000,000 was added to the reserves in the summer months of last year.

WWC. Page two of No. 285 from London, May 13, 7 P.M.

The total holding of gold in the issue department now rises to pounds 313,666,000 circulated at the old price of 85 shillings per ounce.

BINGHAM

CSB

RECEIVED
MAY 13 1937
TREASURY DEPARTMENT
Office of the Comptroller
General of the Treasury

FS

GRAY

London

Dated May 14, 1937

Rec'd 2:20 p. m.

Secretary of State,
Washington.

288, May 14, 7 p. m.

FOR TREASURY FROM BUTTERWORTH

The general feeling of nervousness continues augmented by the Swedish Finance Minister's statement.

In the gold market there were literally no buyers of futures today despite heavy offerings from India at as low as six pence discount two months delivery. It is rumored that the Soviets have made arrangements to ship their gold direct to New York.

RR:WVC

BINGHAM

STOCKHOLM

Dated May 14, 1937

Rec'd 10:40 p.m.

Secretary of State,
Washington, D.C.

41, May 14, 9 p.m.

Your telegram No. 14..

On May 12 the ~~Swiss~~ ^{Swedish} Government presented to the Riksdag proposals for the enactment of new financial legislation.

The measures proposed are far more limited in scope than the statement that was submitted with them by the Minister of Finance, Herr Wigforss, when they were presented to the King's Council. The Minister of Finance therein made clearer references to the possibility of a change in the international rate of the crown than had hitherto appeared. He said that the circumstances which had made necessary a reflationary policy had disappeared; that the increase in domestic wholesale prices had reached a point which probably already exceeded the "reasonable increase" that had been the Government's former objective; and that a continued increase in wholesale prices must gradually be reflected in a substantial rise in the cost of living. He indicated that with the most effective means for preventing an undesirable development in prices might be to

raise

-2-

From Stockholm, #41.

raise the value of the crown as against sterling and to curtail the extension of domestic credit, such measures were of very doubtful desirability and should be employed only for very strong reasons. He asserted, however, that a stable exchange value of the crown must be regarded as secondary in importance as compared with checking an inflationary price development. He pointed out that it was the crown's firm relationship to sterling through which an increase in world prices was transmitted to Swedish industry and trade; that while he had a high appreciation of the advantages connected with a fixed sterling crown rate, particularly so long as the principal international currencies maintained a firm relationship among themselves; this did not exclude the possibility that conditions might develop under which a change in the international value of the crown might be preferable to refraining from that effort to bring about stability in the Swedish price level and Swedish economic life.

END OF SECTION ONE.

SCHOENFELD

RGC SMS

LMS

A portion of this telegram must be closely paraphrased before being communicated to anyone. (B)

Stockholm

Dated May 14, 1937

Rec'd 12:10 p. m., 15th

Secretary of State,
Washington.

41, May 14, 9 p. m. (SECTION TWO)

(GRAY) The actual measures which the Government proposes at this time are:

(1) Authorization for the Government to utilize the Riksbank's holdings of foreign exchange and gold to a minimum of 100,000,000 crowns for state purchases of commodities abroad. To finance such imports the National Debt Office would make available to a special purchasing office Treasury notes which could be exchanged at the Riksbank for foreign exchange and gold. The Riksbank would in turn be authorized to sell such notes in the open market.

(2) Authorization for the Government to increase the stamp tax on the transfer of stocks and bonds from three-tenths of one per cent to not more than one point two per cent whenever it deemed this necessary to discourage speculation.

(3) Extension to February 28th 1938 of the existing law relieving the Riksbank of the duty to redeem its notes in gold.

The

-2-

The Minister of Finance added that he assumed that in addition the authority of the National Debt Office which is valid until May 31, 1937 to place at the disposal of the Riksbank Treasury notes in any amount which the bank desires for its control of the capital market would be prolonged.

He also assumed that the Riksbank would enact a proposal, introduced on April 30 last, authorizing the Riksbank, when it deemed it necessary, to require the commercial banks to deposit with it a certain portion of their cash reserves.

CONFIDENTIAL. Mr. Wigforss, with whom I have just had a conversation, stated that it was the purpose of proposal (1) to use a part of the foreign exchange and gold of the Riksbank which is now idle and to provide strategic materials such as coal, metals and super phosphates. It was his feeling that these strategic commodities were as good a risk as gold or foreign exchange, especially since uncertainty exists concerning the gold policy of the United States. Furthermore, they might be more valuable to Sweden than gold in case of an emergency. The principal value of proposal (2) was psychological. Proposal 3 was a continuation of the situation existing at the present time.

It

-3-

It was stated by Mr. Wigforss that the Riksbank had insufficient control over the credit market due to the fact that there was so much liquid money in Sweden. He said that the discount rate was ineffective as long as this condition continued changing. Thus, the chief aim of the proposals was to give the Government greater control over the money market by giving authority to sterilize excess funds to the Riksbank.

Wigforss admitted that the price level could not be appreciably influenced by these measures, which would be their ostensible purpose if there should be a substantial rise in international prices. He stated that the wisdom of the monetary policies of Great Britain and the United States and the reaction of the international price level to these policies inevitably affected Sweden. However, if Sweden were forced to choose between a change in the crown sterling rate or an excessive rise in living costs, it would choose the former.

Such a step, Mr. Wigforss stated, was feasible politically. He emphasized the fact that this could be carried out by a simple decision on the part of the Riksbank in agreement with the Government.

It was Mr. Wigforss' feeling that no credit inflation or inflationary industrial expansion were to be observed

-4-

observed in Sweden thus far but he felt that greater financial preparedness was called for because of the present abundance of money, which represented a potential danger.

I also had a talk with Mr. Rooth, Governor of the Riksbank, about the situation. Mr. Wigforss, Mr. Rooth said, had been misinterpreted abroad, and Swedish monetary policy was unchanged. He said that any inflationary influences arising from domestic causes could be handled by Sweden but he said that such influences from abroad could not be resisted under the present proposals. Sweden, therefore, would meet this by revaluation if it were forced to do so by the international price level.

Both Mr. Wigforss and Mr. Rooth seemed to be uncertain with respect to the probable future price of gold and also with respect to the future gold policy of the United States and Great Britain.

My conclusion is that the authorities in Sweden prefer to avoid revaluation of the crown but psychologically they are prepared to resort to a measure of this kind if prices rise appreciably.

(END OF TELEGRAM)

SCHOENFELD

EA:EB

May 14, 1937.
11:46 a.m.

H.M.Jr: Hello

Operator: Senator Wheeler is in a Senate hearing and he can't be reached until 12:30 or a quarter to one.

H.M.Jr: Well leave word that I'd like to call him about five minutes to one.

O: All right.

H.M.Jr: If he can be reached.

O: All right, I'll do that.

H.M.Jr: Five minutes of one sharp.

O: Right.

12:56 p.m.

H.M.Jr: Hello

Operator: Senator Wheeler.

H.M.Jr: Hello

Wheeler: Hello Henry.

H.M.Jr: How are you?

W: Fine.

H.M.Jr: Did you get my letter?

W: Yes.

H.M.Jr: Now in addition to that I just want to tell you.....

W: Yes.

H.M.Jr:as man to man.....

W: Yes.

- 2 -

H.M.Jr:as long as I have been here and as long as I stay here.....

W: Yes.

H.M.Jr:the office of the Secretary of the Treasury will never be used to persecute anybody on income tax.

W: Well I - Henry, I didn 't think as far as you were concerned and that's why I sent the letter to you.

H.M.Jr: Well just as long as I am here it never will be used for friend or foe.....

W: Yes.

H.M.Jr:and it never has.....

W: Yes.

H.M.Jr:and the minute it has or I'm guilty of it I'm willing to quit.

W: Yes.

H.M.Jr: See?

W: Well, of course.

H.M.Jr: But I wanted to tell you that and if anybody under me uses it for that purpose he goes out on his ear in 15 seconds.

W: Yes, well, of course, that's what they should do, Henry.

H.M.Jr: And - but I wanted to tell you that personally.

W: Well I - I - Henry.....

H.M.Jr: I mean all through - listen -

W: Yes.

H.M.Jr: All through the campaign there were suggestions made to me.....

W: Yes.

- 3 -

H.M.Jr:and I've never never used it and never will.

W: Yes, well, Henry, I felt that that was your position.....

H.M.Jr: Yes.

W:and that 's the reason I sent it to you.

H.M.Jr: Well....

W: Now as far as I'm concerned, Henry,

H.M.Jr: Yes.

W:I'm perfectly willing and perhaps I was overly suspicious - ah - I've been out to Kansas - ah - what happened in Kansas I felt came from a certain source and then I went out there and then I got this - and in addition to that you know this has been - they've been circulating around and some of these 2 x 4 fellows around here you know that claim to be close advised kept saying - ah - this fellow will be punished and that fellow will be punished and some other fellow will be punished.

H.M.Jr: Well Burt I - I hold my office too high for anything like that.

W: Well, of course, I know you do but Henry.....

H.M.Jr: Yes.

W:as far as I'm concerned I expect they can start in with me anytime that they want to.

H.M.Jr: Yes.

W: I - a lot of experts have tried to punish me and they haven't got away with it.

H.M.Jr: Yes.

W: Ah - it may be - I - I - I'm taking - I - I - believe what you say positively and absolutely because I know that you wouldn't be a party to it but I didn't care about it excepting I just had to get that letter at this particular time.....

H.M.Jr: Ah-ha.

- W:and it's the first time - it's the first time, to my knowledge, that it was ever attempted or ever checked up on us in all the time that there's been an income tax because, as I've said, I've always tried to lean backwards; I don't keep any books because I don't have any income sufficient to keep books on.
- H.M.Jr: I see.
- W: I don't have any income to keep books on. When they questioned about the 3% on the building when I was United States District Attorney the fellows out there who checked up on income tax made it - I went down there and they said well this is what you ought to take and I took it; I don't know any more about securities.....
- H.M.Jr: Well all I know. I don't know anything about your case personally but I do know that on this question of depreciation of mines,.....
- W: Yes.
- H.M.Jr:and oil wells the boys are going after that and I'll.....
- W: I think they should.
- H.M.Jr:I'll tell you why.
- W: Yes.
- H.M.Jr: Because in the case of oil wells - ah - we find that they've depreciated a hundred per cent.....
- W: Yes.
- H.M.Jr:and then keep on depreciating.
- W: Well you know, Henry,
- H.M.Jr: Yes.
- W:as a matter of fact I - I presume - I don't know a thing about depreciation; I don't know a thing about those things but, as far as I'm concerned if they said to me, "You should put a 10% depreciation", I'd have put a 10% - if they said you should have put it 1% I'd put it 1%.

- 5 -

H.M.Jr: Well but - but aside from the case - the principle and that's what you're interested in.....

W: Exactly.

H.M.Jr: Ah - you have my word that there's nothing and if there is anything or any subordinate took it upon himself.....

W: Yes.

H.M.Jr: See?

W: Yes.

H.M.Jr: I can assure you he'll be out on the street in two seconds.

W: Well I mean it's just bad business.

H.M.Jr: And there's been no request of any kind from across the street - I want to tell you that too.

W: Yes.

H.M.Jr: No request or no hint of anything.

W: Well I couldn't - listen I couldn't - I didn't think that - candidly - I mean it never occurred to me that the Chief would do anything like that.

H.M.Jr: Nothing - nothing like that.

W: Listen, Henry.....

H.M.Jr: Yes.

W:it never occurred to me for a second.....

H.M.Jr: Yes.

W:that he would be and, as a matter of fact, I know that he wouldn't do it. I just thought that you know some misunderstanding of some kind.....

- 6 -

H.M.Jr: It's perfectly possible; I've got 65,000 employees.

W: Exactly.

H.M.Jr: And - ah - some of them are always making a God-damned fool of themselves.

W: Exactly and they're over-zealous sometimes.....

H.M.Jr: Yes.

W:and some of them think well by God they can make themselves solid by doing things that they shouldn't do.

H.M.Jr: Yes.

W: That's the reason that I wrote it direct to you.

H.M.Jr: O.K.

W: It never occurred to me that either you or the President - either one of you would.....

H.M.Jr: All right Burt.

W: Yes, all right, Henry, take care of yourself. Thanks for calling up.

H.M.Jr: Goodbye.

90


FS

A portion of this telegram must be closely paraphrased before being communicated to anyone.(A)

Paris

Dated May 14, 1937

Rec'd 1:52 p. m.

Secretary of State,
Washington.

631, May 14, 5 p. m.

(GRAY) FROM COCHRAN.

Little trading on Paris exchange market today in spite of this being last business day until Tuesday 18th. No evidence of operations by French control. Soviets selling dollars for sterling. Belga still weak presumably due to Belgian purchases of florins to subscribe to Belgian loan recently issued on Dutch and other markets. French rentes unchanged or slightly higher. Stock market dead.

Paris press continues to give attention to anything touching gold question. Today's items concern revival of possibility of Sweden revaluing the crown upward because of rising prices and opposition of Acting Minister of Finance in South Africa to demands for higher taxes on gold mining which he thinks would only further depress the market for gold shares.

Since French banks are closed all day on Saturdays

future

- 2 -

future Bank of France statements (which are issued on Thursdays) will be closed as of the preceding Thursday instead of Friday night.

Jean Liambey today invoiced to Johnson, Matthey 40,000 dollars United States gold pieces LAFAYETTE.

According to my market contact, no one, including the Bank of England, is willing to make forward purchases of gold. Rates are declining as a result. Indian gold for forward delivery today was eight pence per ounce below the current price. My contact told me his colleague in London is no longer permitted by the Bank of England to know how much of the day's market supply of gold is being purchased by the Bank. It is believed therefore that the control is taking back quite a bit of the gold offered on the market.

