Fin

229

September 7, 1937.
11:28 a.m.

H.M.Jr: Hello

O: Dr. Burgess is busy on a long distance call. I'm waiting for him.

H.M.Jr: Thank you.

11:33 a.m.

H.M.Jr: Hello

O: Dr. Burgess.

H.M.Jr: Thank you.

O: Go ahead.

B: Hello

H.M.Jr: Yes Randolph.

B: Yes sir, well it's a little slow.

H.M.Jr: So I gather but personally I consider when the stock market is off five points I think that our little show is going very well.

B: I think you're doing very well on the whole.

H.M.Jr: I think I - I - I mean I think our show is going very well.

B: Yes. Now I've got an order in - we're going to buy some of these rights if they get down so we can get them at 5.

H.M.Jr: At 5.

B: I thought we'd just have a little block in there if anything happens.

H.M.Jr: Ah-ha - as a gamble.

B: Yes. Well because I think they're cheap at that price and I think we ought to - they oughtn't to go much below that point; I think it may look bad.

H.M.Jr: The rights go down to five.

B: Yes.

H.M.Jr: Have you bought any yet?

B: No.

H.M.Jr: How many are you willing to buy?

B: Oh - ah - we can buy quite a little - we can - ah - we can use them against Treasury bill maturities - that 1-1/4 note, of course, is - is going quite well.

H.M.Jr: What do you call quite a little?

B: Oh I don't know - I haven't talked with my associates but we could start in and buy at that price,I think.

H.M.Jr: Well what do you do, walk around the desk and then talk to yourself?

B: (Hearty laughter) No, I'd have to call up Ronald before I went over.

H.M.Jr: Oh I see. Well if you - if you begin to buy let me know, will you?

B: All right, yes - yes.

H.M.Jr: If you - if you get any let me know.

B: Yes, all right.

H.M.Jr: Thank you.

B: Very good.

September 7, 1937.
2:04 p.m.

H.M.Jr: Hello

O: Dr. Burgess.

B: Well Hello sir.

H.M.Jr: Hello Randolph.

B: Well it looks as though they were closing just a touch above the lows.

H.M.Jr: Just a what?

B: Just a touch above the lows - a 32d or two better than the lows.....

H.M.Jr: Yes.

B: .....but it's not a very cheerful market.

H.M.Jr: No I don't - I - well personally I think it's remarkable that the government bonds have done as well as they have.

B: I think it's giving pretty good account of itself in the face of this general market.

H.M.Jr: The last I saw, the stock market was off over six points.

B: That's right, it's been lousy; it steadied off in the middle of the day and then it took another nosedive.....

H.M.Jr: Yes.

B: .....so that it's been very lousy.

H.M.Jr: Well what I'm doing is I'm having a little meeting in my room at 4:30 Washington time.....

B: Yes.

H.M.Jr: .....at which time we'll have the report.....

B: Yes.

H.M.Jr: .....and then I'd like to talk to you then.

B: All right, I'll be here.

H.M.Jr: Pardon me?

B: I'll be here.

H.M.Jr: I'd like you to stay there.

B: Yes.

H.M.Jr: And then we can decide if we want to close tomorrow night or let it go over till Thursday night.

B: Yes. I don't think you're going to have many turn-ins to-day.

H.M.Jr: You don't.

B: No, very few.

H.M.Jr: Ah-ha.

B: Most of them will wait. The argument for waiting is that we've been accused sometimes of unfairness to the investor in not giving him a chance. A fellow who is up in New Hampshire or some place is just coming down and he has to get his stuff out of his safe deposit box and make his arrangements and a lot of them get shut off.....

H.M.Jr: I see.

B: .....if you close it too fast.

H.M.Jr: Well the boys looked up and, as far as I can find out, we've never closed it less than three days.

B: I think that's true.....

H.M.Jr: And,.....

B: .....but I think we can do it Thursday night all right.

H.M.Jr: Ah-ha. Well.....

B: That's fair enough and I don't think you're going to get it any worse than this anyway.

H.M.Jr: (Laughs) I don't think so either.

B: (Laughs)

H.M.Jr: I don't - I.....

B: If you have a couple of days we're more apt to get a better day before we get through.

H.M.Jr: I don't see how it can be any worse.

B: No.

H.M.Jr: Ah- you didn't have to buy anything?

B: Ah - I just told - well I couldn't get you a few minutes ago that we bought a million and a half on an exchange - ah - at par 5.

H.M.Jr: Ah - what did you swap?

B: We swapped some June '39's.

H.M.Jr: Oh.

B: There's somebody wanted some.....

H.M.Jr: Well -

B: .....and in that way they could give us some at five but those are the only ones that have been available at that price.

H.M.Jr: Well that has no significance has it?

B: No not the slightest really.

H.M.Jr: And you say it did close a little bit up from the bottom?

B: Well just a touch; the bonds were a 32d or two higher than the.....

H.M.Jr: Well they'll continue trading for a while, won't they?

B: Yes they will.

H.M.Jr: What?

B: I'm sorry to say they will.

H.M.Jr: Well supposing you call me at about five minutes to four your time, will you?

B: All right.

H.M.Jr: Five minutes to four your time.

B: All right.

H.M.Jr: Thank you.

B: Very good.

H.M.Jr: Thank you.

September 7, 1937.
2:18 p.m.

H.M.Jr: Hello

Feis: Henry, how are you?

H.M.Jr: Well they certainly celebrate your return and mine, don't they?

F: They certainly do.

H.M.Jr: Yes.

F: They'll have to start a new war somewhere, won't they?

H.M.Jr: Well (laughs) you mean the one - what do you call a war?

F: (Laughs)

H.M.Jr: Please write me a memorandum on what is a war.

F: Well that's what I wanted to talk to you about.

H.M.Jr: Yes.

F: Ah - I mean it seriously, Henry.

H.M.Jr: Yes.

F: Ah - I sat - there's an all-morning conference over here bearing on that subject and I thought - felt - the Secretary suggested we ought to know whether you had anything on the fire that might be involved and vice-versa.

H.M.Jr: I - I don't know what you mean "if I had anything on the fire".

F: Well (laughs) anything that would be affected by action - neutrality statute.

H.M.Jr: Well I have a - I have a memorandum here which says just what we would have to do in case the President invoked it.

F: Say that again now, Henry.

H.M.Jr: We have a memorandum - I've had a memorandum prepared what would fall on the Treasury in case the President invoked the Neutrality Act.....

F: Yes.

H.M.Jr: .....and - ah - would you care to have a copy of that?

F: Yes.

H.M.Jr: What?

F: Very much.

H.M.Jr: Very much. Well I'll tell Oliphant to send it over to you.

F: All right.

H.M.Jr: How's that?

F: All right. Now you - ah - I mean if you want I can report to you where the matters seem to stand over here.

H.M.Jr: I wish you would.

F: Well whenever you say.

H.M.Jr: Oh you mean you're ready to report to-day?

F: I'd rather not do it over the telephone although it's not very much.

H.M.Jr: Well - ah.....

F: Would your - would your arrangement with one of those governments be - ah - involved at all?

H.M.Jr: Tell you what - why don't you come - ah - if I gave 30 minutes, would that be enough?

F: Too - well you can do it in 15, Henry.

H.M.Jr: Well I'll be free at 4 o'clock.

F: I think probably it might avoid something unanticipated if I did.

H.M.Jr: Supposing you come at 4 o'clock.

F: I'll be there at four.

H.M.Jr: And I'll have Oliphant here because he's been handling it for me.

F: All right.

H.M.Jr: Please.

F: Right.

H.M.Jr: Thank you.

F: Goodbye.

F.n

September 7, 1937.
2:58 P.M.

H.M.Jr: Hello

O: Dr. Burgess.

Burgess: Hello sir.

H.M.Jr: Hello - Burgess?

B: Well the market was as dead as a doornail.

H.M.Jr: Dead as a doornail.

B: No change in the quotations from the close that we could find.

H.M.Jr: Well is that a good or bad sign?

B: Why I think that's a good sign.

H.M.Jr: Good sign.

B: I think so.

H.M.Jr: Ah-ha.

B: Now - ah - we have only the 27 million of subscriptions so far.

H.M.Jr: Ah-ha.

B: Didn't expect to have any .

H.M.Jr: Ah-ha.

B: And that is 17 for the short and ten for the long - ten and a half for the long.

H.M.Jr: 17 for the short.

B: Yes.

H.M.Jr: And how much for the long?

B: Ten and one half.

H.M.Jr: Ah-ha.

B: So if they just keep up that ratio we're all right. (Laughs)

H.M.Jr: I see.

B: (Laughs) They got a good start.

H.M.Jr: Ah-ha. Well - ah - any explanations in the Street for the fall of the market?

B: No, they think it's the European news - they think it's war news.

H.M.Jr: Ah-ha.

B: I was just in seeing the press to-day. I thought I'd pester them about this thing.

H.M.Jr: Who?

B: The press - the boys of the press.

H.M.Jr: Yes.

B: And they think it's all war stuff.

H.M.Jr: Ah-ha.

B: Of course, the Amsterdam market did the same thing ....

H.M.Jr: Ah-ha.

B: .....and London did a little of the same thing.....

H.M.Jr: Ah-ha.

B: .....not quite as severe.....

H.M.Jr: Ah-ha.

B: .....but it's clearly war scare.

H.M.Jr: All right.

B: Although there is talk that - ah - of - of industrial reaction.

H.M.Jr: Ah-ha.

B: That is they - there is some expectation that business won't be so good.

H.M.Jr: I see.

B: I haven't been able to find any real basis to that but there's some talk about it.

H.M.Jr: Well -

B: There's - ah - some estimates around the street that New York will get 75 for the short and 25 for the long and outside they might get 50-50.

H.M.Jr: I see.

B: Other than that we'll be perfectly satisfied, won't we?

H.M.Jr: Perfectly.

B: I don't think it will do quite that well if business keeps up this way but tomorrow is another day.

H.M.Jr: Yes.

B: Now I think the general agreement is that we'd like to see it open for three days.

H.M.Jr: You do.

B: And close it Thursday night.

H.M.Jr: Well you don't mind waiting till 5:30 your time.

B: Well I very seldom go home before then so I guess I can't complain, can I.

H.M.Jr: Well to-day would be a bad day to go home early.

B: Yes (Laughs)

H.M.Jr: Might think you were running away.

B: That's right. (Laughs)

H.M.Jr: I'll call you up sharp 5:30.

B: Very good.

H.M.Jr: All right.

Fin

RE CLOSING ON RIGHT TO EXCHANGE
IN SEPTEMBER 15 FINANCING

September 7, 1937
4:30 p.m.

Present: Mr. Taylor
Mr. Bell
Mr. Gaston
Mr. Lochhead
Mr. Haas
Dr. Viner
Mr. Harris
Mr. Kilby

H.M.Jr: Who's got the reports - Bell and what's-his-name, the young fellow who always has the reports?

Gaston: Kilby.

H.M.Jr: Have you had any inquiries about what's going to happen?

Gaston: Have I had?

H.M.Jr: Yes.

Gaston: The boys wanted to know if we could give them any clue to the amount of refunding today or any announcement as to closing. I told them I didn't have any information yet. Several of the boys asked.

H.M.Jr: (On phone) Mr. Burgess in New York.

Any more market?

Harris: Just talked to them. Still five, seven. Seemed to be a better tone, although quotes haven't showed any improvement. They say there are several bids around, that one Chicago bank is bidding for the rights at five and that one - the First Boston reported that, but that is not - asked not to be quoted on it.

H.M.Jr: On what?

Harris: That the Chicago bank was bidding on the rights at five.

(Phone conversation with Burgess follows:)

September 7, 1937.
4:35 p.m.

H.M.Jr: Hello

O: Dr. Burgess. Go ahead.

B: Hello sir.

H.M.Jr: Ah - how does it look now?

B: It looks about the same as at the close; the prices were just about the same and there was very little trading after the market had closed.

H.M.Jr: Ah-ha.

B: There's one other interesting thing - there was a bid around for some of the rights at par 6 which is just a little better than the dealers had been quoting.

H.M.Jr: I see.

B: It had been par 5.

H.M.Jr: Where did that come from?

B: Somebody said Chicago but I don't know exactly.

H.M.Jr: Ah-ha. Did they buy any or are they just bidding?

B: No, they're just bidding but I imagine they bought some though. (Laughs)

H.M.Jr: (Laughs) I see.

B: Ah - but that's no - there's no great change here so far. Now we didn't get any more subscriptions in so that the 17 million total I gave you - 27 million is the whole total.

H.M.Jr: Yes. Well how do you feel about closing?

B: I would announce closing for Thursday night.

H.M.Jr: You would.

B: Yes.

H.M.Jr: Ah-ha.

B: I don't think you can leave them less time than that and I don't think you need to leave them more.

H.M.Jr: Ah-ha.

B: Now there's only one of them that I use for a longer closing - that's Levy.

H.M.Jr: Yes.

B: He says that you ought to give him more time; that conditions might improve and you'd get more conversions into the note - into the long note. On the other hand, if you delay I think it looks a little bit weak as though you hadn't gotten conversions and you've got to do something to force them in.....

H.M.Jr: Ah-ha.

B: .....and if you make an announcement tonight that you're closing the books Thursday night that gives them two days and yet you start it moving.

H.M.Jr: Ah-ha. Now - ah - did anyone tell you about my idea - I'd like - I thought of sending out telegrams to all the Members of the Federal Deposit Insurance telling them when the closing would be.

B: Ah - just so you'd be sure that they get the notice, you mean?

H.M.Jr: Yes.

B: I don't think you need too. That is, we've had this before and you see they all get notices from the Reserve Banks. You see we send out notices to.....

H.M.Jr: Yes but do they go to non-members?

B: Oh yes.

H.M.Jr: They do.

B: You see, the non-members are in the different branches of the government.

H.M.Jr: Ah-ha. You don't think it's necessary?

B: No I really don't. Each Federal sends out stuff, you see?

H.M.Jr: Do you think it might be interpreted that I was scared?

B: Yes I think anything unusual now might - might attract attention.