BULLITT.

EA:LWW

MEMORANDUM

May 14, 1937

To: Secretary Morgenthau

From: Dr. Burgess

Treasury bonds tended slightly easier in the forenoon in a quiet market, quotations remaining thereafter approximately at that level. Closing quotations were generally unchanged to 2/32 off from yesterday. In the guaranteed group, F.F.M.C.'s were generally 2/32 to 7/32 off and H.O.L.C.'s were 1/32 to 4/32 off. The turnover of Treasury and government guaranteed bonds was \$844,000. Note market was dull and a shade lower. The short and middle maturities generally closed 1/32 off on the day, with the 3s of 1938 2/32 off.

Domestic bonds were extremely quiet and price fluctuations were minor. High grade bonds closed about the same as yesterday and second grades showed small losses ranging up to 1/2 of a point.

Foreigns were generally quiet and steady.

No purchases for Treasury today.

Memorandum prepared by
Messrs. Haas, Saltzer, Gram,
O'Donnell and Zucker.

DEPARTMENT

193

Division of Research and Statistics

COMMUNICATION

DATE May 14, 1937.

(Copy furnished Mr. Magill)

TO Secretary Morgenthau

FROM Mr. Haas

Subject: Methods of income-tax avoidance.

Summary and Conclusions

A partial list of methods of avoiding or reducing the full impact of income taxes is presented below. Most of these methods are not new, but the changes made in our tax structure by the Revenue Acts of 1935 and 1936, coupled with the substantial rise in incomes resulting from our business recovery, naturally increase the incentive for the full employment of these and other methods of reducing income tax liability. It is reasonable to expect that unless existing loopholes are greatly reduced by suitable legislation and by vigorous administrative efforts, their use will become more widespread during the calendar year 1937 than was true in 1936; and that our income tax collections during the fiscal year 1938 might, in consequence, be further reduced.

It might be unwise to delay recommendations for remedial legislation in the expectation that existing loopholes will be eliminated in the substantial reorganization of our revenue laws that Congress may effect next year. It is altogether unlikely that such reorganization can be enacted next year in time to be applicable to the calendar year 1937.

Ideally, therefore, specific recommendations for the elimination of each important source of income tax avoidance should be made immediately for congressional consideration. Unfortunately, however, up-to-date and adequate information respecting all the more important methods of tax avoidance, and suitable remedies therefor, are not now available. Based solely on revenue considerations, it would be highly desirable, nevertheless, to make recommendations for immediate action with respect to a few loopholes on which the case appears clear, and to announce that further recommendations would be made in the fall. Such early action would be likely to have favorable effects upon our revenue collections in the fiscal year 1938, not only because of the specific loopholes eliminated, but also because of the important psychological effect.

If, for other reasons, immediate recommendations for legislative action appear inadvisable, a great deal could nevertheless be accomplished by vigorous administrative efforts directed especially to tax avoidance cases. In this connection, a number of well chosen deficiency assessments and court suits would undoubtedly have important psychological effect.

Secretary Morgenthau - 2

Personal holding companies

One clear-cut case of very considerable potential importance as a method of tax avoidance is the use of the personal holding company. In each of the last three revenue acts Congress has specifically recognized the very special character of such companies by imposing graduated taxes upon their undistributed adjusted net incomes. A careful analysis of the relevant provisions of the Revenue Act of 1936 clearly discloses that every individual with a net income of \$40,000 or more, exclusive of additional dividends, may reduce his total income taxes by receiving and reinvesting all additional dividend income through one or more personal holding companies. An individual who expects to receive a total net income of \$2,000,000, of which at least \$1,000,000 will consist of dividends, may, by having \$1,000,000 in dividends paid to and retained by a personal holding company, reduce his total tax liability by \$357,079. If, instead of using one personal holding company, he uses five such companies, his tax saving may amount to \$412,367 (assuming that he is married, has two children, and is entitled to the maximum earned income credit).

These tax savings through the use of personal holding companies, as indicated already, are not confined to individuals with extremely large incomes. In some instances an individual with a net income of only \$22,000, may, if \$2,000 of the income consists of dividends, secure a tax advantage if he arranges to have this \$2,000 received and retained by a personal holding company. An individual who anticipates a total net income of \$200,000, of which \$100,000 will consist of dividends, may save \$30,000 in taxes, if he employs a personal holding company to receive and retain \$100,000 of dividend income.

There appears to be no persuasive reason, as respects either business necessity or tax equity, why the incomes of personal holding companies should not, for tax purposes, be treated as the incomes of partnerships, each stockholder including in his individual income tax return his allocated share of the income of the personal holding company. Such a provision would definitely remove all possibility of the personal holding company, as now defined, being employed as a means of tax avoidance.

In the event that the constitutionality of such a provision in outright form were seriously questioned, the same result could be achieved by another method: The rate of tax on the net income of a personal holding company could be fixed at 75 percent, which tax could be treated as an income tax payment at the source on behalf of the individual stockholders. The latter, with each receipt of a dividend payment from

Secretary Morgenthau - 3

the personal holding company, could receive a certificate from the company evidencing the prepayment at the source of his individual income tax liability to an amount equal to three times the amount of the dividend payment. The stockholder's individual income tax return would include as dividend income the amount of the tax certificate; and he would use this tax certificate in partial payment of his individual income tax liability. In those cases where the amount of the tax certificate exceeded the total tax liability of the stockholder, he would obtain a cash refund from the Treasury. This procedure is an application to personal holding companies of the British method of taxing corporations and their stockholders.

If either of the two alternative methods here suggested of taxing personal holding companies were adopted, all the special credits and exemptions applicable to personal holding companies could be eliminated; and, if desired, all corporation taxes, other than the tax of 75 percent, could be eliminated for personal holding companies. Consideration might also be given to the recognition of rents as one of the defined sources of income of personal holding companies, and to other changes of definition that would restrict the use of such companies as means of tax avoidance.

Foreign investment corporations

A closely related measure could be used to diminish the volume of tax avoidance resulting from the use by Americans of non-resident foreign investment corporations. At present a resident of the United States who enjoys a beneficial interest in the income of a Canadian or other non-resident foreign corporation, including companies that would be defined as personal holding companies under American law, is subject to no income tax liability in the United States on the amount of such beneficial income accumulated on his behalf, except to the extent of the 10 percent withholding tax on dividends paid to such foreign company by American corporations. The Canadian income tax laws, as revised, give decidedly preferential tax treatment to investment corporations owned by or for the beneficial interest of foreigners. There thus exists a very powerful inducement for Americans of large incomes to establish personal holding companies on Canadian soil.

There would appear to be no sound reason why the United States need recognize, for the purpose of determining the taxable incomes of its citizens and residents, corporate charters granted by foreign governments. Conceivably, all American residents could be required, for income tax purposes, to report their shares in the incomes of foreign corporations as partnership incomes. If such a provision were generally applied to include ordinary industrial corporations, practical difficulties would doubtless arise. But there would appear to be no sound objection to applying such a provision to investment corporations, suitably defined, in which Americans hold interest.

If such a provision were adopted, such Americans would be required to include in their individual income tax returns their share of the undivided profits of foreign investment corporations in which they hold interests. It is true that tax evasion would still remain possible by failure to report such beneficial income, but what is now lawful tax avoidance would be changed to unlawful tax evasion; to which would be added the stigma and penalties, if discovered, of swearing to a false income tax return.

Foreign beneficiaries of American trusts

A somewhat related principle could be applied in the taxation of foreign beneficiaries of American trusts. A withholding tax of about 7 percent could be levied on the income received by any American trustee for the beneficial interest of any non-resident alien; and a rebate of taxes may be made to or on behalf of such non-resident alien upon the filing of a complete income tax return with the Bureau of Internal Revenue establishing the non-resident alien's right to such rebate. This income tax return would include income from all sources and all countries and the income tax applicable to the American portion of the income would be the difference between the total taxes that would be payable if the whole income were earned in this country and tax that would be payable if only the income earned in other countries were taxable.

* * * * *

Notwithstanding the admitted legality of tax avoidance as distinguished from tax evasion, tax avoidance constitutes a serious problem viewed from the standpoint of safeguarding revenue yields. It is a problem that merits constant attention in order to effect corrective legislation. Tax avoidance raises moral and economic issues also. Practically every avenue of tax avoidance is a means of circumventing the just levy of taxes in accordance with the "ability to pay" principle.

Directed against income taxes, tax avoidance, in a broad sense, comprehends the devising of means for the prevention of receipt of income in taxable form, or the manipulation of its receipt or accrual in such manner (legal) as to make it subject to the lowest possible tax. Tax avoidance is the conscious shaping of tax determining events, usually proceeding in accordance with advice from tax counsel.

There thus exists continuous manoeuvring of income into paths of least tax. This process of employing legal ingenuity to discover fertile sources of tax avoidance has been going on for many years. Comfort for the tax avoider is found in the case of *United States vs. Iaham* decided in 1873. This case established the legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them by means which the law permits. A comparatively recent decision, the *Gregory vs. Helvering* case (1935), may have somewhat curbed the breadth of tax avoidance by holding that though the motive of tax avoidance cannot

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be attacked, the utilization of such means as may be merely artifices and have nothing to do with business realities, cannot be considered effective means for accomplishing tax reduction.

There are certain known methods, some of which have afforded refuge from just tax liability over and over again. The publicity which in recent years has been given to methods for minimizing taxes, the condoning attitude which must be inferred from the several recent works on tax avoidance, are tending to develop a philosophy that a tax burden is only to be borne by those who cannot so manipulate their transactions as to make them wholly tax free or subject only to a minimum amount of tax. This is a policy which if carried to extremes will have the effect of working havoc with the attempts of Congress and the Treasury in their quests for adequate revenue. The widely circularized methods for tax minimization and tax avoidance contained in the Federal Tax Services like Prentice-Hall, Commerce Clearing House, the books on tax reduction by authors like Sears, Hartman, Cochran and others, all have the effect of laying emphasis on tactics and procedure to be followed in advance of consummating transactions or in the methods of conducting business in order to accomplish tax reduction.

Whether or not tax avoidance is to be stigmatized with an unsavory tinge is not of importance. From a standpoint of revenue, it is important, however, that known loopholes in tax statutes be eliminated, so far as is practicable. It is recognized that certain methods for minimizing taxes are not the specific outgrowth of defects in the statutes, but rather are inherent in the broad privileges and rights of constitutional origin. For example, our revenue laws cannot compel any individual to make a sale of property in a year when it will result in greater income tax than in another year.

Apart from tax avoidance methods, the ways of curtailing tax liability are many, particularly if we include on the one hand so-called legitimate methods for minimizing taxes and on the other the instances of reduced tax liability because of existing inequities in the tax laws. Some of the methods have been the subject of concern by Congress in its study of tax avoidance (Preliminary Report of the Subcommittee of the Committee on Ways and Means, 1933), and have also been considered by the Treasury Department (Statement of the Acting Secretary of the Treasury regarding the Preliminary Report of a Subcommittee of the Committee on Ways and Means, relative to methods of preventing the avoidance and evasion of internal revenue laws, 1933).

Without attempting anything which approaches an exhaustive listing, there are given below some loopholes affording means for avoiding income taxes.

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(1) Undistributed profits tax avoidance

In a real sense, an adequate discussion of the methods of avoiding this tax cannot be divorced from most of the methods of avoiding individual and corporate income taxes. Virtually all methods that reduce the taxable income of corporations likewise reduce their undistributed net incomes subject to this tax. And the increase in dividend distributions to individuals arising out of the desire of corporate managements to eliminate surtaxes on undistributed income may be cancelled in significant degree, so far as affects tax revenues, by an increased use of methods of avoiding individual income taxes. For these reasons virtually all of the general methods of income tax avoidance cited hereinafter are relevant in this connection.

(2) Nullifying the \$2,000 capital loss limitation

In instances where the capital gains are not enough to absorb the capital losses an intentional sale of securities may be made at a profit, which profit would not be taxed but rather offset against the capital losses. By arrangement, identical securities can be repurchased, presumably at the market price, and the taxpayer gets a stepped-up basis for subsequent sale. There has been accomplished by this manipulation the establishing of a higher basis for purposes of offset against future sales price, without any tax having been paid on the profit made from the first sale.

(3) Identification of securities for sale

In the case of ownership of shares of certain stock acquired at different times and at different prices, a sale of some of the stock can be made to best tax advantage by indicating specifically to the broker the shares of stock desired to figure in the sale, thus the "first in and first out" rule is defeated and the largest amount of loss or the smallest amount of profit can be effected for reflection in the tax return.

(4) Avoidance of surtax applicable in the high brackets

Allocation of income sources between husband and wife and other family members, by legal arrangement, is still a costly medium for tax reduction from the Government's standpoint. A partnership can be created, thus dividing the income among the several members, each one paying his tax, but none reaching into the high brackets which would have been the case if the income were left chargeable to one individual. Similar methods of saving tax in the high brackets can be accomplished by the establishment of trusts, the beneficiaries of which will pay tax on their respective interests. The total tax will be far

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less than what would be due, on a progressive rate scale, from one owner. The gift tax constitutes, to some extent, a halting factor, but there are methods of avoiding the gift tax, and in many instances there is still an income tax net saving even though a gift tax is contemplated to be paid.

(5) Avoiding the wash sale provision

Notwithstanding the thirty-day limitation with respect to wash sales now in the income tax law, an individual may make a sale of securities for purposes of claiming a loss on his return and immediately thereafter his wife or other member of his family may repurchase the securities at the existing market price. Thus the individual has been able to claim a loss, though the securities may still be within his control. Such a transaction has been held valid even though husband and wife file a joint return.

(6) Use of installment method

The installment basis for reporting income, permitted under the statute, particularly for real estate transactions, can be effectively used to defer the payment of tax on a realized gain over a long-term period during which collections are received. By spreading the reporting of the profits over several years one can effect a savings of tax so long as the progressive surtax remains in the statute.

(7) Charitable gifts in property

A fulfillment of a contribution pledge may be made by donating property of a market value of the gift without the taxpayer being subject to tax on the difference between cost of such property and its possibly high market value. Notwithstanding this form of tax avoidance, the individual can utilize the full amount of the donation as a deduction for charitable contributions against his income, subject only to the 15 percent limitation provision.

(8) Full allowance for worthless securities and obsolete assets

A sale of securities having but nominal value, may, under the statute result in the allowance of only a portion of the loss in view of the step scale arrangement now in effect for the allowance of capital losses. However, if in lieu of a sale, complete worthlessness were proved for the securities, no matter how long the securities had been held, full loss is allowable under Section 23(e)(2). Similarly, an abandonment of obsolete physical assets rather than a sale of such assets will accomplish the allowance of full loss deduction in lieu of only a portion, permissible under Section 117.

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(9) Percentage depletion and use of discovery value

The existence of provisions in the statute covering the use of discovery value as a basis for depletion, and the allowance of percentage depletion permit the taking of depletion deductions even after the full cost of the property had been recovered.

(10) Tax-free exchanges

Accomplished through effecting exchanges and reorganizations, and the payment of liquidating dividends under the existing provisions contained in Sections 112 and 115.

(11) Dividends paid in property

A corporation may vote a dividend payable in kind and, notwithstanding the appreciation in the value of this property, the corporation pays no tax on such increased value between cost and market price at date of distribution. If the corporation had declared the dividend in money and had sold the identical property to satisfy the dividend payment, it would be taxed.

(12) Contributions to pension trusts

Under the provisions of Section 23(p) of the 1936 Act, it is permissible for a close corporation to deduct as expenses, amounts paid in to a bona fide pension trust for the benefit of its officers. The trust need not be a perpetual one and amounts paid in may revert to the corporation in a later year, when the treatment of such reversionary amounts as income may nevertheless be accomplished at a tax saving over all. The officers are not taxable on pension amounts put aside for their benefit until actually received by them.

(13) Payment of interest in lieu of dividends

A tax saving may be accomplished by a corporation issuing, for example, debenture bonds in lieu of stock and claiming as a deduction from income the amounts paid as interest. No corresponding deduction, of course, would be allowed if the amounts paid out were dividends, even if payments to preferred stockholders were labelled "interest."

(14) No return necessary if gross income under \$5,000

No return is required, under the provisions of Section 51, if gross income is under \$5,000 and net income is less than \$2,500 if married or \$1,000 if single. Tax avoidance is possible, in view of the fact that the Government is afforded no opportunity to check the exclusions from gross income or to determine whether the deductions taken by the prospective taxpayer are fully allowable.

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(15) Loans from corporations in lieu of dividends

In cases where the stock of a corporation is closely held, it is possible for the stockholders to make loans from the corporation and to give non-interest-bearing notes payable on demand for such loans. This manipulation results in the receipt of the amount of the profits by the stockholders without them having to pay normal tax and surtax thereon, which would be the case if distributed as dividends. This method of minimizing taxes cannot be used as readily today in view of the existence of the undistributed profits tax.

-COPY-

EMBASSY OF THE UNITED STATES OF AMERICA

Office of the Treasury Attache

Customs

2 Avenue Gabriel
Paris, France

May 14, 1937

Memorandum for the Secretary of the Treasury.From Commander Thompson, Special Assistant
to the SecretarySubject: Narcotic Smuggling in the Balkans
and the Near East.

In connection with my trip to Athens to start Christides working in the proper channels and producing concrete results, I made a survey of narcotic smuggling conditions in countries en route as follows:

Greece
Turkey
Bulgaria
Yugoslavia

The results of this survey follow.

Greece.

The principal ports for us to watch in Greece are Piraeus (Athens) and Salonika. The American Export Line makes both these ports and, in addition, steamers of various nationalities and tramp steamers under charter call there, these vessels making United States ports in their itinerary.

While no opium is grown in Greece legitimately, nevertheless narcotics

are plentiful for smuggling purposes, the sources being the Balkans, principally Yugoslavia but also Bulgaria, and the Near East, namely, Turkey. Smuggling is directed to the United States through two channels: overland to Hamburg and thence out, and direct from Piraeus and Salonika. In addition to the United States traffic, narcotics are smuggled for local consumption, to other European countries, and to Egypt (hashish and heroin). Cocaine is also available, coming very probably from the Dutch East Indies. The white drugs are turned out in illicit factories, such as the Voutsinas plant recently seized by the Greek police.

While in Athens, I talked to two underworld characters, the result of which conversations gave a brief picture of what is going on. The first person consulted was Christides' No. 2 informer, who is a runner for the Voutsinas gang. The work of this individual has been confined largely to conveying narcotic shipments to other European countries. He verified the fact that narcotic smuggling is active and that narcotics are available in large quantities.

The second individual was a narcotic trafficker, who volunteered to furnish narcotics in any amount, either put aboard ship at Piraeus (Athens) direct to the United States or over Berlin and Hamburg for transshipment to the United States at the latter point.

The Greek police are reported to be suspected strongly of crookedness, both by the latter individual and our consular authorities.

I advised Christides to cover Salonika as well as Athens. During a brief stop at Salonika, I lined up an informer for him as a start at that point. American Export ships call at Salonika.

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I talked over with Consul Shantz the matter of the return of our black lists to the Greek authorities. He feels that it should not be done, for the reason that the lists will probably be treated as before, namely, they will be kept on open shelves where they will be available to all and sundry police employees including any crooked ones who will pass along information concerning these lists to their trafficker friends. I agree with him on this.

Turkey.

Turkey is a large opium growing country. It has a considerable commerce in this commodity and exports important quantities of it, a considerable portion of which goes to American manufacturers. The legitimate sale is controlled by the joint Turko-Yugoslav opium monopoly with head offices in Istanbul. The purpose of this monopoly is to pool orders from these two opium producing countries as regards raw opium and smoking opium, in order to control the market price of same. Turkey is allotted 75 per cent of the opium sales, and Yugoslavia 25 per cent. (See more about this under "Yugoslavia".)

Istanbul is a comparatively large port. In addition to the American Export Line vessels, ships of other nationalities, with ports of call in the United States, stop there. The officers of the monopoly are reputed to be easily approachable for the proper amount of money. The smuggling angles are two: (1) diversion of monopoly opium through crookedness and (2) bootleg opium, namely, that which is held out by the farmers and sold into illegitimate channels.

I took Christides with me to Istanbul in order to get him started

there. The Ambassador and consular staff in Istanbul expressed their desire to cooperate, as was the case at Athens regarding the Minister and the consular staff. In view of the general atmosphere of helpfulness prevailing, I think Christides should produce something. I was able to set him in through a personal contact with a prominent American business man there, who has been dealing for some thirty years with the Turkish Government.

Bulgaria.

Bulgaria has a regular legitimate industry in opium growing, the areas under cultivation being in the south, the product being known as Macedonian opium. The legitimate export is under national control, which is supposed to be strict. However, we have information from underworld circles to the contrary; therefore, we should keep our eyes open to the smuggling possibilities of this country, over the ports of Constanza and Bourgas, on the Black Sea, and Salonika in northern Greece. The American Export ships call at Constanza. Another possible avenue of egress would also be Salonika in northern Greece. As to the legitimate export of narcotics from this country, one of the largest customers is the United States. There are two legitimate derivative factories, both located in Sofia, the capital, the output being principally for national consumption.

Yugoslavia.

Yugoslavia has a considerable industry in opium production. The areas under cultivation are principally in the south. The legitimate commerce is under the National Monopoly Bureau which, as remarked under the subject of Turkey, works in conjunction with the Turkish monopoly. A local corporation, the Privileged Export Company, has the contract for collecting and marketing the product, under the monopoly. The

control of opium throughout is very loose, which probably accounts for its appearance in the illegal market from time to time in the United States. The farmer harvests his crop and turns the proceeds, presumably in entirety, into the collection warehouses of the Privileged Export Company. However, in many cases he will hold part of the output back for diversion into illegal channels and for local consumption. From the collection points in the south, the opium moves as regular freight, not under guard, to the concentration warehouse at Belgrade. From there it moves by rail to the port of Gruz, shipping suburb of the seaport city of Dubrovnik. From the warehouse in Belgrade, where it is kept under loose guard, it moves to the railroad station, packed just as any other freight would be; this also pertains to the railroad transportation from Belgrade to Gruz. At Gruz it is concentrated at another warehouse, also under loose control. Diversion is therefore possible at any point from the farmer to the seaport. At Ragusa, the "Vulcania" calls at intervals, and shipments are made to the United States by this avenue. (It is to be noted that the United States is the principal customer for legitimate shipments of Yugoslavian opium.) Other vessels which call at ports in the United States also stop there.

An example of the looseness of control above mentioned was shown in the case of the recent legitimate shipment to Eli Lilley and Company, Indianapolis, which upon arrival was found to be part rocks, the substitution of rocks for opium undoubtedly having been made in Yugoslavia, probably at the warehouse in Gruz.

While the presence of Americans interested in arranging illegitimate

shipments of narcotics has not been noted particularly in Yugoslavia, nevertheless, the situation will bear watching. I say this because the looseness of control as regards opium and the presence of illegitimate factories at Belgrade and Zagreb presents an excellent opening for the smuggling traffic. The absence of Americans may possibly be accounted for by the surmise that their hook-up in Yugoslavia is so good that they can conduct operations from Paris without coming to Yugoslavia.

Other ports of interest in Yugoslavia are Split, with direct connections from Zagreb, and Susak in the north just across the border from Fiume. It is also believed that an outlet for illegitimate Yugoslavian narcotics is Salonika, this port being but a comparatively short distance from the southern Yugoslavian border.

The Yugoslavian monopoly authorities are much concerned over the recent stand of American legitimate opium importers, who apparently have stated in effect that they are not in favor of ordering narcotics from a country in which the control is so loose as to permit smuggling. The aforementioned authorities feel that they may lose their best customer thereby.

It is to be noted that the agents for the Privileged Export Company in the United States are the Massachusetts Trading Corporation.

Due to recent developments, a situation presents itself which will probably lead to an increase of narcotic smuggling out of Yugoslavia. This is due to the introduction into the picture of a large French private corporation. The set-up, briefly, is as follows: Some years ago the building of a Balkan railway in which Turkey and Yugoslavia

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were heavily interested was financed by this French corporation. This indebtedness was never paid off by either country, the excuse being that due to the national financial conditions the export of the necessary money was not practicable. The French company, in an endeavor to get payment of the debt, attempted to arrange payment in goods instead of money. They first approached Turkey, saying that since payment in money had been refused they were willing to take payment in commodities, among these, opium. The Turkish Government agreed to this, saying they would turn over the opium under the Turko-Yugoslavian monopoly, and the orders therefor, to the French corporation.

Yugoslavia was next approached. The Yugoslavians had heard of the Turkish arrangement and, knowing that their consent was necessary to fulfill the agreement under the joint monopoly, they told the French corporation that they would not pay in goods, and that if the latter wished their opium they would pay for it in foreign exchange. In order to make a deal, the French corporation had to accept this arrangement.

The present situation, as related to me in Belgrade, is that the above agreement is now in force, namely, that the business of the Turko-Yugoslavian monopoly will be transmitted through the French company, which will receive payment therefor. It is felt that this will present an opening for smuggling, in that the Yugoslavians, as well as the people of other Balkan and Near Eastern countries, are generally reputed to have a peculiar psychology as regards right and wrong when it comes to financial matters, in that it is considered smart to put anything over by hook or crook in this regard. Accordingly, it is a reasonable assumption that

not all the Yugoslavian opium will be turned over to the French company at the relatively small legitimate price, but instead a considerable portion of it will be held back for smuggling purposes at the higher prices pertaining in this traffic.

One thing I learned in Belgrade may identify the large store of opium in a warehouse in the free port of Hamburg, about which we have heard so many rumors in connection with the source of a considerable amount of the illegitimate supply of this product for smuggling into the United States. What I learned was as follows:

Before the joint Turko-Yugoslavian monopoly was set up, the sale of narcotics in Yugoslavia was confined to two private firms. About a month before the joint monopoly started to function, these two firms, in order to get their stock on hand of opium out of the country so it could be sold, moved it to two warehouses: one in Hamburg and one in Marseille. I would suggest, in view of this, in our present endeavor to locate the warehouse in Hamburg, that we simply get the information in Hamburg as to the inward movement of this opium, which was supposed to have taken place about December, 1933. The same pertains to Marseille. Undoubtedly, a considerable portion of the stock has been surreptitiously removed for smuggling, but if the information we have received from Hamburg is correct, there is a large amount still remaining at that point.

Incidentally, the Yugoslavian branch of the joint monopoly pays 18.73 dinars, or 35 cents gold, per kilo of morphine content for their opium.

Vice Consul Calnan of the Belgrade Consulate, agreed, at my suggestion, to obtain from the Yugoslavian monopoly several of their legitimate wrappings for opium, in order that we might compare these in the United States with wrappings on seized narcotics.

Miscellaneous Information.