H.M.Jr: Ah-ha. Well I don't want to do that.

B: Yes. I'm sure it reaches them because you know on these exchanges we've had 90 days - I understand they are 96% conversions which shows that it reaches everybody.

H.M.Jr: I see. Now Kilby came in - just a minute - let me see what he's got. (Conversation aside with Kilby) I had to ask him three times - I couldn't believe it.

B: (Laughs)

H.M.Jr: 23 on the short and 25 on the long.

B: Well now that's the rate you ought to continue.

H.M.Jr: Yes.

B: Just keep up the way you're going and you're all right.

H.M.Jr: I asked him three times.

B: (Laughs)

H.M.Jr: Bell's stuttering.

B: (Laughs) Well I'm afraid it doesn't mean much.

H.M.Jr: Well (Laughs) I could give you a lot worse figures.

B: (Laughs)

H.M.Jr: And those would worry you. When they're good they don't mean anything.

B: That's right. (Laughs)

H.M.Jr: Oh you fellows up there, you're hard to please. Well I think - now just hold on a minute will you please?

B: Yes.

(Conversation aside with someone)

H.M.Jr: Ah - it's unanimous here that we announce tonight we'll close Thursday night.

B: Well that's swell.

H.M.Jr: Yes. We all feel that the news couldn't be any worse.

B: I think that's right, yes. The - ah - sharpers tell me that the stock market has not reached the selling climax to-day.

H.M.Jr: It has not.

B: No they say we have never reached the climax in one day.

H.M.Jr: Ah-ha.

B: Sounds like a lot of baloney to me.

H.M.Jr: Ah-ha. Well - ah.....

B: They also tell me this is the biggest decline - ah - since things went off the gold standard.

H.M.Jr: As a - as a market forecaster, I'm a bond expert.

B: (Hearty laughter)

H.M.Jr: How's that?

B: Same here.

H.M.Jr: What?

B: Same here.

H.M.Jr: We'll all subscribe to that, eh?

B: Yes.

H.M.Jr: Well - ah.....

B: Well I'm going to reserve my formal congratulations until tomorrow.

H.M.Jr: Oh you better wait till Thursday.

B: (Hearty laughter)

H.M.Jr: All right, we'll get out the notice from here.

B: Very good.

H.M.Jr: Good night.

B: Good night to you, Henry.

H.M.Jr: That's all right. Herbert, do your duty. I simply would say that for the first day - would you say "under the circumstances"?

Gaston: I would just say that "the Secretary announced that the books on the exchange offering would close Thursday night at the close of business" and let it go at that.

H.M.Jr: O.K.

Bell: Right.

H.M.Jr: All right.

Taylor: You don't want to say that early subscriptions indicated an even split between the two?

Bell: Without qualifications.

Lochhead: Less details the first day.

Bell: 23 and 25, and he (Taylor) wants it about even.

H.M.Jr: Anybody got anything else?

Gaston: I don't think we'll send this radio to the Press Radio Bureau, would you?

H.M.Jr: No.

Taylor: The wire's dead.

Bell: Yes, no wire to the banks.

GROUP MEETING

September 7, 1937
9:30 a.m.

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

H.M.Jr: Well, the first reports on our financing look as though it will go pretty well. I just talked to Dr. Burgess on the telephone. War news hasn't helped it any, but we tried to make it bombproof. The rights are still selling up where they were. Looks as though the premium on the five-year two might be a little more than on the 15-months.

Bell, I wish that you and Taylor would let me know this afternoon - check with New York - if we're going to close tomorrow night, I might want to tonight send right from the Treasury a telegram to every member of the Federal Deposit Insurance banks, notifying of this closing, because it is such short time that these little state banks, out of the way, they'll never get it. It doesn't cost so much when you consider what's involved. I'd like Gaston to help make it a very courteous telegram - wish to let them know that they can advise their customers the right to exchange will close midnight the 8th; send one out - a telegram to everyone on the Federal Deposit list.

Bell: Of course, you know, we don't have to close because of the shortness of time; it is news that is liable to .....

H.M.Jr: Sure, what's the sense of fooling around for more than two days?

Bell: That's what I'm afraid of, that a lot of them will wait until the third day, and the third day will be bad news.

H.M.Jr: Oh, I'm going to close tomorrow night. I don't want

some state bank to say, "You closed and we never were notified." Now, so - until the Federal Reserve machinery gets in motion - why not send it? If I send it, I don't want to use the Army and Navy telegraph system; I want to use Western Union and Postal. They can get the list ready. It costs $7,000 to send the telegram to 15,000 banks - 50 cents apiece, about. I don't want some bank to write in - "Well, I wasn't notified." Huh?

Bell: All right.

H.M.Jr: And Mac can see that the telegraph room gets ready. Supposing they write the list and we don't use it - and address it. If they could address it and put in the name of the President of the bank.... - get the list from Crowley. And if that could be done - I don't want to use the Government telegraph system; I want to give half to Western and half to Postal, - it just saves some small institution from saying, "Well, we didn't know." What? Mac?

McR: I'll have it. I can find out about the list of the names of the presidents of the banks, how available that is, whether we can get that out promptly. You folks will have to dig up the wording of the telegram and we'll see that it gets out.

H.M.Jr: Don't you think, Cy, some small bank in Iowa - they're not going - there isn't a newspaper that carries that in time.

Upham: I know it will help the banks, because they do claim they can't act promptly because they have to get it from the newspapers.

H.M.Jr: And the state member banks - do they notify them? I'd ask the Radio News to carry it tonight.

Gaston: Oh, you have asked them?

H.M.Jr: No, I haven't. I want you to.

Gaston: Oh yes, I will.

H.M.Jr: All right. Now, who wants - who's got anything?

Oliphant: I've got some personnel problems, some very interesting ones, for you.

H.M.Jr: Is that Shafroth and Ryan?

Oliphant: Yes. And another one.

H.M.Jr: And another one.

When do you want to bring me up-to-date, Ros?

Magill: Any time.

H.M.Jr: I mean when will you be ready to talk?

Magill: I'm ready now, at your pleasure.

H.M.Jr: O.K.

Do you (Taylor) want to call up Ransom and tell him that I'd rather have him for lunch tomorrow instead of today. And does he want to bring anybody with him? Huh? I'll put it down for tomorrow, one o'clock.

Taylor: All right.

H.M.Jr: Well, supposing you (Magill) come in at 10:30.

Magill: All right.

H.M.Jr: George?

Haas: I've just got a few things. Here's this memorandum on the.....

H.M.Jr: Oh, grand. Now, who else gets that?

Haas: Anybody you wish.

H.M.Jr: Well, who wants it?

Bell: What is it?

H.M.Jr: It's a memorandum on how the small man can or can not finance himself.

Haas: I should think it would have some relation to Ros.

Viner: I'd like to see it.

H.M.Jr: Take notes on who wants it, George.

Haas: I've only got two now, Mr. Taylor and Mr. Magill.

Oliphant: I'd like to see it.

Bell: I'd like to see it as a matter of interest; I'd like to read it. You (Lochhead) get it and I'll read it.

Lochhead: Let me have a copy and I'll let Dan read it. Only one will do.

Viner: Pass it on.

H.M.Jr: Cy wanted one. Give one to Riefler; he'll be here tomorrow.

Haas: And I'll give one to Herbert.

H.M.Jr: Incidentally, I'd like to compliment your organization on that financing memorandum. I think it was excellent.

Haas: Thank you; I'll tell them about it.

There's one - there's two other things. One is that there is going to be a budget summation. The estimates - I gave them to Danny unofficially, but they haven't officially cleared the Treasury. You haven't reviewed them. Last time you asked Ros to do it.

H.M.Jr: What's the business forecast?

Haas: Oh no, it's the - each time a new budget summation is put out, we review all the estimates again. We have done that. Which took us four weeks.

Magill: What have you done with the Commissioner?

Haas: I didn't get that.

Magill: I said, to what extent have you cleared with the Commissioner of Internal Revenue?

H.M.Jr: Last time he didn't agree with our estimates.

Haas: I haven't contacted him at all. I didn't want to do that. I thought it would be better to run through you.

Magill: If you like, I'd be glad to look them over. Would you?

H.M.Jr: I would. I think we ought to avoid being shy.

Haas: I think Helvering ought to be in at the meeting that's called.

H.M.Jr: Well, if it's agreeable to Magill I'd like him to handle it for me. I don't see anything particularly in it for me. I think Taylor ought to sit in on it.

Magill: What's your deadline?

Bell: I've got to clear this whole budget summation in three days - when the President is here, and I understand that will be the 16th, 17th, and 18th. I'm going to spend all tomorrow morning with the Secretary on it.

H.M.Jr: Thursday.

Bell: Oh, Thursday, that's right.

H.M.Jr: He and I are working together on it Thursday morning.

Bell: So the deadline is certainly Saturday of this week for any further revision.

Magill: Why don't I try to see the Commissioner, say, this afternoon? Is that all right with you (Taylor)?

Taylor: (Nods yes)

H.M.Jr: All right. And then if there is anything - well, I'm going to leave it this way, if you don't mind. I think - because I remember the last time I pinned the responsibility on you, and then when it left your hands - you and Taylor went to Bell, and I

worked with Bell direct.

Magill: I don't know about that last part, but that's about the.....

H.M.Jr: I think that's about right. After all, Bell was seeing it as Director of the Budget and not as a member of the Treasury, so when it leaves the Treasury it ought to have your (Magill) O.K., and then it goes to the Director of the Budget. Right? Will you assume that responsibility?

Magill: I will.

H.M.Jr: What else, George?

Haas: Some time when you have a minute you might want to look over those business charts and daily charts, which you haven't seen for a while. I can give you a business memorandum today too, if you want it.

H.M.Jr: All right. Don't - hold on to that business memorandum. I want you to give it to me personally. I'll try to fix up a time. Is that clear to you?

Haas: That's clear to me.

H.M.Jr: Now, how near ready are you to giving Magill this tax stuff?

Haas: He has it. I have a copy for you; I'll have it trucked in.

H.M.Jr: But he has it?

Haas: He has it all bound up in ribbons.

H.M.Jr: When did he get it?

Haas: Oh, I could have got it to him an hour or two earlier, but he told me he didn't want it until today.

Magill: I gave him until today. George would have had it on September 1, as stated.

H.M.Jr: But you (Haas) came through.

Viner: George ought to give him a deadline now on reading it.

H.M.Jr: All right. Well then, you've got it, huh? Well then, George has made good on two things, hasn't he? That's something.

Viner: I read one of them; I thought it was swell.

H.M.Jr: There's certain things in his financing memorandum that have to do with this gold question. I think you (Viner) might like to read it.

Haas: I'll give you a copy.

H.M.Jr: I mean there's a first part of it - there's certain things there about excess reserves and that sort of thing which I think would be helpful. was to me.

All right, George. Now, the only other thing which I understand is still undone is that memorandum which I gave to Mr. Taylor and which was given me by Stewart McDonald; it has to do with his complaint against Home Owners Loan. When do you think that will be done?

Haas: Maybe the way to get that thing out is to say when you want it. We'll get it.

H.M.Jr: No, I'm not - under the new system I don't give you a date; I ask you when you think you can do it comfortably. Comfortably.

Haas: Could I look over my situation?

H.M.Jr: Tell me tomorrow.

Haas: O.K.

H.M.Jr: Tell me tomorrow when you can do it comfortably, without using sweat shop methods.

McR: And without hiring too many new ones.

Haas: Be quiet, Mac.

Bell: Is that the same thing as the President's letter dealt with?

Taylor: It's all the same thing.

H.M.Jr: I don't know about the President's letter.

Bell: Don't you?

H.M.Jr: No, what's that?

Taylor: Mr. Daiger wrote a letter - a memorandum for Mr. Eccles, and the President took the memorandum and wrote to us and Mr. Eccles.

H.M.Jr: Well then, if he wrote it - he's working for Stewart McDonald, so it must be the same angle. Well, just before I left Stewart McDonald handed me a memorandum which I handed to Taylor, and Taylor handed it to George Haas. Now, at the staff meeting tomorrow morning George will tell us when he will give us something on it.

Now, Jake, if you could this morning - you know what I want, Jake - and suppose you could sort of - no reason why you shouldn't talk with anybody in the Goldenweiser group, and suppose you be ready to talk to me by three. I mean we could sit down and chin about it. What?

Viner: Sure.

H.M.Jr: Now, would you rather put the thing down in writing, your own impressions, first? Is that crowding you too much, to have a preliminary talk at three?

Viner: You mean give you a little memorandum at three and then talk to you about it?

H.M.Jr: Yes, and talk to me about it. What?

Viner: All right, I'll do that.

H.M.Jr: This is all terribly confidential, but for those of you who weren't here, we have moved pretty fast the last couple days, and we're thinking very seriously of discontinuing sterilization of gold for the time being. If we do it we want to announce it next Monday. And then right after that - there's no particular hurry on the question of 9-months bills; that will come afterwards, but we.....

Viner: Let me get this straight. No further sterilization for the time being, or is it desterilization?

H.M.Jr: No, I hadn't thought of that. I'd just thought of stopping the sterilization - of just stopping the sterilization, - in my own mental reservations, until the first of January, but in the announcement I wouldn't give it any time limit. Just stop the sterilization. You'll find that their figures show that between now and Christmas excess reserves will go down to between two and three hundred million, with three or four of the big banks in New York minus. See?

And the thing that broke so nicely was that Ransom approached me on behalf of himself and Eccles. They approached me, and they wanted - they felt that the thing to do was an open market operation, but Ransom feels that it wouldn't be effective. But we feel that - here I feel from what I've got that if that was done it might call the turn of things - might force crops, might force a change on corn, and everything else - I mean the whole business. The thing is just too tight; it's getting tighter all the time.

And they admit that it will go down to two or three hundred million dollars. Now, if we can put 250 to 400 million dollars more gold to work between now and the first of January, it will just ease that situation. I told Ransom, "I'm not going to wait once we make up our minds that we're right, see?" But they've got a very tight situation and it's getting tighter all the time.

Oliphant: Very spotty distribution of the excess too.