(a) I was interested in observing in Belgrade that Russia's activities in the opium growing and marketing business are a cause of concern to the Yugoslavian authorities. I came across this from two angles. First, I learned that the Yugoslavian monopoly is concerned over the fact that Russian opium was offered in the Hamburg market at 15 francs under the Yugoslavian monopoly price. Second, I learned that the Turko-Yugoslavian monopoly had made overtures for the Russians to join the joint monopoly. Incidentally, the monopoly has made similar overtures to the Persians.

(b) In Belgrade, it was also brought out that the Yugoslavian authorities are likewise somewhat concerned over the sections of the European "alcoloid cartel", a commercial union (international) which functions for the supply and price control of legitimate narcotics, with head office in Paris.

Respectfully,

B. M. THOMPSON

PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Paris, France

DATE: May 15, 1937, 10 a.m.

NO.: 633

FROM COCHRAN.

Last night I had a talk with Charon of the Financial Section of the League. On Tuesday he came here from Geneva to discuss with French officials plans for future work of the League, and to meet Frere of Belgium.

The League's Secretariat is anxious that the League regain through technical studies and undertakings some of the prestige which through unsuccessful intervention in political affairs has been lost. The League's Financial Section wants to advance beyond checking up periodically on the finances of the minor states that used the League for borrowing. The study of international loan contracts was a step in this direction. Charon came to Paris to try out a more pretentious plan - that of bringing together under the League's auspices and through its Financial Section, a group of experts to investigate the possibilities of extending and making something more permanent and far reaching of the Tripartite Monetary Agreement.

It is the opinion of League officials that while the Tripartite ~~agreement~~ Agreement is on only a 24-hour basis all parties actually make an effort to keep the agreement

as

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as stable as they can. However, they believe that various stabilization funds should cooperate more than they think they are doing in daily exchange of ideas and orders between the foreign exchange experts who operate the funds. With regard to control, studies should be made of the utility of stabilization funds, their place in the organization of the government, the manner of international cooperation, and so on. The League officials should like to have experts familiar with the present funds discuss their experiences and their problems.

This matter was discussed by Charon with Ricard, economist of the Bank of France. Ricard could not commit the Bank, and Charon did not see the Governor himself.

Charon said that he had also discussed this question with Rist, who evidenced much interest in it. I heard nothing about this matter in Geneva but the plans of which Charon informed me last night had been known to some of my B. I. S. friends.

I was informed by Charon that the concern aroused in both business and official circles by the gold problem and the nervousness of Paris bankers over the possibility of further franc devaluation had impressed him.

Frese

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Frere, on his way from Brussels to Rome, passed through Paris. Frere told Charon, an old friend and associate, about his visit in Berlin. Charon told me that Frere was much disheartened by the talks he had in Berlin. He had talked with Goering, Schacht and Ritter. He asked them about the possibility of Germany taking measures to hold their monetary unit steady at a new level and the possibility of Germany devaluing. To these questions the three German officials insisted that these were mere technical details and that they could handle them whenever the time might come. Until political problems were cleared up, they said, they were entirely unwilling to discuss these matters.

Emphasis was placed on colonies by Schacht. It seemed to be Goering's feeling that Schacht placed too much stress on this point. No demand for full ownership of colonies was made by Germany but rather for some kind of mandatory or control of that kind over such areas as Kamerun. Abolition of the League's article 18 was the most insistent German demand. It was their opinion that it had been shown by recent experiences that the next country branded as an aggressor might encounter very serious difficulties in case sanctions were applied against it. In this connection the Germans said that their

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their nationals were being encouraged to liquidate their holdings abroad which might be seized in wartime. The losses incurred through foreign seizure of German (enemy) property) had been greater, they said, than the amounts paid in reparations. The necessity of adjusting Danzig and Schleswig problems was discussed. According to Frere's feeling, the whole Berlin atmosphere indicated that on political measures Germany and Italy would stand together and that any chance for real world wide progress through Van Zeeland's undertaking would be blocked by these two countries. For this reason Frere left Paris for Rome, in spite of the fact that his Italian hosts have promised him a generous reception, since he was worried for fear the results of his trip might be unsatisfactory.

Charon did not wish to be quoted in any way, so please consider this message strictly confidential.

(END MESSAGE)

BULLITT.

EA:LWW:EB

May 14, 1937
4:10 P.M.

H.M.Jr: Hello.

Operator: Senator Pittman. Go ahead.

H.M.Jr: Hello.

Key

Pittman: Hello, Henry.

H.M.Jr: Hello.

P: Hello.

H.M.Jr: Key?

P: Yes

H.M.Jr: Henry talking.

P: Yes

H.M.Jr: How are you?

P: Fine.

H.M.Jr: I'm calling you up at the request of Cordell Hull.

P: Yes

H.M.Jr: Do you remember, some time ago I called you up and said that he'd like to have that Canadian tax thing held up?

P: Yes

H.M.Jr: Well now he'd like to have it go ahead.

P: Very good.

H.M.Jr: 'But I - I want - I think I ought to say this to you in confidence, and - I mean Hull knows this, and he told it to the Canadians: that in the not too distant future we most likely are going to talk to Senator Harrison and Doughton about the possibilities of putting quite a heavy tax on aliens who have investments in the United States....

P: Yes

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H.M.Jr:which will supersede this.

P: Yes

H.M.Jr: Now, he's explained that to the Canadian Minister...

P: Yes

H.M.Jr: ...but he feels that we've got a moral obligation to go through with this, and he's counting on them very heavily at this Empire Conference in London.

P: Yes

H.M.Jr: The Canadians. So I told him that I'd call you up and explain to you just... As far as the Treasury is concerned, we have no objection, but I think before the session is over that we will be up with a proposal to Harrison to - a new device to tax these aliens, see?

P: I see.

H.M.Jr: At least tax them as much as we tax our own citizens.

P: Well, it's - the matter is ready to report in.

H.M.Jr: Pardon me?

P: The Senate - Senate Subcommittee, of which Senator Harrison is chairman, are ready to - they've made their report to.....

H.M.Jr: I see.

P: ...to the full Committee.

H.M.Jr: Yes

P: And it's ready to go onto the floor.

H.M.Jr: Well, that's all right.

P: And Harrison will have charge of it as chairman of the Subcommittee.

H.M.Jr: Well, that's all right. But this other thing about a possible later proposal is just between the two of us.

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P: I understand, certainly.

H.M.Jr: How are you?

P: I'm fine. I just flew out to Nevada and back.

H.M.Jr: Good for you.

P: Yes

H.M.Jr: Well, hope to see you soon.

P: All right.

H.M.Jr: Goodbye.

May 14, 1937
4:38 P.M.

H.M.Jr: Hello.
Operator: Secretary Hull's coming on.
H.M.Jr: Thank you.

(Long pause)

Cordell
Hull: Hello?
H.M.Jr: Cordell?
H: Yes, sir.
H.M.Jr: I just talked to Key Pittman....
H: Yes.
H.M.Jr: ...about that Canadian tax.
H: Yes.
H.M.Jr: And he's going to talk to Pat Harrison and bring it out on the floor - I gathered right away.
H: Yes, all right. Thank you, Henry. I didn't see how we could get out of it without....
H.M.Jr: Well, I wanted to let you know I'd done it.
H: I noticed today that MacKenzie King led off over there by referring to the expansion of trade by the Canadian-United States agreement.
H.M.Jr: I see.
H: So we may - they may wake up their and broaden out a little.
H.M.Jr: I hope so.
H: Yes, thank you, Henry.
H.M.Jr: Goodbye.

GROUP MEETING

May 17, 1937
9:30 A.M.

Present: Mrs Klotz
Mr. McReynolds
Mr. Bell
Mr. Lochhead
Miss Roche
Mr. Gibbons
Mr. Oliphant
Mr. Magill

H.M.Jr: Hello, Mac.

McR: Good morning.

H.M.Jr: What you got?

McR: Fire report - fire prevention report on the Bureau.

H.M.Jr: Oh. Well, what you going to do? Tell me.

McR: They want to do a lot of things that cost a lot of money.

Bell: Ever hear of anything that didn't cost any money?
Anybody ever absorb anything?

McR: But in view of the recommendation of this committee of three engineers that went through it....

H.M.Jr: Yes

McR:and the relatively expensive work that would be required, Peoples recommends, and I told him last Friday to go ahead and submit this to this Fire Council, which he has done, so as to get their recommendation and judgment as to the necessity of some of these things that they recommend, certain changes; for instance, that drying racks be changed from wood to metal, and things of that sort. So that is under way, and if you want to let it ride until we hear from them....

H.M.Jr: How long will that be?

McR: Ought to hear from them in three days.

H.M.Jr: How about a simple thing of having carpenters go through and fix all the doors so they will open? Don't need any experts on that.

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- McR: Well, they want one fire door changed from wood to metal, which seems reasonable, and that oughtn't to be expensive.
- H.M.Jr: Let me read this thing. How much is it?
- McR: Well, it isn't very long. (Hands to H.M.Jr)
- H.M.Jr: Well, I'll read it. It certainly - I'll get at it.
- McR: There is a letter written by the Secretary of War to the Secretary of State requesting the Secretary of State to submit an estimate to the Budget to pay the expenses of a group of veterinary doctors to go to Switzerland for a conference in August, and it is in accordance with the treaty. And the Secretary of War, in making that request on State, says that the Secretary of the Treasury and the Secretary of Agriculture "concur in the above" and they have sent it over here for you to initial, to indicate your concurrence.
- H.M.Jr: Well, I don't pass on appropriations. (Nods at Bell)
- McR: I don't see how you could consistently.....
- H.M.Jr: Well, you fix it up with Bell. I don't touch anything like that.
- McR: I don't see how you could consistently - there's a reason.
- H.M.Jr: Consistently what?
- McR: The fact that you've got....
- H.M.Jr: A dairy?
- Roche: As good as any. Better.
- McR: No, it was that a Public Health man is going abroad, or proposed to go; and that's the reason for sending it over here. I told Dan Saturday that I wasn't going to let you initial it if I could help it.
- H.M.Jr: Well listen, you, Dan, and Miss Roche - a committee of three.

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Roche: Oh dear!

H.M.Jr: Do whatever you want.

McR: Miss Roche will initial it, but I don't think she has much interest.

H.M.Jr: Well, if she's interested she can get in on it; if not, she can stay out. How's that?

McR: All right.

Roche: They're afraid to see me get in on anything that costs money.

H.M.Jr: All right, Mac?

McR: O.K.

You remember we fired old man Fix - was Collector of Internal Revenue?

H.M.Jr: Wait a minute. In Pennsylvania?

McR: Yes. We suspended - we fired one Civil Service man and suspended quite a number for a year. Everybody's back except one Brown, who has been 27 years in the Government service.

Gaston: He was Assistant Collector.

McR: He was Assistant Collector. He's been trying through the Democratic National Committee members, including Guffey - has been trying quite actively to get Brown restored to duty for quite some time. Commissioner of Internal Revenue has now come through recommending that Brown be authorized to be reinstated, that is, the status that makes it impossible for him to get back in the Government service be raised. Of course, we can't do it. The Civil Service Commission will have to do it. But Helvering is now recommending that we suggest to the Commission that he be permitted - that he be brought back in in Internal Revenue. I'm inclined to say we ought to let him do it. He's been out two or three years now; pretty hard for him to get a job, and I think he's been sufficiently made an example of so we might take him back.

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H.M.Jr: All right. Will we do anything?

McR: No, I'll just indicate it.

H.M.Jr: Anything else?

McR: Not unless you want to take up the Birgfeld case.

H.M.Jr: I've been waiting for about six months.

McR: And specifically been waiting since last Monday.

H.M.Jr: What?

McR: And specifically been waiting since last Monday, when I was supposed to bring in a report on it.

H.M.Jr: I specifically asked for it at least six months ago, when the committee was appointed. Now wait a minute; that committee was appointed - well, it was either October or November.

McR: There's no question as to the time.

H.M.Jr: Well, the committee - from the time the committee's appointed is the time you wait for a report.

McR: No, it hasn't been a question of time. I just wanted.....

H.M.Jr: No, but I just said it was at least six months. I've been waiting since - for two weeks since I asked definitely.

McR: That's right. But the time you told me I'd have to have it was last week - Monday, a week ago today.

H.M.Jr: All right, Joan (laughing). (To Magill) Kid! What's your (Bell) daughter's name?

Bell: Kathleen.

H.M.Jr: I'm thinking of all the 14-year old girls that he sounds like.

McR: Mine is sixteen; I'll go you better.

H.M.Jr: Don't even attempt to argue with her.

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McR: No.

H.M.Jr: All right.

McR: We had the audit on those funds brought down to a week ago Saturday. We had the accounts set up; the funds were all balanced, money's all there. Birgfeld was short on some of them, but under conditions that a committee found, where he was personally responsible; they were not Government funds. When the thing was checked and he was shown to be - not having all the funds on hand, he produced them immediately. The accounts were put in shape; proper form of accounting was put in; money deposited in the bank with Sam Marks and Miss Holland jointly governing the thing, so that Birgfeld has no authority to withdraw any money himself.

H.M.Jr: Which fund was short, Mac?

McR: Butter fund.

H.M.Jr: How much?

McR: Well, over a period - of course, the biggest shortage was taken care of before we came over here. That was in '33; came out in connection with the closing of the banks. I think it was a couple thousand dollars on that one, which he made up at the time. He made up subsequently about four hundred dollars which was shown to be short by the audit. First time these funds had been audited in twenty years.

H.M.Jr: Is there a written report on that?

McR: Yes.

H.M.Jr: I think I'll read it.

McR: There is a written report.

H.M.Jr: I think I'll read it.

McR: Shows you the whole story from the time the funds were started until the last audit - clear down to today.

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H.M.Jr: Will you let me have it?

McR: Yes, sir.

H.M.Jr: What?

McR: I'll bring it in.

H.M.Jr: With recommendations?

McR: Yes, we'll give you a written report with recommendations.

H.M.Jr: Has that been written?

Bell: The audit report is separate.

H.M.Jr: Well, I want the whole thing. You two do it.

Mrs Klotz: Their (Bell) report is written.

H.M.Jr: Isn't your (McR) report written recommending?

McR: No, we haven't written a specific report on that. Of course, the details of everything have been handled.

Bell: There is a written report of the audit, but there is no report in from this other committee.

H.M.Jr: A written - I mean audit, that was done under you (Bell).

Bell: Yes, sir.

H.M.Jr: But how about the three writing it?

McR: All right.

H.M.Jr: Will you do that?

McR: Yes.

H.M.Jr: This week?

McR: Yes.

H.M.Jr: That's what I've been waiting for.

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McR: As a matter of fact, I have one draft.

H.M.Jr: That's what I've been waiting for.

McR: I've been doing the best I can to get out of doing it; but if we've got to do it, we'll go ahead.

H.M.Jr: Well, I think it should be written.

McR: I'm perfectly willing.

H.M.Jr: What?

McR: I'm perfectly willing.

H.M.Jr: I mean we crossed that bridge when I asked you were you willing to serve and I asked each of you were you willing to serve, and each of you said, "Yes."

McR: Birgfeld - you know what time he came in Government Service? 1892.

H.M.Jr: Now listen, Mac. Either you know by now, after having worked with me four years, what my attitude is towards people, or you don't; now, if you don't know it, well then, there is something the matter with both of us.

McR: I know it.

H.M.Jr: What?

McR: I know it.

H.M.Jr: O.K. Well now, I've been fussing around with this thing, and you can't do a thing like this without putting the thing down in writing for everybody concerned, including Birgfeld. I mean in justice to him he's entitled to a report one way or the other.

Bell: The delay on this thing is probably due more to me; I've been busy on other stuff, just haven't got to it.

H.M.Jr: The other point is - I mean Birgfeld personally to me is just an employee of the Treasury, and I have no feeling one way or the other about the matter. But I....

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McR: Well, I've drafted a report.

H.M.Jr: But I think the thing should be cleaned up and I think it should be written, and we've crossed that bridge. After all, as a result of asking one man to go on that committee, he was asked to leave the Treasury, so I think it is important enough for all concerned that the thing should be written. All right?

McR: All right.

H.M.Jr: And then I'm also ready for a report on the Treasury guards.

McR: You mean.....

H.M.Jr: I understand they made an investigation of the Treasury guards - to be 17 or 18 transfers. I think I ought to have a written report.

McR: There is a written report in great detail on all the guards, which I turned over to Frank Wilson, in view of the fact that the guards were being transferred to him, for his recommendations as to any action taken.

H.M.Jr: That's in Frank Wilson's hands?

McR: That's in his hands.

H.M.Jr: O.K.

McR: All right.

H.M.Jr: Dan?

Bell: I haven't anything, except that you probably ought to have a meeting of the Library of Congress Trust Fund Board this week. Got some matters that've been hanging fire since March.

H.M.Jr: Can't you let it go until after the first of June? I'll give it to you right after Decoration Day? What?

Bell: It involves the switching, you remember, of the investments.

H.M.Jr: Right after the first of June?

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Bell: Yes, I suppose. It's been delayed for three months now.

H.M.Jr: Give him a date on Wednesday at 10 o'clock - 11 o'clock, first Wednesday in June.

Bell: The second.

H.M.Jr: 11 o'clock.

Mrs Klotz: The second, uh-huh.

H.M.Jr: You (Bell) take care of the invitation?

Bell: Yes. I think we better do it probably next week.

H.M.Jr: Yes, but you take care of it.
Anything else?

Bell: That's all.

Lochhead: New York is quiet this morning. First section of that Swedish report that you asked for through Mr. Taylor has come through. Only one section. I'm waiting for the complete report. That's the cable.

H.M.Jr: You leave any time you feel like it, but not later than 12.

Roche: I think nothing special, sir. Extremely nice meeting up in Boston last Thursday night; every State in the Union represented there.

H.M.Jr: What's the status of your problem over there, the people in that bureau? I'm tough this morning, going after some of these things.

Roche: Good.

H.M.Jr: I mean the old Post Office.

Roche: Well, I met Mr. McReynolds in the hall a couple days ago. He wasn't terribly encouraging about our getting the addition to the Public Health building, but I didn't report it and didn't take it as final until....

H.M.Jr: Well, I signed.....

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McR: You've signed the request and it's gone to Mr. Bell...

H.M.Jr: So.....

McR: ... - to authorize the completion of that building.

H.M.Jr: I don't see... Dan seems to be doing all right.

Roche: That's all right.

H.M.Jr: Little tougher for you, Mac. Well, anyway, I signed it and it's with Mr. Bell.

Bell: So I understand.

H.M.Jr: All right. Well, at least you know where it is.

Roche: Thank you so much, Mr. Secretary.

H.M.Jr: All right.

Bell: I'll assure you it won't get out.

H.M.Jr: I'll tell you what we'll do - have a regular staff luncheon there.

Roche: Excellent place for lunch. I was just.....

H.M.Jr: To do what with their lunch?

Roche: Nice and hot and crowded.

Gibbons: They don't eat in there, do they?

Roche: Yes.

H.M.Jr: How are you (Gibbons)? Been up to the city?

Gibbons: What?

H.M.Jr: Been up to the big city?

Gibbons: No, but I was - must go Wednesday. It's my youngster's birthday.

H.M.Jr: O.K.

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Gibbons: Regardless of whether the Treasury just falls apart.

H.M.Jr: All right.

Gibbons: Nothing but our Customs personnel, which Mac and Ballinger and I - continual headache; be straightened out eventually, and breaking it down.

H.M.Jr: Nothing else?

Gibbons: Nothing else, no. Outside of that, everything's....

H.M.Jr: On this Joe Woolf matter I'm just sitting tight.

Gibbons: I - we have just put it in somebody's lap, haven't we?

H.M.Jr: That's right. But every time I see Farley he kids me about it.

Gibbons: Yes.

By the way, there is another one. I went up to see Senator Sheppard. There's a Collector down in Texas whom he recommended, and he's missing four hundred bottles of liquor. So I - he was ill and I told the Senator I thought probably he wouldn't be able to come back, and I was trying to let him out. He said, "Oh yes, he's back on the job." I said, "Now Senator, there's a rather indelicate proposition that, June 30th being the end of his time, I thought we could get him to stay out." He said, "Oh no, somebody's lied about that. I want a hearing on this."

They got - picked up a gun on a narcotic raid, liquor raid, or something like that - brand-new revolver. The brand-new revolver was found in this man's real estate office in his drawer; and one that he had, vintage of 1776, was in the inventory of the Customs. Just little graft like that.

Gaston: Which man is this?

Gibbons: Pabst, down in one of the ports in Texas.

Gaston: Don't know him.

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Gibbons: "But my dear friend" and all that - a hypocrite. I really had to laugh. I went up with the thought we would ease him out. But no, we must have a hearing. So we're going to have another one in our lap.

H.M.Jr: (Nods to Gaston)

Gaston: I don't know anything new.

H.M.Jr: I think this (article in Wall Street Journal, 5-17-37, headed "June 15 Treasury Financing Estimated at \$750,000,000") is a little premature, don't you? Know how they got that?

Gaston: That's just their own guess.

H.M.Jr: Well, it's pretty close, isn't it?

Gaston: I don't know.

H.M.Jr: What?

Herbert, can you give me the names during the morning of who comes down from Standard Statistics and Moody's? I think they each have a man that comes down to Washington, a bond man.

Gaston: Yes. The only man I know of Standard Statistics is Eder, and the Moody's is Donald Woodward.

Bell: I don't believe Don Woodward is the bond man. He's an economist and financial adviser, but I don't believe he's a Government bond man.

H.M.Jr: Well, look up who the top men are on the services, will you?

Gaston: Yes. I haven't had contact with anybody except Don Woodward.

H.M.Jr: I mean first find out who the head of each agency is and who advises the banks on the investments.

Gaston: Yes.

H.M.Jr: What?

Gaston: Uh-huh.

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- H.M.Jr: I'd like to know that.
Anything else?
- Gaston: That's all.
- Oliphant: (Nods nothing)
- H.M.Jr: Bell asked me the question walking down this morning, who was getting ready in case we got an unfavorable decision on the Social Security. I said you (Oliphant) were.
- Oliphant: Well, Opper went over the whole picture and then, nobody else being around, turned the problem over to Wayne Taylor.
- H.M.Jr: That doesn't leave it very.... I mean what Bell says, supposing we got one today, would we be ready to go. The answer is we are not.
- Bell: Seems to me we are - very important that we have a program worked out pretty quickly after this decision, if it is adverse.
- Oliphant: Well, I - I've been talking that for three weeks.
- H.M.Jr: Well.....
- Oliphant: Everybody seemed to feel it was going to be sustained.
- H.M.Jr: Well, who could head it up? Why Wayne Taylor?
- Oliphant: He just at the moment happened to be on the spot.
- H.M.Jr: What about you (Magill)? Why don't you fellows get together with Altmeyer today?
- Oliphant: You....
- H.M.Jr: What?
- Oliphant: Do you want - I think we got the picture from your (Bell) shop; I mean Opper got the picture from your shop.
- H.M.Jr: I think we better do something about it; think we ought to work with Altmeyer. What?

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Oliphant: Yes, I've felt for some time that we should.

H.M.Jr: And I think we ought to find out from the Attorney General's office if anybody over there is....

Oliphant: I know. No. I think the danger is slight, but I think something ought to be planned.

H.M.Jr: Well, will you.....

Magill: Yes.

H.M.Jr: ..fellows go after it?

Bell got something out of the walk this morning anyway.

Bell: Or maybe if it materially affects the bond market you may want to make some statement of our going to Congress for additional tax legislation to take the place of what's been thrown out.

H.M.Jr: Now, have you (Magill) got some of the stuff for me that I....

Magill: I'm having it typed right now; no doubt be ready in a few minutes.

H.M.Jr: When do you want to come in?

Magill: Any time.

H.M.Jr: 10:30?

Magill: 10:30 be fine. I've got two letters for you.

H.M.Jr: What's what I want.

Magill: The legislation for the extension of the excise tax I understand has been completed now. They are reviewing it. I'd like to see the Ways and Means on it if that's agreeable.

H.M.Jr: Well, I mentioned it at Cabinet and the President said, "Why wait until June?" That was his comment.

Magill: Well, they'll go right ahead with it, but the June

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date - they said it would take them a little while to get it over to the Senate.

H.M.Jr: But + told him they didn't - I didn't think it would be reported out on the floor until June.

Magill: No, they expect to get it out before that. They talk about getting it over... They're hard to deal with at the moment because they're very much irritated about the Social Security business and they said, "Why should we give all this time to the Senate, and they'll change it around and mess with it, and so on, so we're not going to do it; we'll pass it and get it over to the Senate in the first week of June," and they'll consider it themselves in the meantime. Now, if you want me to convey to them that you wish they'd get it over there sooner....

H.M.Jr: No, because I don't know yet what the President has talked to them over the weekend. I mean he's seen the leaders and I don't know, you see, until it fits into a picture.

Magill: As far as we're concerned, there's no reason why they can't go ahead at once, but we can.....

H.M.Jr: Anybody want to see me this morning? Anybody want an appointment? - - Swell.

MEMORANDUM OF CONCLUSIONS RELATING TO POSSIBLE
INVALIDATION OF THE SOCIAL SECURITY ACT

At a meeting held May 17, 1937, in Mr. Magill's office, the following questions were discussed and the conclusions indicated reached thereon:

1. Repayment of amounts in Unemployment Trust Fund. Three possible courses of action were discussed: making the payments; withholding payments pending reargument on the ground that payments had not been duly requisitioned; or attempting to induce the States to withhold requests for payment. In the last connection, it was decided that an attempt should be made to prepare a statement to be issued by the President immediately upon announcement of the decisions, although some doubt was expressed as to whether it would be politic to make any effort in this direction.
2. Refunds of Old Age and Unemployment taxes. This subject was discussed but no definite conclusion reached. It was decided that the administrative officers would consider the various problems and possible solutions and make recommendations.
3. If Unemployment and Old Age taxes are validated, but benefits held unconstitutional. Mr. Altmeier's suggestion of a program of grants-in-aid was discussed. It was tentatively decided, however, that no immediate announcement in this connection would be necessary and that it was essentially a problem for the Social Security Board.
4. If benefits are validated, but taxes declared unconstitutional. The payment of benefits should be repealed or temporarily suspended pending reargument, and the appropriation to the Old Age Reserve Account should be repealed.

It was concluded that an outline draft of a statement by the President should be prepared, together with legislation effectuating the repeal or suspension of benefit payments and appropriation.

The following were present:

Messrs. Magill, Taylor, Bell, Halvering, Opper, Kent, Bliss and Russell.

May 17, 1937

2:30 p. m.

Present:

Mr. Magill
Mr. Oliphant
Mr. Gaston
Mrs. Klotz

This morning when we got word that the Attorney General was going to meet the President at ten minutes of two, I asked Oliphant to prepare a memorandum on the so-called Smith case, Los Angeles. In discussing it with him and with Magill I said, I hope before Mr. Roosevelt retires as President of the United States that we will have one Jimmie Walker case. And we got one, too!