H.M.Jr: Oh yes, and it hits the big New York banks the hardest; that's where it's going to hit them.

Viner: Have they given any thought at all to their lowering their reserve requirements?

Taylor: No.

Viner: They think that's out of the question. That seems to me the most logical move.

Taylor: They're talking about open market operations.

Bell: They'd buy governments first.

Viner: Why not the other?

Bell: I don't know; that's the way they're thinking.

H.M.Jr: Well, I don't want to - what I'd like - I don't want to argue; I'd much rather have you put your own thoughts down in writing.

Viner: I just want to know what's in the air.

H.M.Jr: Well, I haven't - I think the Board is meeting this morning. But as far as - if Goldenweiser is free there's no reason why you shouldn't go over and talk to him, see? But I'm not going to have - it's either - it's one of those things that have to be done, and I'm not going to have one of these long rows.

Oliphant: Not under the new regime.

Viner: They tell me Goldenweiser is away.

Bell: He was last week. Away on vacation. He may be back - Labor Day.

H.M.Jr: All I want - I want it absolutely confined to the Federal Reserve Board here. I don't want to talk to anybody in the Federal Reserve of New York. That includes Williams; I don't want to talk to Williams. Federal Reserve Board, Treasury, nobody else.

Cy?

Upham: (Nods nothing)

H.M.Jr: If we do this, then I may want you to make one of your swings around the country after the announcement, talk to the banks, explain it to them, get their reaction. See? If we do it. I mean I'd want you to maybe leave here next Sunday to make two or three weeks' swing through the country, going out and explaining what we're doing, getting their reaction.

And the interesting thing - they all say we want to sell a one-year certificate. Then you say, "All right, when should we sell it?" And there isn't anybody can tell me when the banks want them. They all say the country banks want them, but do they want them weekly, monthly, quarterly? Nobody knows. Here's a man like Ransom admits he doesn't know. Now, if he doesn't know, what chance is there for me to know? See what I mean?

What I don't want to do, Cy, is to sell something that they tell me in New York that the country banks want, when maybe it's the last thing in the world the country banks want. In other words, if we're going to change our bills to 90-days, discontinue 9-months, what do the country banks want? I want to get it fresh, firsthand? I don't want to have the New York crowd tell me that's what they want and find it is just what they don't want. See? I mean they seem to think they're just staying awake nights waiting for a one-year certificate. Maybe it's the last thing in the world that they want; and the only way to find out is to go out and ask them.

Have you had any vacation?

Upham: Oh yes.

H.M.Jr: Is your mother all right?

Upham: Yes, she seems better.

Lochhead: There's nothing new since I saw you before.

Oliphant: What's the general news? Is Bonnet going to lick the job?

Lochhead: What's that again?

Oliphant: Is Bonnet going to lick his job?

Lochhead: There seems to be very general doubt as to what real progress they've made. The main point is, though, that they have managed to gain slightly

in their gold reserve since he went in. But the decree period is over now and they're watching to see what he'll be able to do.

Viner: But he's done well considering the circumstances.

Lochhead: Considering the circumstances, I think he has done very well.

H.M.Jr: They have an excellent tourist trade.

Oliphant: Have they?

H.M.Jr: Mrs. Klotz says they have a wonderful tourist trade.

George, you go right along on this thing - your crowd - this question of whether we should stop sterilization or not.

Haas: I have already started.

H.M.Jr: I want you to move right along.

Dan?

Bell: I told you shortly after you left we got a letter from Mr. Aldrich on the Sinking Fund, and we acknowledged it, said that you were away and we'd take it up with you as soon as you got back. I have a rough draft of a reply which I will clear with Herbert and also with Herman before we send it to you; but I hope to get it out this week. It is quite a lengthy document, and he raised a good many questions.

H.M.Jr: You thought it was coming from Ogden Mills.

Bell: I think it has all the earmarks of Ogden Mills' language, and he's on the Board of Directors, so I'm sure it's Ogden Mills' letter. And the interesting part of it, it was mailed from Darkharbor, Maine, while Aldrich was on vacation, and I don't - I know very well he didn't dictate it.

Viner: You're sure? That's the Chase National Bank?

Bell: Yes.

Viner: Don't you think that's B. M. Anderson?

Bell: No, I think it's Ogden Mills, because in his (Aldrich) conversation with me he said that the Board of Directors of the Chase National Bank was worried about our policy in respect to Sinking Fund.

Viner: I'd like to have a look at it.

Bell: He's on that Board.

The other thing is the matter of information I've dug up - the situation with respect to loans made by the Resettlement Administration. They have made about 151 million dollars in loans up to July 31; 52 million, 500 thousand of those loans have matured, and they have received 23 million, 500 thousand on account.

H.M.Jr: About 50 percent.

Bell: Yes. There's 29 million dollars of loans matured but not paid, and there's 98 million dollars unmatured. It's about - a little less than 50 percent collections.

H.M.Jr: What do we do, send a bill to American Molasses Company?

Bell: I doubt if that will be paid. It's better than I thought it was.

Viner: Yes, I'm surprised at the figures.

Bell: Recovered into the Treasury, 23 million dollars; it's pretty good.

H.M.Jr: Well, that's all right. What else?

Bell: That's all.

H.M.Jr: All right.

Dan, when I sit down with you Thursday, one of the things - if you could do, or have someone do it, have

it prepared - I'd like if we could to take a look at the first sixty days on a cash basis; I mean just to check it. I mean how much cash has gone out, and eliminate the revolving funds; then compare the first sixty days with the same sixty days last year. Do I make myself clear?

Bell: Uh-huh.

H.M.Jr: What? Put it on a strictly - I mean just let's eliminate....

McR: Just money actually spent out of appropriations.

H.M.Jr: Let's just eliminate the revolving fund; then break it down into regular and emergency. That oughtn't to be very difficult.

Bell: No, it's all on the daily.

H.M.Jr: Yes.

Mac?

McR: I haven't got anything. Really, I'd like a chance - will you have a chance some day this week?

H.M.Jr: Yes.

McR: Nothing particularly urgent, but a few things that have happened that I'd like to tell you about. Most of them are done.

H.M.Jr: Good.

McR: And a few things that I'm holding for you to see.

H.M.Jr: I suppose that Minnesota Collector is all cleaned up. Magill took that, I suppose.

Upham: Congressman called in Saturday on that.

Magill: Is he still there?

Gaston: Yes, he's still there. I think Guy gave him a deadline until Wednesday of this week that he'd have to come in.

McR: I got hold of Steve Gibbons - Jim Farley's been calling him about it - I got hold of Steve and said, "If you let the boss come back and see that fellow is still in, somebody's going to burn." And Jim finally got around to the point where he's washed his hands of it; he said he can't get his resignation. But Guy called him in the other day and I understand that he gave him a deadline.

Gaston: I think it was Wednesday.

McR: And he's ready to see him go - that is, Jim Farley.

H.M.Jr: When is the deadline?

Gaston: I think it's Wednesday; not absolutely certain.

McR: That's another deadline. But apparently we've got Jim Farley in the frame of mind where he is willing to recommend to the President that he fire this fellow. So that's the situation.

H.M.Jr: It's just where I left it.

McR: Well, for all practical purposes.

(Hearty laughter)

Except Jim Farley's frame of mind.

H.M.Jr: Well, the last time Jim - just before I left, Jim had his secretary call me up and he wanted me to know that he couldn't do anything because this judge who was now the boss of Minnesota was in the hospital - how could I expect him to make up his mind?

And my Collector at Cleveland?

McR: Oh, you have a Collector at Cleveland.

H.M.Jr: Same one?

McR: No, he's out, and you've got a new one. Everybody agreed on him - was a good man, selected, endorsed by both Senators.

H.M.Jr: Now what will we do with the other two fellows - Customs and Secret Service men?

McR: I think we'll just clamp down on them. I wasn't willing to act.

H.M.Jr: Put them on the list; I'll get around to them.

McR: There's one more thing that I thought I'd tell you before you - you've probably found out otherwise, saw it in the paper; we have a new Register of the Treasury.

H.M.Jr: So I understand.

Taylor: I reported on that.

McR: Did you tell him that you signed the papers while you were kicking and squealing? That's what he's told me.

H.M.Jr: Well, the last one was President of the American Magicians Society.

McR: This one is a dentist. Herman insists that we set up a clinic for him.

Gaston: We're going to announce this closing for tomorrow morning's papers?

H.M.Jr: Well, I'll talk to Burgess. I want to get all the machinery set. We can give it out tonight for tomorrow morning's papers.

Gaston: You don't want any press conference today?

H.M.Jr: Oh no.

All right. I'd like Herbert to stay a minute.

Chronology of Important Events

in China

From July 1, 1937 to September 7, 1937.

(A detailed chronology is being maintained and is available.)

FAR EASTERN EVENTS

July 1 - July 8, 1937: The Amur Incident (Russia-Japan)

Soviet ship sunk in the Amur River by Japanese as a result of disputed ownership claims to islands in the Amur River--the boundary between Manchukuo and Russia. Both sides mass sea, land and air forces but incident is settled when both agree to withdraw. Ownership of the islands remains unsettled.

July 8, 1937: The Lukouchiao Incident (North China-Japan)

Unexplained Japanese troops 10 miles west of Peiping clash at Marco Polo Bridge with Chinese troops. Slight casualties on both sides. Both sides claim to be "protecting their rights".

July 9 - July 19, 1937: Period of Negotiation

Japan meeting with unexpected resistance from Nanking government. Shifts the basis of her demands from "an apology from Nanking" to a demand for a purely local settlement. Japanese "demands" stiffen during period of negotiation (see p. 3 and p. 12 - Peiping dispatches). On the 19th, General Sung Cheh-Yuan, commander of the 29th Army, makes independent agreement with Japan to withdraw his troops. At Nanking Japan asks for demilitarization of North China.

Intermittent fighting of increasing intensity in the Peiping area during this period. Japan rushes reinforcements to area increasing her strength from 7,000 on July 8th to 16,000 on July 16th. Severe clashes on the 14th and 15th. Movement of 100,000 Manchukuoan troops toward Tientsin; one complete division (20,000) dispatched from Tokio on July 15th.

July 20 - July 26, 1937: Increasing tension

Nanking rejects the independent settlement of General Sung. The 37th division of the 29th Army rebels from General Sung's orders and engages in new clashes with Japanese troops. Japan presents six major Chinese-Japanese "issues" to Nanking (see p. 21) and Japanese military extremists advocate 9 reasons for war (see p. 24).

July 27 - July 29, 1937: Both sides declare for "war"

Negotiations break down. Active war preparations on both sides. Nanking pledges support to North China and starts moving troops. Important pledges of aid to Nanking from war lords of Shantung and from General Mao Tse-Tung, Chief of the Chinese Communist Armies.

Severe fighting at Peiping, Fengtai, Tungchow and Langfang. Systematic destruction of Tungchow by planned Japanese attack using airplanes, bombs, artillery and machine guns. First major engagement of the undeclared war. Surprise attack by Chinese on Japanese at Tientsin. Japan begins systematic airplane destruction of cities surrounding Peiping. 2 American marines killed in Peiping.

July 30 - August 5, 1937: War in North China

Chinese troops mass at Nankow Pass; Japanese troops outside of Kalgan. Japan calls up army reservists on August 5th (reported years called back to 1927). Nanking receives pledged support from war lords of all important China provinces, including the Chinese Soviets. No accurate estimate of army strength on either side. Skirmishes throughout Peiping-Tientsin area.

August 6 - August 9, 1937: War fear spreads to Central China

Japan announces intention of controlling North China as far south as Yellow River. Chiang Kai-Shek announces China will yield no more territory to Japan. Foreign diplomats (on advises from Japan) advise their nationals to leave central China. Chinese refugees flee from Nanking to Shanghai.

August 10, 1937: The Hungjao Incident - at Shanghai

1 Japanese naval officer and 1 seaman killed by Chinese when they attempt to enter Hungjao military airdrome outside of Shanghai. 1 Chinese gendarme wounded. Conflicting Chinese and Japanese stories of the incident.

August 11 - August 12, 1937: Tension at Shanghai

Investigation of incident and negotiations aided by foreigners. Mayor Wu of Shanghai meets Japanese demands but on August 12th 27 Japanese warships, 12 destroyers, 1 light cruiser and 2 aircraft carriers massed at Shanghai harbor. 500 - 1,000 Japanese sailors landed. Chinese reguler troops marched into Shanghai.

August 13 - August 14, 1937: Fighting in northern Shanghai

Japanese naval forces on patrol fought with Chinese in civilian garb. Japanese forces estimated at 8,000; land, sea, air reinforcements being rushed in.

August 15 to date: Outstanding events in Shanghai

August 15- 863 killed, 1,140 wounded by Chinese bombs which fell on the Cathay and Palace Hotels.

- 3 Americans killed.

- Foreign concessions north of Soochow creek bombed.

August 21- U.S.S. Augusta hit by airbomb of undetermined origin. 1 killed; 18 injured.

August 22- One-third of International Settlement ablaze. (Yangtzepoo district). Chinese Chapei, Japanese Hongkew destroyed.

August 24- 400 dead, 1,000 injured in air bombing of business district at Sincere and Wing On department stores. Anthony Billingham of New York Times severely wounded.

- Secretary Hull urges belligerents to refrain from war. Reaffirms American policy as expressed in Washington Pact (1922) and Kellogg-Briand Pact of Paris.

August 26- Japan orders blockade of Chinese coast as far south as Hong Kong. Foreign shipping exempted.

August 27- British Ambassador severely wounded by Japanese fliers.

- Japan serves notice foreign shipping may be included in blockade.

August 29- Japanese bomb Nantao - Chinese district adjoining French concession.

August 30- British note to Japan demands formal apology for shooting of British Ambassador, punishment for those responsible and assurances of non-occurrence.

- Russia-Chinese non-aggression pact announced.

August 31- U.S.S. President Hoover bombed by Chinese planes. 7 members of crew injured.

- China appeals to League of Nations - blames Japan on 4 counts (see pp. 65-66)

September 2-Japan begins systematic plane attacks along 2,000 mile front from Nankow in north to Canton in south.