Lunched with the President. He threw himself back and he says, Henry, it has come time to attack, and, he says, you have got more material than anybody else in Washington to lead this attack. He said, Did you notice how downcast Jack Garner was at Cabinet? He said, Well, when I saw Jack before Cabinet rather than give him a chance to attack me, I attacked him. He said, People like Garner, Senator Bailey, Walsh of Massachusetts, and numerous other conservative Democrats, knowingly or not, are getting prepared for a Conservative Democratic Party. They won't go along with any reform measures and are only interested in balancing the Budget. He said, I told Jack Garner what's going on in Texas. He said, Look at the election of Congressman Johnson. He said, He ran in the capitol district. He had five people against him. He got 18,000 votes and all the other five candidates got 5,000 or 6,000 votes. He said he would come to Washington and support the President. The others all said the opposite.

He said, I told Jack Garner that it's good for me to get around the country and, he said, I think I am going to do more of it before the next Primaries. He said, I wish you could have seen Garner's face. He said, One thing they don't want is for me to get out in the country and fight. He said, I gave him the example of Congressman Maverick. He said, Every banker, every public utility man including Jack Garner, was against Maverick. He said, I sent my uncle, Fred Delano, down there and we elected Maverick with Garner against us. He said, I served notice on Garner.

Then he leaned back and he said, Now it's up to you to

-2-

fight. He got so excited that I could not help but laugh and he said, Why are you laughing? And I said, Because you are such a wonderful showman, I don't know what's going to happen. I can't guess what I have got that's so useful to you! So he said, Well, you and I have kept quiet while they have talked so about the Federal revenue being short five or six hundred million dollars. He said, They have been unfair and lumped it altogether, not distinguishing between the money we lost through Court action and the rest of the decrease in taxes. Now, he said, the time has come when we have to fight back and, he said, The only way to fight back is to begin to name names of these very wealthy individuals who have found means of avoiding their taxes both at home and abroad. He said, What do you think of it? So I said, Well, Mr. President, I have two memoranda here, one that has to do with the aliens who send their money here for investment and the other group of Americans who send their money abroad. I said, This takes care of the 'hot money' situation and Hull, Landis and Eccles have all approved it. I said, The other memorandum has to do with the American individuals who have found means, loopholes, to evade their taxes. I said, It's just as well that Mr. Hull opposed us a couple of months ago because it has given us time to improve our suggestions.

He said, Let me have the 'hot money' memorandum first. (See exhibit "A" attached.) He read it all very carefully and then when he came to the following sentence: " * * * and that the stockholders be taxed upon their pro rata shares of the corporate earnings, whether distributed or not," he said, I don't think that that would do the trick. I said, As I understand it, what that means is that a man, if he owned 10,000 shares of Chrysler in a foreign-holding company, will have to pay the tax on that particular amount of stock in that holding company. He said, Well, that does not say it. And not being a tax expert, I could not argue with him.

He said, Examine that sentence again. That does not satisfy me. What I think you want is that you want to be able to make the man pay a tax on the dividends which he receives on stocks which he has placed in a holding company abroad.

Then he said, Now let me see this list of cases that Magill found of people who have found means of avoiding the present income tax law. (See exhibit "B" attached.) The President kept the original, but this is a copy. He read this memo-

-3-

random through very carefully and he said, This is a very nice editorial in the New York Times, but, he said, it has no punch in it, has no fight, and, he said, I want something that I can use. I said, Are you going to use it or am I? He said, No, I am going to use it.

So I said, Well, now, if you want something with punch and feeling and emotion, I said, here's a document that Oliphant, Magill and I collaborated on this morning in regard to the Smith case, (see exhibit "C" attached) and when he got through the first page he started to chuckle out loud. He said, Now, that's more like it! He said, We have got to rouse public sentiment in this country against men who are practicing fraud by evading their income tax.

So I said, Well, Mr. President, the Attorney General is coming in in a few minutes and you haven't got any better example than the Smith case. And, I said, in case he should raise the point of policy, may I point out to you that several years ago the Attorney General had me come over here to see you with him insisting that we try Mellon civilly after he had lost the criminal case. Now, what we are asking is that he try Smith in Los Angeles criminally and not settle the case.

Of course, what the President has in mind is to fight back at the people partly on account of the Court and partly because the Conservative Reactionary members of the Democratic Party are getting the upper hand and during the course of the conversation he said, I told Jack Garner if you continue your policy on the Hill, we will have three Parties instead of two: the Republican Party, the Conservative Democratic Party and a new Third Party and you might just as well make up your mind to it.

It was just my luck that, first, he has come back with the idea that he wants to go on the air publicly and expose these people who are practicing fraud in evading their income tax; second, that I was ready to give him the memorandum that he wanted and, third, that the Attorney General forced himself on the President on just this day, because the Smith case was an ideal if the President wanted a moral issue.

I said to the President, The reason I have been holding back is because I wish to point out to you (1) that you said in November you would study 'hot money'; (2) about a month ago in your Budget message you said you would take up the tax reform in November, and the reason that I am holding back

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is that I am fearful that if you go beyond recommending to Congress that they take care of the 'hot money' and the American who sends his money abroad to escape taxes, you will find that Congress will say, Oh, Mr. President! If you do "a" we will do "b" and that they will then go after the Surplus Tax bill and the Capital Gains. And, I said, You will have to assure yourself by talking to Joe Robinson and the gang that they will stand by you if you open up this question; otherwise you are going to open up the whole tax bill and, I said, Mr. President, we are not ready.

I said, Now, if you agree to that, then, I said, I am together with you 100%, but, I said, I must caution you. He said, I will make them agree to it. I said, Then I am with you.

Then the Attorney General, Oliphant and Magill came in. I wrote on a piece of paper and handed it to Oliphant, "We won our case." I could not reach Magill because he was sitting too far away from me.

Then the President started to read Magill's memorandum (see exhibit "B" attached), but read it in a sort of sing-song manner and at the end of each sentence he would say, This has no punch. This does not say anything. No indication. It's all right, but no indication. Every time he said that I kicked Herman Oliphant on the shin because I knew what he was doing. He was playing down the one memorandum in order to build up the Smith memorandum.

When he got all through, he kept smiling at Homer Cummings and saying, See, this memorandum has no indication. He said, Now let me read you one that is a little better. And he started to read the Smith memorandum and when he got half-way down he said, This is pretty good! And he pounded the desk and said, Why don't you attack this fellow? Why don't you call him a s.o.b.? (He didn't even use the abbreviation; he used the whole thing.) As he read the memorandum he worked himself into a fervor and he turned to Cummings and he said, Now I want you to try this. Then Cummings said, Well, let me explain to you about this case. And then Cummings went into his explanation of how the taxpayer had offered to pay the full tax, penalty and interest and to plead guilty. (Which was untrue.)

The President then inquired whether Smith had agreed to

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plead guilty to all counts in the indictment and the Attorney General said he had agreed to plead nolle contendere to one count and submit to sentence. He then said he would present the exact offer which Smith had made, which, in fact, is that Smith has a tax liability of something over \$2,500,000. He offers to pay \$1,000,000 cash and \$500,000 at the end of a year plus such additional amounts as might be determined, presumably by the Board of Tax Appeals. The Attorney General stated that Smith is heavily indebted to the banks and that his wealth consists of stock in his own companies which is pledged to the banks for about \$1,000,000 and that if he were compelled to pay the entire liability the Attorney General did not know what would happen to him or to the 500 or 600 employees of his companies. The Attorney General stressed the fact that the poor employees would be laid off.

The Attorney General pointed out that if we declined to accept Smith's offer and he pleaded guilty, then he would say to the Judge, about to sentence him, that he had made this offer. At this point the President interrupted to say that if he was presenting the case for the Government, he would say, May it please the Court, the Government has refused to accept this offer in compromise because there is a moral issue being settled by the taxpayer being sentenced before taking up with the taxpayer his liability for the tax. He said, There is not a man in the street knows when a case is settled, but when a man is put behind the bars it means something and, he said, after 1929 the sentencing of Foshay of Minneapolis did more good than any other single thing in stopping fly-by-night concerns in the Northwest and, he said, it will help more to put this man Smith behind the bars than all the settlements in the world.

And then the President said, It's about time, Homer, that you began to build up -- he stopped there; what he meant to say was build up your Department so that you can handle cases like this. Through this whole thing Cummings was as white as a sheet and his eyes were as angry as I have ever seen them. He sat there pleading for the plaintiff just as much as though Bruce Kremer was sitting there himself. And I hope that as long as I work for the Government that I never take a moral licking like the one Cummings took today.

I thought that Cummings handled himself very badly; was very stupid about the whole matter, because he continued to

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argue for the taxpayer after the President told him point-blank that he wanted this case tried. He stopped short in one of his arguments, flushed and showing every sign of complete demoralization, and said, Well, if that's the way you want to handle it, we will handle it.

Before Cummings came in the President said, I want the Treasury to start at once working on a speech for me. He said, I want to name names. And he said, I am going on the air and tell this story. And he said, I want a list of the people who formed foreign corporations, and he kept referring to some Statute that he believes makes it illegal to evade one's taxes. The last thing he said was to ask how long it would be before we could have this stuff back over to him because he wanted it as soon as possible and he said, "In the words of Theodore Roosevelt, my spear knows no brother." He said, I don't know who's on this list; I don't care. It may be Barney Baruch. He said, Who is 'Incorporated Yacht' and Magill said, Sloan. He said, I didn't know it was Sloan; it might have been Baruch. I told him we would start this afternoon.

The President also said that he is definitely going to balance the Budget in the next fiscal year, but he wants some of these reform measures like Housing, but he said, I am definitely going to balance the Budget next year.

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THE SECRETARY OF THE TREASURY
WASHINGTON

May 17, 1937

My dear Mr. President:

In your budget message of April 20, 1937, you advised the Congress that the Treasury would be ready next November to discuss amendments to the revenue laws to stop loopholes and to increase administrative effectiveness. The Treasury is now engaged in a general survey of the revenue laws and their administration, in order that the requisite information may be supplied to the appropriate committees of the Congress in compliance with your message. At the outset, we have found that our present tax laws discriminate in favor of the wealthy non-resident alien; and do not adequately discourage the formation by our citizens of foreign personal holding corporations, in both cases to the disadvantage of the revenues. Since both defects can be promptly corrected, without reference to any general overhauling of the revenue laws, I desire to bring them to your attention at this time.

The 1936 Act eliminated the requirement that a non-resident alien, (without United States office or business) should file a return; fixed the withholding rate for individuals at 10 percent; and freed the non-resident alien from taxation on American capital gains. Since the total Federal tax upon a citizen or resident amounts to 10 percent of his total net income at about \$25,000, (in the case of a married individual with no dependents); the withholding rate is too low as applied to non-resident

- 2 -

alien individuals with American incomes of more than \$25,000, and too high as applied to such individuals with American incomes of less than that amount. Moreover, in fairness to our citizens and residents, who are subject to tax upon their capital gains, non-resident aliens should be given similar treatment.

With a view to obtaining these objectives, I recommend that the withholding rate applicable to non-resident alien individuals should be increased to 35 percent; with the proviso that if the alien will file a return showing his entire American income, including capital gains in this country, there shall be refunded to him any excess of the tax withheld over the tax shown to be due on the return at the rates applicable to American citizens. In this way, the taxes of non-resident aliens on their American incomes will be brought to a parity with those of our citizens with corresponding incomes. Since the alien's domicile is the only place which can take into account his entire income and his personal status, he should receive his personal exemption from his domicile. I, therefore, recommend that no personal exemption be allowed by this country to non-resident aliens.

Foreign corporations having no American business should be subjected to the same withholding rate. Since the undistributed profits tax cannot readily be applied to such corporations, I suggest that their American incomes, including capital gains, be subjected to graduated rates, corresponding as nearly as may be to the average rates imposed upon American corporations with similar incomes.

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Some American citizens have organized foreign personal holding corporations, with the obvious design of avoiding the surtaxes upon their individual incomes, as well as our corporation taxes. I see no reason why we need recognize the existence of the corporate fiction in these cases. Hence, I recommend that citizens or residents owning any securities in foreign personal holding corporations be required to disclose their interests upon their individual returns; and that the stockholders be taxed upon their pro rata shares of the corporate earnings, whether distributed or not. To increase the effectiveness of these provisions, persons forming such corporations, or their American advisers, should be required to file information returns with the Commissioner of Internal Revenue.

I have not attempted to set forth all the details of my recommendations, but I should be glad to discuss them with you at your convenience.

Faithfully,

A handwritten signature in dark ink, appearing to read "J. M. [unclear]". The signature is written in a cursive style and is positioned to the right of the typed name.

The President,

The White House.

May 17, 1937

My dear Mr. President:

During this Administration, the audit of income tax returns has been made nearly current, although the number of returns filed has greatly increased. Our field examinations of the 5,011,214 returns filed March 15, 1937, are just now beginning. By the end of the summer, enough returns will have been examined to enable us to draw satisfactory conclusions as to the actual operation of the present law. In order that any important loopholes might be more promptly discovered and stopped, I directed an immediate audit and investigation of typical returns of individuals and corporations in six major Internal Revenue districts. The report which I have received may be briefly summarized as follows:

The investigation to date has not disclosed a large loss of revenue due to the employment of new devices for tax avoidance. It has disclosed that taxpayers have utilized to an increasing extent each of the various possibilities for tax reduction still available under the law. Thus corporate deductions for repairs, wages and salaries, taxes, and bond discount and premium have increased to such an extent as to suggest that a careful audit will disclose that in part the deductions are unjustifiable. In other words, it is quite likely that the estimated receipts will ultimately be realized, but only after careful investigation and vigorous prosecution of delinquents.

The President - 5/19/37 - 2.