September 4- American nationals urged to leave China. Warships will be provided.

September 6- Japan launches big offensive on whole Shanghai front. Chinese lines firm.

- Japan extends blockade to whole China coast; exempts Tsingtao and leased foreign territory.

- President Roosevelt warns Americans to leave China or remain at their own risk.

September 7- Tokio responds to British note but refuses to accept responsibility for the wounding of the British Ambassador. Great Britain offended. Summons cabinet.

- China will invoke League Covenant; perhaps under Article SVII (which provides for conflicts between League members and non-members) which because of its severity may cause "trouble" at Geneva.

The situation in Shanghai today:

Shanghai is a shambles. Business is paralyzed, property destroyed and foreigners in increasing danger. Neither China nor Japan has gained a distinct advantage. Chinese resistance has been unexpectedly strong. The area of conflict has widened to include the Nanking-Shanghai district with heavy concentrations 20 miles north of Shanghai at Luiko. Foreign observers on September 2nd admitted for first time China has a chance of success. The "big push" launched by Japan at Shanghai on Sept. 6th has so far netted Japan no major success.

Estimates of Japan's strength in Shanghai vary. Probably 100,000 regular army troops have been sent, of whom not more than 60,000 have been landed (estimate of September 7th). Landing troops has been one of Japan's main difficulties because of the water hazards in the whole area and determined Chinese resistance.

Chinese strength in Shanghai estimated at approximately 200,000 — all regular army troops.

The situation in North China today:

Chinese resisted Japanese at Nankow Pass from August 7th to September 1, 1937. News from North China entirely controlled by Japanese. Peiping-Tientsin area controlled by Japanese with government of Peiping now in Japanese hands.

Estimates on September 1, 1937 were 120,000 Japanese regular troops in North China with approximately 100,000 Manchukuoan troops. These latter (according to reports difficult to confirm) have shown strong signs of revolt against Japan.

Chinese troops estimated (by Japanese sources) at 200,000 on September 1st and 400,000 on September 7th. (There are no Chinese or foreign estimates.)

Japanese admit unexpected resistance in North China. Chinese sources claim their armies control the area 20 miles south of Peiping and south from Tientsin, beginning at Machang.

The next major battle in the north will probably be near Machang (south of Tientsin and on the main route from Nanking to North China), where the Chinese are entrenched and the Japanese concentrating.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE September 7, 1937.

TO : Secretary Morgenthau.

FROM : Jacob Viner

Subject: Excess Reserves.

I believe that there is a strong case for taking action aimed at bringing about a substantial increase in the existing level of excess reserves. I have at no time been convinced that it was desirable to make a drastic decrease in excess reserves while business activity was still at a depression level, and it is still my opinion that in general brakes should not have been applied before it was desired actually to check forward movement. In any case, the manifestations of prospective tightness of money, the virtual cessation of new security issues, the decline in bond and stock prices, and the signs that a substantial reduction in business activity is impending make this an appropriate time to restore abundant excess reserves to the banks. The issues in question, therefore, are

(a) the amount of increase in excess reserves which is desirable, and

(b) the choice which should be made as between the several available methods of increasing the excess reserves.

As to the amount, I believe that it would be a good working rule that the excess reserves of the system should not be permitted to fall below $1,000,000,000 as long as increase in business activity at a greater rate than the rate of increase pervailing - if any - was desired, and that the money market should gradually be taught that a fall in the reserves substantially below $1,000,000,000 was to be regarded as a signal that the control authorities thought contraction was necessary, and would take whatever steps were necessary to bring it about if it did not occur spontaneously.

The usable methods of increasing excess reserves available at present are: (1) reductions in rediscount rates of the reserve banks; (2) open-market purchases of governments by the reserve banks; (3) reduction in the federal reserve requirements; and (4) cessation of sterilization of gold inflows and (5) desterilization of the "inactive" gold. These will be commented on in the order in which they are listed above.

(1) Reductions in Rediscount Rates.

This is a desirable move, but as the rates of most of the banks are now down to 1%, the possibilities in this direction have already been exploited to their practical limits. This method, moreover, has, and has ha in the past, very limited effectiveness, because the member banks, since 1922, have shown a persistent and marked reluctance to become indebted to the federal reserve banks, except on a very temporary basis or when they were in real distress, and when for any reason they have become indebted, they have looked upon their indebtedness as a claim on their reserves, so that while technically their reserves may have increased as the result of such borrowing, psychological y the effect on their lending policies was null or nearly so.

(2) Open-market Purchases.

Open-market purchases would have a direct and immediate effect on excess reserves, corresponding fairly closely in amount to the amount of the purchases. They would result in a transfer of holdings of governments from the member banks to the federal reserve banks, thus increasing the earnings of the latter and, by reducing the earning assets of the former, forcing them to seek other security and commercial loan investments. Open-market purchases would also, of course, tend to raise the prices of government securities. In case of undesirably rapid credit expansion, the process could readily be reversed. The only important objection to open-market purchases under the present circumstances that I can see is that the bankers and the money-market public in general associate open-market purchases closely with Treasury finance, and almost invariably interpret them as directed by a narrow and short-run view of Treasury interests rather than by long-run general market considerations. I would think it inadvisable, therefore, to increase substantially the holdings of governments by the reserve banks until such progress has been made toward budget balancing and genuine reduction of the debt as convinces the money market that there is no longer any real danger of inflation resulting from Treasury deficits.

(3) Reduction in the Federal Reserve Requirements.

I would recommend this method as the most desirable one of those now available for increasing excess reserves. It would be the one least closely connected with Treasury

finances and therefore least likely to be interpreted as dictated by narrow Treasury considerations. It would demonstrate to the public that the reserve requirements were a reversible and potentially flexible instrument of credit control. It would have a relaxing effect on bank credit throughout the country, and not merely in the financial centers. It would be more favorably received by the public, I believe, than would the use of any of the alternative methods.

(4) Cessation of Sterilization of Gold Inflows.

This would operate to increase excess reserves to the extent of the inflow of gold. Since it is impossible to forecast this inflow, there would be little basis for prediction of the extent or the timing of the increase in excess reserves resulting therefrom, and banks would undoubtedly wait for actual results on their reserves before expanding their loans or investments. It would represent a reversal of a practice of recent origin, and would therefore be interpreted as the correction of a mistake rather than as the routine and sound application of a reversible control device. Since gold flows are unpredictable, and since sterilization is a Treasury operation, while credit control is primarily the responsibility of the federal reserve system, I think there is a great deal to be said for continuing sterilization operations as a routine practice, leaving it to the federal reserve to provide the needed flexibility in credit control. Otherwise, possibility of conflict of policy, and operations at cross purposes by Treasury and federal reserve, could arise too easily and with possibility of great damage. There is no connection now between gold flows and the volume of credit needed by the country for purposes of either internal prosperity or international equilibrium. Sterilization breaks the otherwise automatic connection between gold flows and national volume of credit, and is therefore under existing conditions a logical procedure if practiced as a regular routine. It would be a mistake, I think, to abandon this routine, as long as the gold situation continues to be abnormal - which will be a long time - and as long as other means of credit control are available.

(5) Desterilization of the Inactive Gold.

Assuming that the federal reserve authorities were willing to lower the reserve requirements or to carry out open-market purchase, I would see no adequate reason for desterilizing the

inactive gold. But if they are unwilling either to lower the reserve requirements or to conduct open-market purchases, I would recommend desterilization of, say, $500,000,000 of the inactive gold while continuing to sterilize subsequent inflows of gold. This would make sterilization the routine procedure, and desterilization of previously-sterilized gold a special intervention with definite credit-control objectives and of definitely prescribed quantitative dimensions. The desterilization would thus continue to be the normal practice, and desterilization would become merely an available, flexible instrument of credit control, used, as far as the public need know, only when and because it seemed to the credit control authorities the most suitable of the various instruments available.

Summary of Recommendations:

(1) Action to be taken to increase excess reserves to approximately $1,000,000,000.

(2) Instrument to be used, in order of desirability

I. Lowering of reserve requirements.
II. Open-market purchases
III. Desterilization of inactive gold.
IV. Permitting future inflows of gold to increase excess reserves.

RE TREASURY POSITION ON POSSIBLE INVOCATION OF NEUTRALITY ACT IN SINO-JAPANESE WAR

September 7, 1937
4:00 p.m.

Present: Mr. Taylor
Mr. Oliphant
Dr. Viner
Dr. Feis

H.M.Jr: Well, we're at your service, Mr. Feis.

Feis: Well, it's just within this room. The Secretary (Hull) is going to talk with the President first chance he gets about the possible application of the Neutrality Act. No decision has been reached, but events seem to be moving in that direction, and there are many reasons for believing that if it is to be done it is best done rather promptly. And the question therefore arose as to whether the Treasury had any business on hand with either of the belligerents that might be affected by such action. That was Question One.

Question Two, whether, since invoking Section One of the Act would bring into operation also Section Three of the Act, the Loan Finance Section - whether there was any preliminary planning that ought to be done there. Those were the two questions.

H.M.Jr: Well, Mr. Oliphant has prepared a memorandum. He had plenty of time to prepare it, because he was ready last Friday because I cabled him, asked him - gave him a week's notice to get ready, feeling in my bones that this would come. So we're ready.

As a matter of fact, interpreting what Mr. Oliphant says, the Treasury can do two things. Inasmuch as our transactions with China originated prior to any trouble, anything that you do with the Neutrality Act - I might say - I first make this sweeping statement, that it can be so interpreted legally, lawfully, that anything that you do under the Neutrality Act will not affect any position of the Treasury now. Right?

Oliphant: That's true of the Neutrality Act, but not of international law.

H.M.Jr: That is true of the Neutrality Act.

Oliphant: True of Neutrality Act, but not of international law.

H.M.Jr: Now, it would be a discretionary policy whether we decide to continue to buy gold and silver from Japan and China - purely a policy matter.

Feis: Mere purchase of gold and silver - that's not a loan transaction which would come under the Act, so it is in the very nature of it a policy question.

Oliphant: Can I go - sort of go over it?

Feis: Would you, yes.

Oliphant: The Neutrality Act has no application at all to the Treasury, the Treasury being part of the sovereign and the sovereign not having been mentioned in the Act. So we just wipe out the Neutrality Act.

The second thing we have to consider is the general principles of international law. What conduct on our part, under general principles of international law, would be unneutral action? Now, from our standpoint I divided those this way. We can continue buying and selling foreign exchange in the ordinary course, where the purpose is not to advance a line of credit to one of the belligerents - assuming you have declared a state of war to exist; that is what brings this international law into operation - but merely to protect the dollar. Now, second, we can't make loans, can't advance credit under the principles of international law; and that would be true, under the authorities, even though you had the prior agreement to make the loan - situation where you have a treaty, and so forth, you're bound to make the loan - if in making the loan the advancement of credit would be an unneutral act.

But now, when you come to the final thing - Can you buy their monetary metals? - there's just no precedent on that; that's wide open, and you could decide that - it seems to me you can make your international law by taking one position or the other, depending upon what as a matter of policy you want to do, so far as what the courts would finally decide to be an unneutral act is concerned, not talking at the moment about whether or not Japan would object.

Feis: There seems to me to be intermediate ground there. The invocation of the Act preventing private individuals from doing certain things would necessarily have to be taken into account in considering the decision of the Treasury of doing similar things.

H.M.Jr: No.

Feis: It is that that seems to us to have more bearing than that vague body of violated and contentious rules that goes by the name of international law in this field.

Let me explain what I mean. You ban loans to the belligerents by private individuals. If, having done that, the Government extended loans, it certainly would have to take into account in the decision the fact that it had prevented individuals from doing it.

Oliphant: Well, as I read the international law authorities, it would be an unneutral act for the Government to make the loan, so that would be out.

Feis: I certainly am not prepared to dispute what is or is not international law. I can only give you my own observation that every discussion that I have sat in at with the lawyers on what was or was not international law in this field of neutrality - before you're finished, the lawyers' case goes completely to pieces. They usually refer to the proposals made at some conference which were only accepted by part of the conference, and there's been - it's been just as frequently violated as observed. I doubt whether you'd find anything of accepted doctrine on this matter of loans to belligerent governments that would entitle it to the term of law.

I put the same matter this way - which comes down to being something of the same thing - that if you did make a loan - the Treasury - to either belligerent government, under any but very special circumstances it would be apt to be regarded by the other government as an unneutral act, just as the financing of the rebels in Spain by Italy and Germany is of course regarded by the Spanish Government.

H.M.Jr: May I interrupt you a minute, if you don't mind. I mean at 4:30 I've got to decide what we're going to

do about our present financing and if you want to continue the discussion of the further technicalities, I want you to go now. But I'd like to say something which is not technical, if I may. See what I mean? I mean this thing can go on for hours.

Feis: Sure.

H.M.Jr: And Mr. Oliphant is available, Mr. Taylor and Mr. Viner are available. Am I right?

Now, I'd just like to say something if you don't mind, see? Whether you invoke the Neutrality Act or not - what I am going to say - I mean I don't think it will stop Japan from doing what she is doing now. I mean - let me give you my thought. I mean she's going to go right on just the same. Congress has placed the responsibility on the President of the United States - I mean to do certain things under the Neutrality Act; and I suppose Mr. Hull advises whether he should or shouldn't, and you're coming over to find out how it would affect us, and I appreciate the courtesy - don't misunderstand me.

Feis: That was the chief thing.

H.M.Jr: And these gentlemen are at your service for as long as you want.

Now, the seed that I'd like to plant with you is this, that if the President and Mr. Hull get to the place that they want to do something to stop this thing, then I've got a plan which I think is perfectly legal, and that is - haven't had a chance to talk about this, but I want to drop the seed - that if France and Great Britain and ourselves should agree that we wouldn't buy any more foreign exchange from Japan, or gold, and give no reasons and no explanation of any kind, but just don't do it - just don't do it; and if they ask me, "I don't know, I just don't know; I haven't - I just don't understand it - an - there must be some misunderstanding" - overnight those people can't buy their raw materials. It is effective at once. At once! And we can do it!

We've got the power, we've got the instruments, we've got the agreement, we can do it. And nothing in writing, nobody can make you talk, nobody can do anything. What the hell is Japan going to do?

Now, if you people get to the point that you want to stop this god-damn thing, I believe - and if the President and Mr. Hull want me to do it - that in one week I can have it for them. And Mr. Oliphant can tell me whether I can get away with it.

Oliphant: No question about the legality.

Taylor: You can do that at any time.

H.M.Jr: I just don't explain. And this thing is effective at once. It's just like the study I made on oil for Italy for the President. If they had held that oil sanctions meeting in Geneva, they could have stopped Italy. She didn't have the oil. The others didn't have the guts to do it. Here we stand while they cut off our noses, as if we've got to do it. And we suffer by it. Why not retaliate and simply freeze this thing and say to these people, "Gentlemen, we're very sorry, we haven't got the foreign exchange to give you."

Japan on January 11 of this year, without saying anything, put in a notice that they wouldn't give anybody foreign exchange, and how long did it last? On January 11 they wrote - we got the cables; they put it on January 11 of this year, and for I don't know how many weeks nobody could get a dollar's exchange from Japan. We didn't say it was an act of war. Nobody could get it. We sent cables over - "When do you think you're going to pay our merchants?" "After a while." It ran through till April. We didn't say it was an act of war. Could our merchants get paid? They could not! They put in exchange control and they're "sorry, gentlemen, but - sss - we haven't got the exchange." And I think it ran from January 11 to somewhere in April. You couldn't get - remember? - seven thousand was the limit, wasn't it?

Feis: I've forgotten.

H.M.Jr: Did anybody say anything? Not a word.

Oliphant: No, nobody suggested that was an unfriendly act.

H.M.Jr: Not a word.

Feis: I don't know which of two ideas you have in mind, one that would involve the refusal to make available in return for a yen or gold - an - dollars, pounds, francs - is that the idea, or is it the other one, the shutting off payment for the purchase of Japanese goods, which is, I think...

H.M.Jr: No, we just don't - when they want to buy dollars and pay us with yen, the dollars just aren't available.

Feis: Well, that - I was trying to find out which of those two ideas....

H.M.Jr: We just don't make the dollars available. Just the way - we just do what they did - I think it was January 11 or - either January 7 or January 11 the yen weren't available.

Oliphant: Couldn't get yen at any price.

H.M.Jr: Couldn't get them at any price. We simply say, "Gentlemen, the dollars aren't available."

Feis: During that period they weren't looking for yen; they were looking for dollars and pounds.

H.M.Jr: It's the idea of furnishing them with the wherewithal to buy supplies; that's the idea. Now, whether you do it the one way or the other, it's the idea of giving them the necessary foreign exchange with which to buy materials. You can't do it alone, but under the tripartite agreement we could do it, work the thing out and have it ready in a week.

Feis: Well, that, as you say, goes much farther than....

H.M.Jr: Well, I know, but I don't want to get into a long lengthy discussion on this very fine point, see; but as I say, these gentlemen are available for just as

long as you want to discuss it. But I do want to plant that seed with you.

Feis: Would I be safe in reporting that as far as the Treasury considers at the present minute, the application of the Neutrality Act would not embarrass its arrangements with the Chinese Government?

Oliphant: That's true; that is because they have this gold on earmark. I don't think we could formally advance credit under that arrangement without raising that question of international law.

H.M.Jr: If they wanted to borrow.

Taylor: But if they want to sell us that gold or want to export it....

H.M.Jr: ....we've got to do it.

Feis: That's the first main question.

H.M.Jr: We have to do it, because as I understand - and I've studied this thing - even if we were at war with China and her gold was earmarked here, we'd recognize it.

Oliphant: We ought to recognize it.

Viner: We ought to.

H.M.Jr: As between governments.

Viner: But the other question, as to whether we could go ahead and advance credit against that gold, is more delicate.

Feis: It is not a matter of law, though; it is a matter of policy.

H.M.Jr: It's purely a matter of Treasury ruling. I mean the only thing we have to decide is, against the 50 or 60 million dollars they've got with us, would we want to lend them money against that? Now, if we say "No," then all they've got to do is sell it. And incidentally, they haven't used a dollar of it.

That's the only thing.

Feis: As to the second question, Two, if they wanted to move rather promptly - none of the obligations that would fall on the Treasury, whether a loan or with other departments - something to be worked out under Section Three - you wouldn't need much time. That's the control of credit by private concerns.

H.M.Jr: Who has.....

Oliphant: Well, that's up to the Attorney General.

Feis: Well, that's something....

H.M.Jr: Who has that machinery?

Feis: There was a small committee at work just before I went away that now has a preliminary report. Wayne, you were on that.

H.M.Jr: Well, who runs that machinery?

Feis: Well, everyone on the committee - the committee's report has not been put in - everyone on the committee was unanimous in the idea that the main part of the task would have to be carried by the Attorney General. But it might be advisable - might or might not be advisable to establish some system of reporting, both for that purpose and also as a very useful government record as to what was going on.

H.M.Jr: Well, if you put this thing into effect tonight, as far as the United States Treasury is concerned, it doesn't embarrass us the slightest; we're ready, and we can comply tonight.

Viner: I think I'd bear in mind there that we might want to use some of the exchange control machinery to operate the neutrality restrictions.

Oliphant: You mean that the Attorney General might.

Viner: Yes, might want to use our machinery.

H.M.Jr: Well, I haven't studied it. I mean when we had exchange control, they set it up.

Viner: The power is still there, you see, and the reporting requirement....

H.M.Jr: I should think you'd want to do it through the Treasury; I don't know.

...

Taylor: From the conversations we had over there, the preliminary conversations, why, it didn't seem to me that - and to most of the other people - that it would be particularly useful to invoke that.

Unfolded

283

FEDERAL RESERVE BANK
OF NEW YORK

OFFICE CORRESPONDENCE

DATE September 7, 1937.

CONFIDENTIAL FILES

SUBJECT TELEPHONE CONVERSATION WITH BANK OF ENGLAND.

L. W. Knoke

Mr. Bolton called at 10:30 today. They had had a heavy day in London, he said, with the franc under very heavy pressure since opening. Cariguel must have lost a great deal of foreign exchange. Sterling had likewise been under attack and so far he had sold $8,000,000 at about 4.95 1/2 with two-thirds of the day gone. What prompted today's weakness of the foreign exchange market were primarily two factors: Firstly, the belief that the Japanese reply to the British was an excuse rather than an apology and secondly, the dog fight going on between Russia and Italy in which France might conceivably become involved because of her pact with Russia. But over and above it all, as far as France was concerned, it was quite evident from many sources that there was a very pessimistic feeling in existence about her whole position, not only because of the fear of a possible war but because of the internal French situation. This pessimistic feeling had existed for some time, even since Bonnet had tried to clean up. The rich Frenchman had not and was not now bringing his money back to France. The underlying weakness in the French position was by now so well known that whenever there was some aggravation of international politics a movement away from the franc, speculative in origin, was promptly started. On the other hand, even when conditions internationally had, from time to time, seemed to have improved in recent months, there had been no indication of repatriation of French funds.

The Russians had become quite heavy sellers of gold again.

FEDERAL RESERVE BANK
OF NEW YORK

OFFICE CORRESPONDENCE

DATE September 7, 1937.

TO CONFIDENTIAL FILES

SUBJECT: TELEPHONE CONVERSATION WITH BANK OF ENGLAND

FROM L. W. Knoke

For the last eight days or so they had sold in London at the rate of £2,500,000 a week; this amount was now being stepped up to about £4,000,000. In explanation of these sales, they had, in their usual evasive way, simply stated they needed the foreign exchange.

LWK:KMC

PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Paris

DATE: September 7, 4 p.m.

NO.: 1255

FROM COCHRAN.

As a result of international political developments the Paris exchange market is nervous. Supporting the franc at 132.96 to 94, considerable sterling was yielded by the French control. It is said that the British control sold $6,000,000 this morning and that Lazard was an important buyer. On the market belief that Van Zeeland, in the special parliamentary session opening today to hear his case, will be given a vote of confidence by a good majority, the belga was firmer. The market is convinced, however, that Van Zeeland's prestige has suffered and that it is inevitable that he will resign before long.

Rentes were lower today and the forward franc was more offered over the weekend. An unofficial estimate has been made that since its creation and until today the French fund for supporting rentes has spent 700,000,000 francs.

The uneasiness today over the French monetary and financial outlook is increased by the following domestic factors, in addition to the international situation:

The

The general increase in the cost of living and particularly the rise in prices over the weekend of milk and bread, the prospect of conflicts between Socialists and Radical Socialists as the time for local elections draws near, a slight unemployment gain, deficiency in the production of French coal and a price increase for imported and domestic coal, the threat that labor troubles will break out again, the high cost of the last Treasury loan, and the weakness of the Treasury position as shown by borrowing from the Bank of France.

I had a call today from Pennachio of the Bank of Italy. Pennachio has just returned from a holiday in Italy. He told me that there was such a heavy foreign tourist trade there that hotel accommodations were inadequate and that there would be a rise in prices. Pennachio said he was informed that because of the French labor situation, Italian automotive manufacturers who have branch factories in France are considering closing their plants.

BULLITT

EA:EB

PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Paris

DATE: September 8, 5 p.m.

NO.: 1259

FROM COCHRAN

The French control is still yielding sterling at 132.97. Rentes down further and forward franc more offered due to Hitler's renewed demand for colonies and to causes mentioned in yesterday's cablegram. On the Paris market as on other important markets, shares are declining. The pathetic impression caused by Van Zeeland's appearance before Parliament has weakened belga. Today's press denied recurrent rumors that Schacht may retire from the Ministry of Economics and possibly from the Reichsbank. Late this afternoon I received a phone call from Beyen at Basel that General Manager Quesnay had drowned; the details are lacking.

I received a call this morning from Doctor Oscar Busch bearing a personal letter of introduction from President Bachmann of the Swiss National Bank. Doctor Busch orally presented his plan for an international gold pool in which the United States would be expected to lead. He said he was going on to Brussels and showed me a similar letter of introduction to Van Zeeland.

BULLITT

EA:DJW

September 7, 1937.
8:40 a.m.

O: Go ahead.

H.M.Jr: Hello

Jim Farley: Hello

H.M.Jr: How are you?

F: Pretty well, I thank you. How are you?

H.M.Jr: Oh I'm very well.

F: Good. Hey, Henry, why don't you sign that damn list so we can get it out of the newspapers tomorrow morning.

H.M.Jr: Well I'll tell you why - because I don't - I suppose you know it that - that the financial community is more jittery than they've been in years and to come out the morning before our financing that we're going to spend 23 million dollars I think is just silly.

F: Why you're crazy.

H.M.Jr: Well I think you are.

F: Why?

H.M.Jr: Well why should we come out with a big expenditure program the day before our - our financing. Give me a good reason to do it.

F: Well my God - everybody - every district in the United States - it's a Labor Day - it's a good thing from Labor's point of view.

H.M.Jr: Well listen.....

F: Twenty - Henry, twenty-six million dollars isn't a drop in the bucket.

H.M.Jr: If - listen, you try to do the financing. You talk to the people there - they say they won't buy anything. Have you talked to anybody down.....

F: Well that isn't my business; I never talk with them.

H.M.Jr: Well it's my business and the President goes away and he says, "Henry, you do it". He says, "It's easy" and the people come down - they go down there and they say they won't buy anything.

F: Well, of course, I think it's all silly not to do it; I don't give a damn personally but I think it's silly not to do it right away.

H.M.Jr: Well that's the only reason - I think to have a story like that breaking the day before our financing is - is - just - you - ah - Jim - ah - if you'll - I think I'm a fairly truthful person; I don't exaggerate; I don't know any time in years that the financial community is so shell-shocked as they are right now.

F: Well why is that?

H.M.Jr: What?

F: Why is that?

H.M.Jr: Oh you know, they're always either in the cellar or on top of the roof and they're simply scared too death and I've got 817 million dollars coming due and it seems to me, if you don't mind my saying, that this is a very unimportant thing and I think our financing is very important.

F: Well when would you release this?

H.M.Jr: What?

F: When would you release this?

H.M.Jr: Just as soon as our financing is passed.

F: Well all right I don't give a damn then but I think - I may be all wrong from my point of view; I don't think it need - I think from the communities they've been waiting for this; it's usually done right after the Congress adjourns.....

H.M.Jr: Well if they'd have done it the way we used to do it - ah - when I was here we did it the day after Congress adjourned.

F: Well I know but we had to wait until the President signed the bills.....

H.M.Jr: Well.....

F: .....and then we were ready to do it - unfortunately you weren't here and there wasn't anybody else over there to do it. You were the one to take the responsibility.

H.M.Jr: Well - ah - when I was here we all - we were ready; your people were ready; we did it the day after Congress - always - the Monday after.

F: Yes, well we waited; we were ready as soon as he had signed the Appropriation Bill.

H.M.Jr: Right.

F: The damn thing should have gone out last week, to be truthful about it.

H.M.Jr: Well I agree with you but now because they didn't, I think to have it just the day before my financing, with everybody so terrifically nervous, I think it's an unnecessary risk.

F: Well all right, I don't - let it go then I don't care.

H.M.Jr: Now that's - that's the facts and if - if - if - once we should not put over our government financing - ah - it would hurt everybody. They're terribly, terribly frightened up there.

F: Well let it go - I don't care - it's all right with me.

H.M.Jr: All right, Jim.

F: O.K.

H.M.Jr: Thank you.

292

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE September 8, 1937

TO Secretary Morgenthau

FROM Mr. Magill

I believe you will be interested in the attached brief summary of the principal changes effected by the Revenue Act of 1937, approved by the President on August 26, 1937.