The other principal devices commonly used to reduce taxes this year are:

1. The creation of multiple trusts for relatives and dependents. One taxpayer has created 64 trusts for his wife and three children; two others, created 40 trusts.

2. Foreign personal holding corporations, in adjacent islands and countries. Twenty-two such corporations were organized in the Bahamas in the past six weeks, and Panama seems to be even more fertile territory.

3. Domestic personal holding corporations, often multiplied to large numbers per individual taxpayer. The rates applicable to such corporations are still too low to defeat their use. One man has incorporated his yacht, along with securities to enable him in effect to secure a deduction for his expenses in operating it.

4. Deductions for non-business interest, losses, etc. The law still permits a deduction for interest on a loan to a taxpayer by his personal holding company, or by the trusts he has created for his adult children. One man deducted \$69,400 as interest on a loan to him by his foreign personal holding company. He showed no net income, and though his company had over \$1,600,000 American income, it has not yet filed a return.

5. The deductions for percentage depletion by large oil and mining corporations, which are now allowed even though the cost of the well or mine has been fully recovered. Thus one of the largest mining companies deducted \$2,322,722 on this account in 1936, although it had already recovered the full cost of its properties. The revenue thereby lost was

The President - 5/19/39 - 3.

\$618,517. These provisions, utilized by many of our largest corporations, constitute perhaps the most costly loophole in the present law.

6. Division of income between husband and wife, particularly in the eight community property states. A New York resident with a salary of \$100,000 pays about \$38,525 Federal income tax; a Californian with the same salary may cause one-half to be reported by his wife, and the total Federal income taxes payable by the two will be only \$18,886. There is an increasing tendency generally to split the family property among its various members.

7. Increasing purchases of tax-exempt bonds by wealthy citizens. The higher surtax brackets cannot be made effective so long as this loophole exists.

A number of other devices have no doubt been employed to an extent which cannot readily be determined until more returns have been audited. Generally speaking, the largest corporations secured extensions of time for filing completed returns. We have set up machinery to report and analyze tax avoidance devices as the audit progresses and to prepare recommendations for corrective legislation. Our recommendations, together with the supporting data, will be completed in time for submission to you early in the fall.

Faithfully,

The President,

The White House.

RM/mf

For original see "C" 247
P. 253
May 17, 1937

Secretary Morgenthau
Herman Oliphant

The tax case of E. M. Smith, et al., is one of the most flagrant in the history of the Department. I attach a brief summary.

E. M. Smith is a prominent business man on the West Coast and in the Southwest country. His tax difficulties are known in the business circles in these areas and there is much speculation as to how his case will come out. In other words, this case is to the West Coast and Southwest what the Mellon case has been to the East.

Besides deliberately omitting large amounts of dividends and profits from the sale of stock, failure to state numerous other items of income, and making false claims for deductions, his principal method of tax evasion was to conceal the receipts of dividends and profits by passing them through the hands of employees, relatives, and corporations he controlled, they paying the taxes and he reimbursing them.

Thus, for his own gain, he engaged in an extended and wide-spread practice of debasing the morals of small employees beholden to him for their livelihood and relatives receiving his bounty. For example, an assistant cashier, working in a bank which Smith dominated and getting a salary of \$225 per month, reported \$18,960 of dividends for him. The fee which Smith paid the assistant cashier for thus joining his criminal conspiracy was \$1,467.

Mr Gray is to send me list of names for I don't have them.

- 2 -

This cashier is but one of many minor employees and relatives whom he thus made criminals. I attach a list of these people and have checked some of the more interesting ones.

This tax case is one of those where we win though we lose. The Mitchell case has put a stop to the general practice of bogus conveyances by taxpayers to their wives. The effect of the Mellon case is already reflected in tax returns from the Pittsburgh area. Whatever its outcome, it is a victory. It proves that no amount of affluence or respectability can gloss over shady practices. Mr. Mellon and the ethics of his kind and time stand condemned in the public esteem, and such condemnation makes way for a new and better leadership in American business. The Raskeb and du Pont cases can have only wholesome effects whatever their outcome.

The only pretense of even a partial justification of Smith's conduct which he has been able to fabricate during the four years since the investigation began is that he was in some sort of trouble with his wife and was seeking to hide his income from her. But his puppets were forced to pay back to him at once all of his income which they reported for him so that it could have been reached by his wife all the time anyway. Moreover, it would be strange indeed if any difficulty he may have had with his wife was acute throughout the long period of five years during which he was engaged in this course of criminal conduct.

- 3 -

These indictments should be pressed. Whether Smith pleads guilty or stands trial, the hope of a substantial sentence would be destroyed if he can say to the court that the Government has already accepted a settlement of his tax case. The Government's course in this case should be just what it has been in former tax cases of like seriousness. There should be no consideration of the settlement of civil liabilities at this time. The criminal cases should be pressed to trial or to plea and sentence. As in previous cases, we can take up the collection or settlement of Smith's tax liability after he has been sentenced.

Enc. 2

May 17, 1957

**Brief Summary of the Tax Cases
of E. M. Smith, et al.**

The case of E. M. Smith, et al. has been characterized as one of the most flagrant tax evasion cases coming to the attention of the Treasury Department. The income for the years 1928 to 1930, inclusive, was understated by the omission of large amounts of dividends and profits from sales of stock. The receipt of such dividends and profits was concealed by having the stocks placed in the names of relatives and employees of Smith, or the corporations controlled by him. There were twenty-four such individuals, ten of whom were relatives and thirteen employees, leaving only one who was not a relative or employee. These individuals reported the dividends and profits in their returns, which resulted in the payment of very low surtaxes, whereas had the amounts been reported by Smith the surtaxes would have been at the maximum rates. In practically every instance the income taxes of the relatives and employees were paid by Smith and each was compensated for his participation in this fraudulent device. In addition to the omission of large amounts of dividends and profits, there were numerous items of income which were not reported and there were claims made for deductions which were false.

The tax liability in this case is set out on the attached Exhibit A and shows a grand total against E. M. Smith, W. C. L. Smith, and E. M. Smith Company of \$2,555,479.45, which includes taxes, penalties and interest to May 1, 1957.

On March 15, 1954, before this case was, on December 4, 1954, sent to the Department of Justice for prosecution, an offer was made in the amount of \$700,000.00, plus the taxes and penalties due by the company; this was rejected. On January 18, 1956, \$1,000,000.00 was offered to the Department of Justice and was rejected. On August 17, 1956, an offer was tendered to the Department of Justice in the sum of \$1,500,000.00, of which \$600,000.00 was to be paid ten days after acceptance of the offer and \$900,000.00 within one year. This offer also provided for the payment of such additional taxes and penalties as might be determined by the Board of Tax Appeals. The Bureau recommended against the acceptance of this final offer and it is understood the offer is under consideration in the Department of Justice at the present time.

- 2 -

Hurried inquiry in Los Angeles today has elicited the information that the present net worth of the taxpayers involved in this case is approximately \$5,000,000.00. E. M. Smith himself is reputed to have assets in the way of listed and unlisted stocks, real estate, notes receivable, and other assets in the sum of \$4,244,284.00, with liabilities of \$345,000.00, leaving an approximate total of \$3,900,000.00. Walter Smith is reported to be worth at this moment \$704,000.00, and the E. M. Smith Company had a book value as of December 31st last of \$376,000.00.

In the opinion of the agents who were engaged in the work on this case and who are thoroughly familiar with all of its ramifications, the offenses of these taxpayers were unusually flagrant. This is particularly true of E. M. and Joseph Smith, who not only perpetrated willful and persistent frauds against the revenue in their own persons, but were primarily responsible for the criminal actions of some twenty-five other individuals, eight of whom are now under indictment. These individuals were so dominated by reason of employment or relationship, or both, that many of them unquestionably considered compliance with the demands of the Smith Brothers, imperative to safeguard their positions and financial holdings, or both, and their expectancy of future benefits from the hands of these individuals. The evidence shows that Walter Smith was the prime mover in the fraud perpetrated on behalf of E. M. Smith Company, while Joseph Smith assisted E. M. Smith in evading the latter's individual income taxes. It is the belief of those officers of the Bureau of Internal Revenue who are familiar with all the facts in this case that the ends of justice would not be properly served unless these individuals are required to pay all of the taxes, penalties and interest found to be due, and the actual facts of the criminal activities of the three defendants named are brought to the attention of the trial court. Any contemplated settlement should require the satisfaction of the tax liability and pleas on felony charges, with the distinct understanding that all of the facts in this case will be brought forcibly to the attention of the presiding judge, in order that he might be fully informed in passing sentence.

Incs.

May 17, 1937

This is what I showed the President when Cummings was there.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE May 17, 1937

6 20 p. - Mrs
C. B. ... 5 9

TO Secretary Morgenthau
FROM Herman Oliphant

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Thomas O. ...

Enc. 2

May 17, 1957

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Encs.

April 23, 1937.

SI-10012-F
 SI-10736-F
 GB:MFS

MEMORANDUM

In re: E. M. Smith,
 E. M. Smith Company.

TABLE OF PERSONS INVOLVED IN THE ABOVE NAMED CASES

- Albert E. Boleky - Brother-in-law of Joseph Smith, brother of the taxpayer. Operated small jewelry store during years involved in criminal case, averaged gross receipts about \$20.00 a day. During 1929 and 1930 Boleky received in dividends \$16,640.00 of which he returned to E. M. Smith \$15,765.00. For the use of his name Boleky was permitted to retain \$875.00. He has nine children, six being under eighteen during 1929 and 1930.
- James T. Duncan - Assistant cashier Pacific National Bank in 1928, of which bank E. M. Smith was Chairman of the Board of Directors. Salary \$225.00 per month. Reported salary and dividends from Smith stock during 1929 and 1930. Duncan received in dividends \$18,960.00, returning to Smith \$17,493.00, retaining \$1,467.00. No relation to Smith.
- Ella J. Engblom - Former bookkeeper for Smith. Received dividends on Smith stock in 1929 and 1930 \$14,740.00, returned to Smith \$14,018.50, retained \$721.50 representing "bonus" and reimbursement Los Angeles County personal property tax upon the Smith stock. During 1929 and 1930 was married to electrical contractor.
- Frank M. Fisher - Engaged in book and stationery business, a partnership, his portion of profits in 1929 and 1930 being \$1,370.52 and \$1,653.00, respectively. Wife employed in drygoods store at \$75.00 per month. Fisher's sister is wife of Joseph Smith. In 1929 and 1930 Fisher received in dividends \$29,360.00, returning to Smith \$28,256.86, retaining \$1,103.14, part for bonus and part for California personal property tax.

- 2 -

SI-10012-F
SI-10736-F

- John P. Fisher - Brother of Frank Fisher and brother-in-law of Joseph Smith. Employed by Smith's Masco Company at \$170.00 per month. Received dividends in 1929 and 1930 \$23,090.00, returned to Smith \$23,327.50, retained \$762.50. Report shows that the so-called bonus to John Fisher amounted to only \$32.50.
- ✓ Francis J. Gouker - Clerk at Masco Company average salary \$145.00 per month. Second cousin by marriage to Joseph Smith. During 1929 and 1930 received dividends amounting to \$14,940.00, returning to Smith \$14,252.50, retaining \$687.50.
- John F. Gouker - Father of Francis Gouker and first cousin by marriage to Joseph Smith. Employed by Masco Company, \$155.00 per month. Received dividends in 1929 and 1930 of \$15,732.20, returned to Smith \$15,053.50, retained \$678.70.
- A. B. Heilbrun - Medicine salesman and operated a collection agency doing certain confidential work for Smith. Received in 1929 and 1930 dividends amounting to \$29,450.00, returned to Smith \$27,375.00, retained \$2,075.00.
- L. M. Heraperger - Long time employee of Smith operations, salary from \$200.00 to \$250.00 a month. His wife is first cousin to E. M. Smith. Dividends during 1929 and 1930 \$26,520.00, returned to Smith \$24,840.00, retained \$1,580.00.
- ✓ Robert G. Johnston - Until September 1929 employed as cashier Pacific National Bank, of which Board of Directors E. M. Smith was chairman. In 1929 and 1930 received \$16,400.00 in dividends, returned to Smith \$16,300, retained \$100.00. No relation to defendant.
- J. S. McGurn - Secretary of Smith's Masco Asbestos Company, no relation to Smith. In 1929 and 1930 received dividends amounting to \$12,610.00, returned to Smith \$11,885.00, retained \$725.00.

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- Frank J. Penders - Former trust officer Pacific National Bank. Received in 1929 and 1930 dividends amounting to \$13,490.00, returning \$12,705.00, retaining \$675.00.
- ✓ M. P. Sahner - Cousin to both E. M. and Joseph Smith. Insurance agent, annualy income about \$1,800.00, received dividends in 1929 and 1930 amounting to \$17,460.00, returned \$16,350.00, retained \$1,110.00.
- ✓ R. L. Sasse, dec'd - Was employed during period involved by the Emco Company. Income about \$2,500.00 per year. Received in 1929 and 1930 dividends amounting to \$14,360.00, returned \$13,694.50, retained \$665.50.
- Frank W. Shelton - Former assistant vice-president Pacific National Bank. Received dividends in 1929 and 1930 amounting to \$15,910.00, entire amount being returned to Smith, nothing retained.
- ✓ Howard J. Smelsire - Cousin to defendant and employed as timekeeper by the Emco Company at salary of about \$1,800.00. Received in 1929 and 1930 dividends amounting to \$15,160.00, returned \$14,591.30, retained \$768.70.
- B. A. Stewart - No relation. Formerly assistant cashier Pacific National Bank. Income about \$2,700.00 per year. Received dividends in 1929 and 1930 amounting to \$19,960.00, returned \$18,513.00, retained \$1,447.00.
- ✓ Roy C. Menzel - Employee of Emco Press Forging Company. Received dividend in 1929 of \$1,360.00, returned \$1,224.00 and retained \$136.00. No relation.
- W. A. DeRidder - Vice-president Emco Press Forging Company. Received dividend in 1929 of \$2,516.00, returned \$2,264.00, retained \$252.00. No relation.
- ✓ M. L. Russell - No relation. Watchman or timekeeper for E. M. Smith Company. Income not over \$200.00 a month. Received dividends in 1929 amounting to \$7,612.50, of which he retained a very small amount. Cannot be exactly stated.