RM

I. Domestic Personal Holding Companies.

The problem of domestic personal holding companies has been met by the new law, principally, by an increase in the rate of surtax. Under the old law the rates ranged from 8 to 48 percent on the undistributed income of these companies, while under the new law the rates have been increased to 65 percent on the first $2,000 of undistributed income and 75 percent on the balance. The rates of surtax are now so high that together with the normal tax on corporations, they will equal the highest surtax rates applicable to individuals. This being so, the utility of domestic personal holding companies as incorporated pocket-books is almost completely done away with. The other substantial changes that have been made in the treatment of domestic personal holding companies are (1) the denial of the former unlimited deduction for charitable contributions which is now restricted to 15 percent of net income and (2) the denial of the deduction allowed under the prior law of 20 percent of the income of these companies as a reserve and (3) the denial of the deduction formerly allowed for capital losses. Also under the old law in defining personal holding company investment income, rents were excluded, and that being so, closely held companies that were really personal holding companies might escape surtax by investing a sufficient amount in rents. Under the new law rents are included in the definition unless these rents constitute more than 50 percent of the gross income of the company. This exception was put in to prevent the taxation of bona fide real estate operating companies as personal holding companies.

II. Incorporated Yachts, Country Estates, Etc.

In order to prevent personal holding companies that own incorporated yachts and country estates from getting the benefit of operating losses which are really personal expenses, the present law provides that the expenses of operation and maintenance of such properties, to the extent that they exceed the rent received from such properties, shall be disallowed, unless it is shown to the satisfaction of the Commissioner that the property was actually held in the course of a business carried on bona fide for profit.

III. Incorporated Talents.

To take care of such cases as the Laughton case, the new law provides that if an individual owns directly or indirectly more than 25 percent of the stock of a personal holding corporation and the corporation derives a profit from hiring out his services, then such a profit shall be considered personal holding company investment income. The result of this provision is that an individual such as Laughton would in effect be taxed at least as much and in most cases considerably more by having his salary or his compensation paid to his personal holding company than if he had his salary paid to himself directly.

IV. Artificial Deductions for Losses from Sales or Exchanges of Property.

Under the old law losses are denied in cases of sales of property between members of a family or between a shareholder and a corporation which he controls. The new law, in order to prevent other artificial deductions for loss on sales of property, also denies losses between two corporations controlled by the same person; between a corporation and an individual who together with his partner owns more than 50 percent of the corporation; between an individual and a trust which he created; between two trusts created by the same individual and between a trust and a beneficiary.

V. Artificial Deductions for Interest and Business Expense.

Under the old law some individuals attempted to take advantage of the difference in operation between the cash receipts method of reporting income and the accrual method of reporting income to obtain artificial deductions for interest and business expense. For example, a debtor who is on an accrual basis would get a deduction for accrued interest which was not actually paid while the creditor who was on a cash basis did not, of course, report as income the accrued interest which was owed to him. The new law meets the situation by denying the deduction for accrued interest or business expense where such interest or expense is owed to a person not dealing at arm's length with the debtor, unless the debtor pays this amount within two and one-half months after the end of the taxable year.

VI. Multiple Trusts.

The new law has partially taken care of the problem of multiple trusts by denying the previously allowed $1,000 exemption to all trusts to accumulate income.

VII. Foreign Personal Holding Companies.

The new law radically changes the treatment of foreign personal holding companies. The scheme of taxation is in general to treat the income of the foreign personal holding company as the income of its stockholders and to tax the stockholders upon their proportionate shares of such income whether or not such income is actually distributed. Provisions have been included so that the general scheme can be carried out even where there is a chain of foreign personal holding companies. In order adequately to enforce the new provision with respect to foreign personal companies the new law provides for the filing of information returns by officers, directors and stockholders and also for returns by persons who have advised or counselled in the formation of foreign personal holding companies.

VIII. Non-resident Aliens.

Under the old law non-resident alien individuals not having an office or place of business in the United States were taxed at the flat rate of 10 percent which was withheld at the source. In order to equalize taxation between domestic tax payers and non-resident aliens having large incomes in the United States, the new law provides that non-resident alien individuals having net incomes in excess of $21,600 from sources within the United States shall file a return and pay the tax on such income that would have been paid by citizens or residents. The $21,600 figure was selected because incomes of $21,600 are at the present time taxed to citizens or residents at about 10 percent.

Rm

TREASURY DEPARTMENT

Washington

FOR RELEASE, MORNING NEWSPAPERS,
Wednesday, September 8, 1937.
9/7/37.

Press Service
No. 11-11

Secretary of the Treasury Morgenthau announced last night that the subscription books for the current offering of 1-1/4 percent Treasury Notes of Series E-1938 and of 2 percent Treasury Notes of Series B-1942 will close at the close of business Thursday, September 9, 1937. This offering is open only to the holders of Treasury Notes of Series A-1937, maturing September 15, 1937.

Subscriptions placed in the mail before 12 o'clock midnight, Thursday, September 9, will be considered as having been entered before the close of the subscription books.

Announcement of the amount of subscriptions and their division among the several Federal Reserve districts will be made later.

-oOo-

Ronald Ransom: Yes Mr. Secretary.

H.M.Jr: Hello Ransom - how are you?

R: I'm fine, thank you.

H.M.Jr: Ransom, in order that I can get myself ready, how far are you people along?

R: I was going to call you this morning and tell you that we were having a meeting of the Board yesterday but we couldn't have it until 5 o'clock because several of them were still out on their Labor Day week-end.

H.M.Jr: I see.

R: I also talked to Marriner twice yesterday.....

H.M.Jr: Yes.

R: .....and again last evening after I got home.

H.M.Jr: Yes.

R: His present plan is to leave Utah by plane tomorrow and be here Thursday.

H.M.Jr: Yes.

R: Both he and I think that the situation justifies a thorough exploration of the whole problem by not only the Board but quite possibly by the federal open market committee if we have your approval of discussing the matter with them because they have a relation to it, as you know, that might have an important bearing on what we do. Now our plan was to have these conferences over this week and Marriner asked me last night to ask you if he and I could have an appointment with you on Friday morning, the idea being that the Executive Committee of the Open Market Committee would meet on Friday afternoon and the whole committee would meet on Saturday and the Board would have an opportunity to survey the situation on Thursday. All of that is not wholly the result of your conversation and

mine but the fact that both Marriner and I think that this stock market situation and its possible reactions on the bond market ought to be considered by the Board and we should try to decide on policies which have some relationship to the situation as it has developed over the last week or ten days.....

H.M.Jr: Yes.

R: ....and, that being the case, all I can say is that - ah - we can't give you anything on it today that - I'd rather be perfectly candid with you - his thoughts and mine are not altogether the thoughts of the Board at the present moment.

H.M.Jr: Well I'll tell you.....

R: There isn't any conflict there isn't a crystallization of thought as yet.

H.M.Jr: Well let me put it this way.

R: Yes.

H.M.Jr: You're coming over for lunch, aren't you?

R: Yes and I think I'm coming along because I don't believe Mr. Broderick's going to be available as I hoped yesterday he would be.

H.M.Jr: Well now will you be perfectly frank - do you want to see me alone or do you.....

R: I would prefer to.

H.M.Jr: You would.

R: Yes.

H.M.Jr: All right, then I'll see you - then supposing we talk it all over.....

R: All right.

H.M.Jr: .....because - ah - the plans that you have mapped out don't quite suit mine because I have an appointment with the President Saturday afternoon.

R: Oh I see. Well then we could - ah - don't you think it might be wise then for Marriner and me to see you Thursday afternoon.

H.M.Jr: Yes, very much so.

R: All right.

H.M.Jr: Yes.

R: I - I think and he thinks too that it's a situation requiring action and then it becomes a question as to what action - which line of action is the most advisable in the public interest.

H.M.Jr: All right, well supposing you and I have lunch alone today.

R: Today and then we - I will tell him that you and I - that he and I can see you Thursday afternoon.

H.M.Jr: Right.

R: Then we could have a meeting of the Executive Committee of the Open Market Committee on Friday morning. I think I'll call that anyway because I think we're going to have a little problem with this bond market.

H.M.Jr: Ah-ha.

R: Marriner and I do not want this new issue to fall through their present prices.....

H.M.Jr: No.

R: ....and we - ah - it's hard as hell, to be frank with you, to get quick action in a situation of that sort.

H.M.Jr: I see.

R: That's when I almost lose the little religion I've got because people seem to want to act after the event rather than ahead of it and I always like to take these things in advance.

H.M.Jr: Well, perfectly frankly, I don't know whether I want to wait beyond Monday.

R: No I don't think so. Neither do Marriner nor I.

H.M.Jr: Yes, and I - I mean - well I'll talk to you about it at lunch but I don't think I can sit around here for a couple of weeks while.....

R: No I don't either, Mr. Secretary, and I'll say this - if we haven't got a better answer or an answer that you think is a better answer you won't have any trouble selling Marriner the idea that action is necessary because we both think it is.

H.M.Jr: Well -

R: And we think Monday - Marriner and I both feel that Monday is the deadline.

H.M.Jr: Thank you very much - I'll see you at 1 o'clock. All right.

R: All right, fine.

Fin

September 8, 1937.
9:21 a.m.

H.M.Jr: Hello

O: Dr. Burgess.

Burgess: Good morning.

H.M.Jr: Good morning.

B: Well there hasn't been any great change from last night; the prices are about the same and the rates are quoted 57.

H.M.Jr: Ah-ha.

B: Ah - market's steady; no great amount of offering.

H.M.Jr: Ah-ha - well - no news is good news.

B: That's right, yes.

H.M.Jr: Yes. If you buy any or do anything will you let me know?

B: All right.

H.M.Jr: You're going to keep your order in?

B: Yes - yes, we're all ready to act.

H.M.Jr: All right, I don't think - I think as far as the Press was - I - I don't - I think it was all right.

B: I think so, yes.

H.M.Jr: Yes.

B: And I think people will make up their minds to-day and we'll get a good majority of turn-ins.

H.M.Jr: Yes. All right, we'll watch it.

B: Very good.

H.M.Jr: Thank you.

GROUP MEETING

September 8, 1937
9:30 a.m.

Present: Mr. Magill
Mr. Gaston
Mr. Bell
Mr. McReynolds
Mr. Oliphant
Dr. Viner
Mr. Riefler
Mr. Taylor
Mr. Lochhead
Mr. Upham

H.M.Jr: Well, who's got anything that they want to clear with me before I start?

Magill: Well, I have a letter....

McR: I forgot to tell you your Assistant Secretary Roche left the day before you arrived because the president of her concern out in Denver died. She asked me to apologize for her.

H.M.Jr: Little late message, but I accept it.

McR: It wasn't her fault.

H.M.Jr: No, I wasn't criticizing her.

Gaston: Would you like to see that Post Office list before we release it? I was planning to let it go Friday morning.

H.M.Jr: O.K., I don't want to see it.

Gaston: Your signature - you have to sign the original.

H.M.Jr: Let it go for a while.

Magill: Here's a letter from Secretary Wallace to you, enclosing a letter which he wants you to sign with him, addressed to the President, suggesting that the Federal Trade Commission ought to make a study of this price maintenance legislation which is tacked onto the District of Columbia tax bill. It doesn't quite seem to be in my

bailiwick. I don't know whose it is.

H.M.Jr: It's Oliphant's pet.

Bell: Little late - should have been studied before the tax bill.

H.M.Jr: That's Oliphant's, a pet of Oliphant's. Am I right?

Oliphant: I've got a man working on it.

H.M.Jr: Anything else?

Magill: Here's the memorandum you wanted on the tax bill. (Hands to Secretary) Ought to have a covering letter on it, but.....

H.M.Jr: That's all right.

Magill: Does anybody else around here wish a memo of the principal provisions of the new tax bill?

H.M.Jr: In high school English.

Bell: Yes, I'd like to have a copy.

Viner: Mimeograph it.

Magill: That's all.

H.M.Jr: Herman, I haven't forgotten you.

Oliphant: Nothing except that.

H.M.Jr: Herbert?

Gaston: Nothing.

H.M.Jr: Well, who has something? Who wants anything?

Now, what I thought I'd do was this - to bring you men up-to-date, I called up Ransom and talked a couple times yesterday to Eccles, and Eccles is flying back - get here tomorrow morning. And he wants to have lunch

with me alone, and he - oh, they're all up in the air. But this isn't the time to fool around and he says that Eccles - well, I'll know more after I've had lunch. What I thought I'd do - I thought we could start in at 10:30 and try to at least clear our own minds. So I'd like to have Riefler and Taylor and Viner and Lochhead and Haas, White, Cy, at 10:30.

Haas: Seltzer? He's been working on it.

H.M.Jr: All right, Seltzer. And then - I don't know whether you have had a chance to have it clear in your mind - at 10:30 we can run through it. I have nothing else this morning. And at least let's try - I got a very good memorandum from Viner last night - to see where we're at.

But I'm not going to - I'm not going to spend a lot of time arguing with the Federal Reserve Board. I mean it always gets down to making up their mind. I mean they're going to call the Open Market Committee and the Board and there's going to be all this stuff. I think it's very simple.

Bell, you're invited if you want to. I just didn't want to tie you up. Won't get anywhere this morning anyway.

Bell: I'd like to sit in, but I think I better prepare for that conference tomorrow morning.

H.M.Jr: All right. Well, that's all. I think if you - the quicker you get together - as far as the bill business goes, that can all wait, but this thing - I think we ought to clear our own mind.

Viner: Put it down 1, 2, 3, 4 in order.

H.M.Jr: But he thinks something must be done.

Viner: Should be done.

Haas: Mr. Secretary, you asked me this morning to set a date on that study.

H.M.Jr: What study?

Haas: On the Building and Loan.

H.M.Jr: Yes.

Haas: I went over it with the boys and the staff, and November 1 is a date we can have it done, and probably a little before, if it need be done earlier. It is quite a sizable job and the boys have been working on it. Murphy and Lindau are burnt out and I had to send them away for ten days. I mean that's one thing that delayed me.

H.M.Jr: What's Lindau been working on?

Haas: He's been working on - oh, he did quite a little work during the summer on this capital gains taxation.

H.M.Jr: Lindau?

Haas: Uh-huh. He worked with Shere on that.

H.M.Jr: Well, what do you think, Wayne? November 1 seems a hell of a way off.

Taylor: I talked to George and the boys yesterday and I don't think they can get it done much before that.

H.M.Jr: All right, November 1.

Taylor: It's....

H.M.Jr: All right, November 1.

Taylor: By the way, did you talk to Mac about Lucius Wilmerding?

Haas: Yes, he's away.

McR: He's away, but he'll be available as soon as he gets back.

H.M.Jr: The other thing of general interest - yesterday I transferred Harold Graves from the work he's been doing to take charge of the administrative reorganization of Internal Revenue.

Gaston: Someone taking over his..... ?

H.M.Jr: Yes, Irey will - no one else. Very informal, very loose. And Irey will do what Harold Graves was doing as the coordinator of the various units. It gives him - he's the best man available that we have to do the work. Mac says he thought about it before, so then I knew it was good. So that made it unanimous.

I have nothing else. See you all at 10:30.

Informal memorandum briefly outlining the principal provisions of the Revenue Act of 1937.

NOT FOR GENERAL CIRCULATION

I. Domestic Personal Holding Companies.

The problem of domestic personal holding companies has been met by the new law, principally, by an increase in the rate of surtax. Under the old law the rates ranged from 8 to 48 per cent on the undistributed income of these companies, while under the new law the rates have been increased to 65 per cent on the first $2,000 of undistributed income and 75 per cent on the balance. The rates of surtax are now so high that together with the normal tax on corporations, they will equal the highest surtax rates applicable to individuals. This being so, the utility of domestic personal holding companies as incorporated pocket-books is almost completely done away with. The other substantial changes that have been made in the treatment of domestic personal holding companies are (1) the denial of the former unlimited deduction for charitable contributions which is now restricted to 15 per cent of net income and (2) the denial of the deduction allowed under the prior law of 20 per cent of the income of these companies as a reserve and (3) the denial of the deduction formerly allowed for capital losses. Also under the old law in defining personal holding company investment income, rents were excluded, and that being so, closely held companies that were really personal holding companies might escape surtax by investing a sufficient amount in rents. Under the new law rents are included in the definition unless these rents constitute more than 50 per cent of the gross income of the company. This exception was put in to prevent the taxation of bona fide real estate operating companies as personal holding companies.

II. Incorporated Yachts, Country Estates, Etc.

In order to prevent personal holding companies that own incorporated yachts and country estates from getting the benefit of operating losses which are really personal expenses, the present law provides that the expenses of operation and maintenance of such properties, to the extent that they exceed the rent received from such properties, shall be disallowed, unless it is shown to the satisfaction of the Commissioner that the property was actually held in the course of a business carried on bona fide for profit.

III. Incorporated Talents.

To take care of such cases as the Laughton case, the new law provides that if an individual owns directly or indirectly more than 25 per cent of the stock of a personal holding corporation and the corporation derives a profit from hiring out his services, then such a profit shall be considered personal holding company investment income. The result of this provision is that an individual such as Laughton would in effect be taxed at least as much and in most cases considerably more by having his salary or his compensation paid to his personal holding company than if he had his salary paid to himself directly.

IV. Artificial Deductions for Losses from Sales or Exchanges of Property.

Under the old law losses are denied in cases of sales of property between members of a family or between a shareholder and a corporation which he controls. The new law, in order to prevent other artificial deductions for loss on sales of property, also denies losses between two corporations controlled by the same person; between a corporation and an individual who together with his partner owns more than 50 per cent of the corporation; between an individual and a trust which he created; between two trusts created by the same individual and between a trust and a beneficiary.

V. Artificial Deductions for Interest and Business Expense.

Under the old law some individuals attempted to take advantage of the difference in operation between the cash receipts method of reporting income and the accrual method of reporting income to obtain artificial deductions for interest and business expense. For example, a debtor who is on an accrual basis would get a deduction for accrued interest which was not actually paid while the creditor who was on a cash basis did not, of course, report as income the accrued interest which was owed to him. The new law meets the situation by denying the deduction for accrued interest or business expense where such interest or expense is owed to a person not dealing at arm's length with the debtor, unless the debtor pays this amount within two and one-half months after the end of the taxable year.

VI. Multiple Trusts.

The new law has partially taken care of the problem of multiple trusts by denying the previously allowed $1,000 exemption to all trusts to accumulate income.

VII. Foreign Personal Holding Companies.

The new law radically changes the treatment of foreign personal holding companies. The scheme of taxation is in general to treat the income of the foreign personal holding company as the income of its stockholders and to tax the stockholders upon their proportionate shares of such income whether or not such income is actually distributed. Provisions have been included so that the general scheme can be carried out even where there is a chain of foreign personal holding companies. In order adequately to enforce the new provision with respect to foreign personal holding companies the new law provides for the filing of information returns by officers, directors and stockholders and also for returns by persons who have advised or counselled in the formation of foreign personal holding companies.

VIII. Non-resident Aliens.

Under the old law non-resident alien individuals not having an office or place of business in the United States were taxed at the flat rate of 10 per cent which was withheld at the source. In order to equalize taxation between domestic taxpayers and non-resident aliens having large incomes in the United States, the new law provides that non-resident alien individuals having net incomes in excess of $21,600 from sources within the United States shall file a return and pay the tax on such income that would have been paid by citizens or residents. The $21,600 figure was selected because incomes of $21,600 are at the present time taxed to citizens or residents at about 10 per cent.

ooOoo

RE TIGHT MONEY MARKET

September 8, 1937
10:30 a.m.

Present: Mr. Taylor
Mr. Lochhead
Mr. Haas
Mr. Riefler
Mr. Upham
Dr. Viner
Mr. Seltzer
Mr. White

(Haas hands memorandum to Secretary)

Haas: The message starts on page 3. First two and a half pages there....

H.M.Jr: Alternative message?

Haas: That's right.

(Secretary reads memorandum)

H.M.Jr: Well, let me ask this. If my memory serves me right, the Federal Reserve people, when they were over here, said that by Christmas they thought the excess reserves would be down to around 200 or 300 million dollars. Is that right?

Haas: I think that.....

H.M.Jr: Well, anyway - I've got a pretty good memory - I think that is what they said.

Haas: I think they told you that in a memorandum.

H.M.Jr: Of course, this desire to do this thing, as far as I'm concerned - I want to make it perfectly plain - has had nothing to do with the stock market, whenever we talked about this thing. The drop in the stock market had to take place; it doesn't influence me a bit. I mean it's a thin market; if something good happens, it would just as well go back in a couple days. But that is not one of the motivating things.

Riefler: It is divorced from this.

H.M.Jr: Yes. But I think I don't - I got a memorandum from Viner; have you had time to think about this?

Riefler: I've been trying to think hard the last two hours.

H.M.Jr: Well, why don't we do this? Why don't you state the case as you see it, Jake? Do you want this memorandum to read from?

Viner: No, I don't need it.

H.M.Jr: All right. Why won't that clear the atmosphere?

Viner: First, I think it would be desirable - don't think the necessity is extremely urgent - desirable to build up the excess reserves to a larger amount than they now are, or are going to be prospectively in the absence of such action. And in the way of light upon the manner in which banks seem to be acting with respect to their reserve position, I am inclined to believe that until their actions get back to a pre-1929 basis, and as long as we still think there is still need for expansion, that one billion dollars is to be regarded as not excess of excess reserves - something in that neighborhood; perhaps 700 million; the figure doesn't matter - and that they ought to be built up now - desirable to build them up now so they are somewhere in that neighborhood.

Then, leaving that and assuming for the moment that we are in agreement on that, the question is how ought they to be built up. Now, after all, that is primarily the choice of methods and is the Federal Reserve responsibility, and I would prefer, in general, assuming that there was a wide range of alternative methods, a method which wouldn't involve the Treasury in the responsibility of daily watching something new and making up its mind and coming daily to decisions. In other words, it is a Federal Reserve operation, and I would prefer, other things being equal, that the instrument you used should be one that they control, so that they should manipulate it from day to day, week to week.

From that I come to the conclusion that we oughtn't to touch our sterilization operations, we ought to

continue them just as they were before. When we went into them, part of the logic was that we prevent by our sterilizing operations an arbitrary interference with the volume of credit in this country and that we create a level platform for the Federal Reserve to operate on, ... and that the day-to-day decisions or the periodic decisions would be made by them as to the amount of credit in the country, and not by us; that something we happen to have control over was interfering with the normal course of their operations and we were neutralizing that interference.

So that would be my argument against abandoning the sterilization. I think it was a desirable move at the time, that it continues to be, under existing circumstances, a desirable move, that we oughtn't to reverse it, oughtn't to abandon it, ought to go on just as we have been doing with respect to sterilization.

Then that means that if the excess reserves are to be built up, some other method is to be used. I think there would be no argument here that you can't do anything with rediscount rates. I mean what could be done has been done, and the effect is merely nominal. So that leaves open market operations and reserve requirements. Now, my feeling as between those two is not very strong, but I have felt all along, perhaps mistakenly, that the reserve requirements should be regarded as a flexible instrument, that there should be a willingness to lower them and raise them on very short notice and in small amounts, and that the choice between them and open market operations should be made in the light of the circumstances at the moment - sometimes both, perhaps, might be used simultaneously - and that they have advantages - I mean the reserve rate changes have advantages over open market operations; that they affect almost immediately and directly the whole banking system and not merely the money market; and that there are times when you want to affect the money market, where that is where you want to contract or want to expand particularly, and at such times the open market operations have their first impact and their main impact for some time in the big money markets.

Now, at the present time it is true that New York shows the signs of being tight, but I think the country banks which have the excess reserves now are just as tight in their own feeling as the New York banks are, because they now want excess reserves and they don't think they have more than they need. And I include by country banks sizable banks in large cities. So that I would say that the New York banks are probably now getting back to the pre-1929 psychology, when they don't need themselves large excess reserves, where their routine banking policy is to use up all their funds nearly to the limit; but I don't think the country banks - including by that, remember, big banks in big towns - have gotten to anywhere that psychology yet. So that I am not sure at all that the picture of the distribution of excess reserves is an accurate picture of the state of banking psychology.

In other words, I feel, from just a little conversation with a few people, that banks that have what are excess reserves in the total don't feel as if they have excess reserves; they feel as if they have no more cash than they need for safe operation. So that that would be my argument for an operation that spreads itself over the country and is not merely concentrated in big money markets.

Seltzer: 250 million be enough then; that is, if you propose raising it to a billion.

Viner: As to the amount, there I'd much prefer to have the judgment of the Federal Reserve people; they must have been watching it. I think they realize now that when they raised the excess reserve requirements they had not given sufficient attention, if any, to the possibility that banks might have a different attitude toward reserves from what they had in '28 and '29. But they must have been giving thought to that, and that is a technical, expert judgment that well-informed people ought to make, and I don't pretend to have that.

Remember this, too, that when you say 200 million or 250 million will be enough if - you see, the Secretary told me that Federal Reserve had reported to him that they expected the reserves to be down to 250 or 300

millions by Christmas, and therefore I am thinking in terms of a 500 or 700 million operation.

Seltzer: That is, seasonally they expect them to go down to 200 million. What would you do, reverse the procedure after that?

Viner: I'd reverse the procedure without hesitation. I understand that there are people who think that the reserve rate change ought not to be used that way.

Seltzer: I am one of them.

Viner: I, on the contrary, think it is a very desirable and very logical instrument - like to see even small changes made in it, move it by one percent or two percent. I'd like to see experimentations with it. I think it's been clumsily used so far, and used with too abrupt changes as to amount and too slow changes as to time. In other words, the amount was - time was too long and the amount too large of change. And I'd like to see it develop into a flexible instrument.

Seltzer: You want to take away all the fixed rules of banking. The bankers like fixed rules. The banker likes to know the rules of the game he is playing. If you're going to say to him, "Your reserves this week are so much; I don't know what they're going to be next week," I don't think that's very healthy.

Viner: Why not?

Seltzer: The banker has a pretty hard time now as it is. Capital funds are way down in proportion to his deposits. He feels that some of his assets are so slow that he has to keep a lot of cash around, so he keeps excess reserves. Now, you tell him, "In addition we may double or further raise these reserves."

Viner: No, no, you can't raise them any further.

Seltzer: Well, you drop them and he'd say, "That drop isn't a real drop because in a couple months from now they're going to raise them again."

Viner: You're assuming he's going to conduct his operations on the basis of not being able to vary his volume of outstanding business.

Riefler: I'd like to see the banks reenter the Federal Reserve on the rediscounts.

H.M.Jr: We have all agreed over the weekend that you can't force that - I mean it's just a - it's one of those things that have to happen. I mean nobody can make them go to the Federal Reserve.

Riefler: There is no occasion for it yet. They're not going into the rediscounts until they have used up their excess reserves, and they haven't used them up yet, so there would be no occasion.

H.M.Jr: I don't know whether you men know, but over the weekend for the first time they sold some of their own paper - the banks did - to ease them over Labor Day.

Riefler: The acceptances?

H.M.Jr: Yes.

Riefler: Good.

H.M.Jr: For the first time they did that. That only cut them off a half of one percent. Why should they go in to discount at one percent? I'm no expert at banking, don't pretend to be; but at least I know when a fellow can borrow money at a half of one percent, he isn't going to discount at one percent.

Viner: And in general I'd include the sale of acceptances; it's been, unfortunately, too minor a factor. I'd like to see it....

H.M.Jr: Well, it just started now.

Lochhead: In addition to the acceptances, of course, they've got a great amount of short-term Government paper yielding less than one percent, and they're going to use that before they discount. They don't have to sell - just let their bills run off.

Riefler: The rate structure hasn't reached any such point yet as to give them any rediscounts.

H.M.Jr: Jake, let me put it this way. What we want to do now is to make a constructive move which will give confidence. That's what we're trying to do, isn't it, huh? I just question whether changing the reserve requirements at this time - whether they won't say to themselves, "My god, don't these fellows know their own business down there?" I mean I wonder if it would give confidence if we change the reserve requirements - I mean if that's the way to give them the most confidence.

Viner: Well, it depends - if you look on reserve requirements as a basic part and an enduring part of our credit structure, as a definite fixture, or you look on it as a thermostatic control. It's been months now - how long has it been? - since they - it was February; it would be more than half a year. And I'd like to see them regard a change, say, twice in a year in the reserve requirements - not by 50 percent change, you see, but a change of some proportions - as not by any means an abnormal phenomenon.