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- Frank Gruber - His wife is a cousin to the defendant. Was "given" stock in Smith's Standard Machine Company in 1929 so he was advised when he was told to include in his 1929 return a profit from the sale of the stock of \$33,340. Check that amount was not endorsed by Gruber. Smith reimbursed Gruber for taxes paid in connection with alleged profit of \$33,340.
- Joseph H. Wheeler - Received dividends in 1929 on which taxes were paid
Deceased in the amount of \$3,093.97. On date Wheeler paid this tax Smith gave him a check for \$3,150.00.
- George B. Smith - Uncle of E. M. Smith. Was requested by the taxpayer to report as operating profits and profits from sale of assets of the Standard Machine Company \$33,340.00. He did so, paid the tax and was reimbursed by Smith.
- Raymond P. Smith - Son of George and cousin of E. M. Smith. Also reported income from transactions similar to that of George B. Smith and Joseph H. Wheeler.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE: May 17, 1937

To Secretary Morgenthau

FROM M. A. Harris

Subject: The Government Security Market since the March Financing and the Present Outlook for the June Financing.

In view of the fact that the government security market has suffered since the March 15th financing its first real severe decline since the summer of 1935 a short review of the market for this period follows.

TREASURY BOND MARKET:

The decline from the December highs prior to the March 15th financing was confined principally to the short and intermediate bonds and the Treasury notes. But in early March, shortly after the announcement of the March 15th refunding, heavy liquidation set in and led by the long, low-coupon issues the market moved sharply lower throughout the month in active trading. The year's low was reached on the first day of April and as of that day Treasury bonds in the average (those not due or callable within 5 years) were about 4-1/2 points lower than in early March and about 5-1/2 points off from their December highs. In April conditions were somewhat steadier and trading for the most part was orderly but up until the last week the market was hesitant with the trend irregularly higher. During this period the decision of the Federal Reserve System, announced the week-end of April 3rd, to increase their holdings had a strengthening

effect. In the week prior to May 1st, the day that the final increase in reserve requirements went into effect, and since then the market has remained fairly steady and quiet but thin. In the average, Treasury bonds are currently a little more than 1-1/8th points above the April 1st low but about 3-3/8th points below the early March level.

TREASURY NOTE MARKET:

During the period of heavy liquidation of Treasury bonds in March Treasury notes also suffered large losses but for the most part the market was orderly and little if any official support was given the note market. The year's low for Treasury notes was not reached until April 8th when the average yield on 1 to 5-year maturities reached 1.44%. During the period since April 8th the notes have been quiet and a firm tone has prevailed with long maturities in very good demand. The average yield now stands at about 1.23%.

JUNE 15TH FINANCING:

As to the June 15th financing, the following possibilities are suggested:

1. A 5-year note.
2. A medium length bond.
3. An offering of both.

The present level of the market indicates a 1-3/4% coupon for a 5-year note and a 2-3/4% coupon for a 10-year bond. Both should sell at a premium of about 1 point. If a bond with a long callable period is contemplated, such as a 1942-52 issue (6-15 year), a coupon of 2-3/4% or larger will probably be necessary. This is only an estimate. The current market basis in 1942 is about 2% while the basis in 1952 is about 2.80%.

A 5-year note seems the logical choice over a bond and particularly a bond with a long callable period for the following reasons:

(1). The movement of the Treasury bond market since the first of the year has resulted in a narrow yield spread between the intermediate and long term bonds. At the present time the yield rise is unusually sharp between 1940 and 1945. The 3-3/8s of 1940-43 are currently selling at a price to yield 1.45% and the 2-3/4s of 1945-47 are selling at a price to yield 2.44%, a difference of 0.99% for a time spread of only 5 years and 3 months but the difference between the yield to be obtained from the 2-3/4s of 1945-47 and the 2-3/4s of 1956-59 (this issue is selling below par so the yield is figured to the maturity date) is only 0.33% and the time spread is 14 years. This close relationship between the intermediate and long issues, I believe, makes it advisable to stay out of the long term field in seeking new money as the slight advance in yield to be obtained from the long bonds over the intermediate issues is not sufficient under present conditions to justify the time difference. The difference in yield between the 3-1/8s of 1949-52 and the 2-3/4s of 1956-59 is only 0.04%.

(2). On the other hand the sharp difference between short bonds and intermediate bonds makes it unadvisable to consider a bond with a long callable period if the first callable date is under eight years. Just how the market would react to such an offering is hard to say. The question would be: whether such a bond would sell at a price whose yield would be somewhat in line with the market basis for the short bonds or whether the market would sell off to meet this new issue? Under present conditions it is more likely the market would decline generally rather than buy the new issue down to the present level. Either way, I think,

would result in an unsettled market, a condition not to be desired at this time. If a bond is to be used, I suggest a 10-13 year bond with a $2\frac{3}{4}\%$ coupon which would bear the dates of 1947-50.

(3). Under the plan for debt retirement it is highly probable that any issue maturing in 1942 can at least be partially paid off in cash. If this be true the interest saving on a $1\frac{3}{4}\%$ 5-year note over a $2\frac{3}{4}\%$ 5-15 year bond for the 5-year period would be \$5,000,000 for every 100 million outstanding or \$25,000,000 if 500 million is asked.

(4). Generally speaking, the short term market since the low was reached in early April has been steady and considerable improvement in sentiment, buying interest and lost ground has taken place. Bankers acceptance rates have recently been lowered due to a better demand; Treasury bill rates have shown a small improvement lately and recent short term financing by the Federal Land Bank and Federal Home Loan banks was highly successful. Whereas the long term market has remained nervous and irregular for the most part and though some buying interest in the short and intermediate bonds has been shown in the past few weeks this movement has not reached important proportions.

It may be concluded that for the near future the short term market may be expected to continue reasonably quiet and steady while the long term market has yet a period of readjustment to go through which will be characterized by irregularity of movement and a hesitancy on the part of investors to commit themselves to any large buying program of securities in the long term field. From market comments it can also be added that the "street" would prefer a short term security.

MEMORANDUM

May 17, 1937

To: Secretary Morgenthau
From: Dr. Burgess

Treasury bonds were firm today in a slow market. Some scattered buying; offerings were scarce. The quotations were at the highs of the day, gains from last Saturday ranging generally from $2/32$ to $4/32$. Guaranteed bonds also firmed and showed gains of up to $4/32$. Turn-over of Treasury bonds on the board was very small at \$178,000. Note market was quiet and firmer with government bonds. Most issues were either $1/32$ or $2/32$ higher than last Saturday at the close.

Both high and second grade domestic bonds were notably dull all day, with no price changes of consequence until the last half hour or so when there was a little selling in the second grade group, which closed small fractions down from last Saturday. High grades held firm and unchanged.

Foreigns were generally quiet and steady.
No purchases for Treasury today.

May 17, 1937
3:20 P.M.

- Bell:I don't know how much. The President kept fishing around and finally said, "Well, we can take some out of this 90 million for rivers and harbors, can't we?" and he turned to me and said, "What do you think about it?" And I said, "Well, I've been contemplating getting a substantial sum out of that appropriation for this saving, to eliminate this deficit." I said, "If you keep on picking up money like that out of appropriations around, and where I'm contemplating saving this 400 million dollars, why" - I said "you make my job impossible." But I have an idea that the President has committed himself to Whittington where he's got to have a flood control authorization this year of somewhere between 30 and 50 million.
- H.M.Jr: Whittington.
- Bell: Whittington is Chairman of the Flood Control Committee in the House.
- H.M.Jr: Well...
- Bell: Then he can get by with a few million dollars appropriation, maybe anywhere from five to fifteen, see? So I tried to get him - I left a last thought, that if they're going to do anything, keep the authorization for this coming year down as low as possible until he gets his comprehensive program that he's been talking about on flood control passed by the National Resources and Water Committee, ah - and then make the 30 million dollars that's already in the Budget for flood control available for this new Act also. Then I said, "If you need any deficiency - I don't think they can spend the 30 million, but if you need any deficiency go after it late next spring." Well, he thought that might be a solution of it.
- H.M.Jr: Yes.
- Bell: But I - I think that - gosh, we're - we're having our problem made harder all the time.
- H.M.Jr: Yes. Well, listen, old man, I think we've just got to sit tight for a couple of days, see?
- B: Yes

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H.M.Jr: Certain things are happening, and I think the President has just got to kind of settle down, see?

B: Well...

H.M.Jr: See, he talks about a - a - oh, taxes, and these people who are evading, and I think he'll get a little of this out of his system. But he told me while I - while I was talking to him - I forgot to put this in my diary - ah - that he is definitely going to balance the budget the next fiscal year. Definitely!

B: (Laughs)

H.M.Jr: But he wants some of these reform measures.

B: He wants what?

H.M.Jr: Some of the reform measures.

B: Yes.

H.M.Jr: Like housing, he mentioned particularly, see?

B: Yes.

H.M.Jr: But he said, "I am definitely going to balance the budget next year," and he said it to me three or four times.

B: Well, he can't do it and - and keep on adding things.

H.M.Jr: Well....

B: Unless he cuts out a lot of stuff.

H.M.Jr: Well, don't get discouraged, Dan, old man. It's just....

B: Well, I'm not discouraged, but I - I just....

H.M.Jr: Well, I

B: Pressure being brought to bear all the time....

H.M.Jr: I know.

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B:all the time, and I think that's.....

H.M.Jr: Well...

B:exactly what we're going to be up against after July... -

H.M.Jr: That's - well, that's what I'm here for.

B: - why, July 1.

H.M.Jr: Well...

B: Well, I just wondered if he'd talked to you about it, and....

H.M.Jr: No, he didn't. Now, while we're on that, what about - how much money did you get out of your May first letters?

B: Oh, we didn't get any - any dollars and cents. They merely wrote in in most cases, particularly the big departments, and showed what they had done; that they had circularized all their fields, as a matter of fact the whole world, and told them this President's letter and they wanted them to cut down wherever they could and spend nothing except where it was absolutely essential.

H.M.Jr: Yes

B: And they didn't put down any actual savings.

H.M.Jr: But the newspapermen are asking.

B: Oh yes. Well, I've told them I won't talk about it.

H.M.Jr: O.K.

B: And the only one that really put down any saving was General Hines, and - ah - I think the less we say about that the better.

H.M.Jr: Yes

B: About fifty million dollars saved on compensation. And when you give that out - as a matter of fact, we took advantage of it in the expenditures - when you

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give that out, why, there's going to be a drive up there for mothers' pensions...

H.M.Jr: Uh-huh.

B: ...which there already is anyhow.

H.M.Jr: Well, don't get discouraged, because I think I....

B: Well, I'm not discouraged; I thought you'd like to know about what's facing us. (Laughs)

H.M.Jr: I know. All right.

B: Fine.

H.M.Jr: 'Night.

B: 'Night.

May 17, 1937
3:27 P.M.

H.M.Jr: Hello?

Operator: Governor Harrison. Go ahead.

H.M.Jr: Hello?

George Harrison: Hello, Henry?

H.M.Jr: Yes, George.

H: Well now, on our first preliminary figures on the bills, they've gone very well.

H.M.Jr: Yes, I just got them. It looks swell.

H: And - ah - I didn't know whether you had them. I called up soon as I got them, but you were busy.

H.M.Jr: Yes.

H: So you've gotten them since then; well, that's all right then.

H.M.Jr: Why, I think it's fine.

H: Well, I think it's very good. And the bill market has been pretty good all week anyway. There's been more interest in it.

H.M.Jr: I hear J. P. Atwood in for 25 million.

H: And - ah - well, they - they - I don't know whether they've done that for their own account or not. Possibly.

H.M.Jr:

H: And I've talked to - ah - a number of the banks around town here, and I'm trying to stir up some real interest in it, not just a perfunctory interest in it.....

H.M.Jr: Yes

H:as a part of what their job is.

H.M.Jr: Good.

H: And I think they'all understand it a lot better now, anyway.

-2-

H.M.Jr: Good.

H: I'm hopeful....

H.M.Jr: Well, I - I - it looks - it looks - all looks to good.

H: And I've also had some of them come to me that, if ever we have a hunch that the thing isn't going right, to let them know in advance.

H.M.Jr: Uh-huh.

H: Of course, that's a very difficult thing to do.

H.M.Jr: Yes.

H: They wanted - Berg said if - if ever, for instance, anything should happen and it'd break down, you don't get your bids or something, "Let us know." Well, of course, we can't do that because you don't know it until after you've opened them....

H.M.Jr: Well....

H: ...ah - which is too bad. But still you can't do it. So I explained that. So they said, well, if we get a hunch in advance that it's going bad to let them know; so I think that the market, to the extent that it can, will be ready to protect it anyway now.

H.M.Jr: Fine. You sound tired.

H: Ah - I am a little tired. I've been awful busy for some reason or another.

H.M.Jr: I see.

H: I'm all right, though.

H.M.Jr: Well.....

H: Fine.

H.M.Jr: All right, George.

H: All right.

H.M.Jr: Thank you.

H: Goodbye.