Riefler: But then, you're not - there is another point in that, Jake; there is another point on that. A bank doesn't like to operate knowing that its reserves are manipulated from Washington. If you buy open markets the individual bank officer may read about it in the paper that the Federal Reserve is buying Governments and that the funds released are finding their way - they are coming into his town as a result. But he says, "God damn it, the paper says that the Government is doing it, but as far as I can see my customers are building up their balances, I've got money to lend." It's a very different psychology than if he happens to have more money to lend through a direct intervention that he can see right before him. The one thing gives him confidence that he is gaining at the expense of his competitors, therefore can take a chance, therefore can go further. But the other just seems arbitrary - "Now I have so much reserves; tomorrow it may be half as much" - it's arbitrary, it makes him cautious, he doesn't like it.

Viner: Supposing that you had a billion dollar open market purchase spread - assuming that they could do it quickly, which they can't, but supposing they could and did it in New York - and here is a sizable bank,

let's say, in Springfield, Illinois. What would cause - when would the flow of funds resulting from it come to that bank?

Riefler: Sizable bank in Springfield - be amazing how quickly it would reach there.

Viner: What's that?

Riefler: Be amazing how quickly it would reach there. If it's a bank dependent on some one crop or something like that, no, it wouldn't, it would be very slow.

Viner: What would be the process? I'm just asking. Whose funds would come into that bank? You see, if you're assuming that it is investors that sell - say, the type of investor who sells and buys because of the small change in rate or in price, as the large institutional investor - they're not in Springfield or its banks, and I don't see customers' money coming in for a long time, and through very indirect channels, to that Springfield bank because of open market operations.

Riefler: But it always has. That's the - it's amazing how quickly that bank has excess reserves.

Viner: You mean the process has been traced back to open market operations?

Riefler: It's amazing, taking the whole group of reporting banks - awful rapid.

Viner: Yes, but that's grouped together; it's the First National of New York, the First National of Boston and of Chicago, that actually.....

Riefler: No, that would hold good if you took them individually.

Viner: Well, I don't know the facts there.

H.M.Jr: I think - I don't know, but I'd be very much surprised - I'll know after lunch and that's going to clear it - but I'm willing to bet three to one that the one thing that the Federal Reserve will not want to do is to change their reserve requirements.

Viner: Four to one.

White: Ten to one.

Seltzer: It is the most expensive thing from the Treasury standpoint.

Viner: I'd say that's an illegitimate consideration in this.

H.M.Jr: What I want to say is this. You haven't heard me make my speech since I'm back, but I've got a new attitude. If I make up my mind, with the assistance of you people, that I am right, I'm going to go ahead and I'm not going to wear myself out physically trying to convince the Federal Reserve about something that I think the Treasury should do. See what I mean? It just - I mean it's one of the things that made me so tired before I left - that three-week dog fight with the Federal Reserve, first on this gold sterilization and then to go in and do something in the open market operation. So what I am saying is this: if everybody in the room thought that the one thing that we should do was to get them to change their reserve requirements, all right, I'm willing to go at them; but if that is the highest hurdle that they have to overcome and there is some better method that the majority want, I'd rather consider that method.

But I think that you'll find - you know, after all Eccles is flying back tonight to get here tomorrow morning; we know how important they consider face saving is. I mean we're - I just can't imagine it, can you?

Viner: No, because I think they'll want to protect their face.

H.M.Jr: You like to teach pure economics, but, on the other hand, you've got to remember that we are all creatures of biology, and that you just can't.....

Viner: One thing I .....

H.M.Jr: You just can't wave aside the human element; that's what I mean. I'm just wondering; let's put it this

way, if you don't mind: does anybody here feel the way Viner does, that from the standpoint of what we are trying to accomplish, reestablish confidence, ease the strain on the money market, that our first line trenches should be a fight to get the Federal Reserve to change their reserve requirements?

Viner: I'd like to make my position clearer. You see, I wouldn't think in terms of a fight. I think that your only right at this moment, unless it involves a desterilizing operation, is to give them advice on request. I don't think that you have a right to take a very decided position as to what tool they shall use or as to what they shall do for credit control purposes, unless it involves definitely some operation that is your responsibility.

White: I disagree flatly.

Viner: I'd say absolutely there - after all, they can't share that responsibility with you in that way.

White: Neither can the Secretary share the responsibility which he has for his fiscal operations and others which are directly concerned.

Taylor: Let's put it this way, another way. If by any chance the Federal Reserve did propose altering the reserve requirements....

H.M.Jr: Say that again.

Taylor: If the Federal Reserve did propose changing reserve requirements at this time, what would the position of the Treasury be?

H.M.Jr: Bé only one answer - "Amen."

Riefler: It's their responsibility.

H.M.Jr: I'd say, "I only have one request, gentlemen. Please announce it at once." That's all.

White: Well, I didn't think we were considering that possibility.

H.M.Jr: That's the only request I'd make - "Please do it at once."

Seltzer: Wouldn't you rather use some of your instruments?

H.M.Jr: Wait now, he didn't ask me that. He asked me, if they wanted to do this, what would be the attitude of the Treasury? There could only be one answer - "All right, gentlemen, fine."

White: I didn't think that was the question at issue.

H.M.Jr: No, but that's the question Taylor asked me. He wanted to clear the atmosphere. You (Taylor) asked me and I gave you a straight answer. Right, Wayne?

Taylor: No, I'd be inclined to argue with them on that.

H.M.Jr: I wouldn't, if that's what they wanted to do. What? I mean it is particularly.....

Taylor: Let's say, or ask questions as to why they had picked that one.

H.M.Jr: It's easy to answer a question so, because I know they aren't going to do that. What?

Haas: Here's one point in this discussion about what instrument to use. In the Board's statement in announcement of the increase in reserve requirements, they described this instrument in the terminology or the inference that it was a rigid thing; then they pointed out that you have a flexible instrument, the open market operation. So they'd be in a tight box to come out of; it would be such a sharp reversal.

Viner: I don't expect them to do it, you know.

H.M.Jr: Well, there are all kinds of people who disagree fundamentally with the position Jake took.

Viner: I think the general preponderance of opinion is against me.

Taylor: I happen to be one of them. I think the worst thing you can do is mess around with the reserve requirements.

H.M.Jr: Well, who has a copy of the statement? Would you (Upham) get a copy of the statement which we gave out when we sterilized gold.

Upham: Surely.

H.M.Jr: Please. Be careful nobody sees you get it.

Taylor: It is just because bankers happen to be funny people.

Viner: I believe in educating them.

H.M.Jr: Let's just put that on the shelf for the moment. I mean we haven't disposed of it - just on the shelf.

I'd like to hear a discussion as between what you gentlemen think is best, not from a Treasury standpoint, but from the financial community - whole community - whether we should add a definite amount of gold from our sterilization fund or we should just stop sterilizing until further notice. I'd like to hear arguments on that.

White: I'd like to support that latter position.

H.M.Jr: All right, go ahead.

White: I think that - and we are in agreement on that in the Division - that it would be more effective in restoring confidence in the expectation that money would not be tight in the future if the bankers knew that incoming gold was no longer going to be sterilized. If they felt further that we had reached the conclusion that the situation warranted some change in policy, I feel that the Treasury ought not to be separated from the public community in identifying the interest served. I think the Treasury point of view is the public point of view and I feel that what is best for the Treasury is best for the public. And I feel that the Treasury was called upon or volunteered to cooperate and reduce the excess reserves at a time when it was felt they were much too high, even though it was an expense to the Treasury, which is to the public; that at the moment the need for that ceases, the Treasury ought to be the first one out, that the Treasury, which is the public, ought to be the first

to be relieved of the burden which they undertook when it was necessary. And for the reason of the burden, for the reason that it would be more effective in restoring confidence, I think that we ought to not sterilize further importations of gold for the time being.

H.M.Jr: Well, let me argue with you a minute on the other side. Getting back to this question of confidence, which gives more confidence? As I talk to Viner, you have scales here that are out of balance, and you've got to add so much to one side of these scales to bring it in balance; that is, you've got to add gold to make it work. Now, if we decide that X hundred millions of dollars of gold be added, then bring the scales in balance, and let the public know after careful study on the part of Federal Reserve they feel that X hundred millions of dollars will do the trick until after the first of the year - or we announce we have stopped sterilizing gold, and then they say, "Well, how long and what is your plan after the situation has corrected itself and gold continues to come in?" And I say, "I have no plan."

White: Well, I think that Jake's statement that we don't want to watch this from day to day - I think I would agree with him - but I would also agree that we don't have to watch it from day to day. The situation we have been watching in the main - we have arrived at the conclusion that the time has come to alter the policy, which we foresaw when we initiated it, and for the time being gold will.....

(Upham comes in with statement on sterilization)

H.M.Jr: Let's all be, if you don't mind, as intellectually honest as possible, and if you don't mind my saying, you're mixing two things.

White: Namely?

H.M.Jr: You're mixing the question of the cost of sterilizing gold to the Treasury and to the public - that's the one thing, the temporary embarrassment in having to borrow - that's Problem One. The other problem is that we are facing a tight money market. I think

they are two distinct problems.

White: I do too.

H.M.Jr: And if you don't mind, I think that you're mixing the two problems, and I think that they are two distinct problems. One is the tight - what is the best thing to do to relieve the money market? The question of gold sterilization, the mechanism, the cost to us and the public - that is something else.

White: That is a separate problem. Well, on the basis of the first, I think it will restore more confidence than open market operations, because..... -

H.M.Jr: What will restore more confidence?

White: The cessation of sterilizing imported gold - an announcement to the effect that we cease to sterilize imported gold; that it will be more spectacular because it will attract more attention than would the only other policy that I think would be invoked, namely, the open market operation, because I don't think the Federal Reserve Board is going to do the other at all.

H.M.Jr: What about this other thing of adding X millions of dollars?

White: That I would have a different objection to, the objection being that the implication would be that the Treasury isn't certain of its policy; that if too much gold was coming in from their point of view, why didn't they stop sterilizing it two months ago, three months ago, why are they doing it now? The situation hasn't changed materially from three months ago.

Taylor: Oh yes.

White: Well, now would you answer the question that if you are now putting back 300 million, why didn't we do it two months ago?

H.M.Jr: Because the Federal Reserve and ourselves didn't realize that we were going to face this tight situation around Christmas time three months ago. It's got nothing to do with sterilization; purely the question of supply and demand of money; nothing to do with sterilization.

White: It would appear to me that we are sort of going back a step if we are adding to the reserves; though I should prefer, if it were politically possible, to take more gold and not add any more, I think it would give the impression that Treasury policy is more carefully being drawn and followed, that there is no hesitation, no uncertainty, if instead of retracing our steps we merely change our future policy.

H.M.Jr: We are not changing our policy on sterilization at all. We're going right ahead and sterilizing. But in order to help out the Federal Reserve and the banks of the country, we're going to give them 3, 4, 5 hundred million dollars worth of gold. The sterilization policy isn't going to be changed.

Haas: Because the policy, as you announced it - it was a flexible one in the public statement.

H.M.Jr: I've shifted my position since Sunday due to Jake.

White: In other words, you're going to be requested, and as a result of the request you will take that action. That has more merit.

Taylor: It is "in consultation with," just the way the original announcement read.

Viner: In fact, I'd say it would be inexcusable unless made that way.

H.M.Jr: Mind you, this whole thing started with a request. See, Harry?

Let's just - let me go over this ground once more. I mean I've changed my stand. What I want to do is - I mean this would be a lovely time for me to stop sterilizing gold and then when Congress met again put the burden, force the issue. Well, I don't think that that's very good long distance diplomacy. I don't want - know what the answer is; in the meantime all this chitter-chatter of "What they going to do?" - now, as far as we're concerned, our sterilization policy hasn't changed.

I'm not worried about it. I thought it was the right thing to do; I still think it is the right thing to do. But Mr. Federal Reserve - due to action on their part, increasing these reserves, they find themselves in a very tight situation, and they want us to put 3, 4, 5 hundred million dollars worth of our gold to work, and we accede to that request.

Now, the way I look at it - the way I look at it - I'm not laying down any law, we've got lots of time - the way I'm looking at it, I think there's just two ways to do this thing with the Federal Reserve. One is that they do open market operation, or, two, that they ask us to put in a certain amount of gold, and I think it is a decision that they've got to make. But I've gone - I've leaned far away from this thing of stopping the sterilizing, because I think that would add uncertainty and that would look as though we didn't know what we were doing. It says here: "Too much deflation is being charged by some critical officials, but these are not identified with the group characterized above. Money-tightening moves by the Federal Reserve are the main target of criticisms aimed at the second group." And banks' reserve requirements is what they mean. And I think Eccles is rushing back - he knows he's in a spot and he wants to make sure that his interests are protected when the thing is announced, and I don't blame him. I don't blame him. If I was in his shoes, I'd be on the phone every day, just the way I was in March.

Viner: Mr. Secretary, I'd like to hear somebody discuss the open market operations. We have said something about the others.

H.M.Jr: All right, let somebody take that.

Lochhead: Possibly I can discuss it just from watching the operation. They authorized the purchase of 250 million dollars some time ago, you remember, when it was a question of whether or not we should put gold in or whether we should do open market operations. The order was put into the market, and from the way it was executed the market immediately

realized that there was no heart in it at all, and the market just simply threw up their hands, didn't pay any attention to it, because there was no forceful method used; and as far as it goes - 250 million authorized - they haven't bought a hundred million out of the 250. I understand they authorized another 200 million.

Viner: Does the public know when they authorize?

Taylor: No.

Viner: They don't know?

Lochhead: Yes, the market knows. They are advised.

White: It is published, but the public isn't aware.

Viner: The money market public doesn't know.

Lochhead: Yes, they know.

H.M.Jr: Well, nobody knows that they took this action.

Lochhead: Before, with the 250 million....

H.M.Jr: There's no formal announcement.

Lochhead: ...they announced they were going to go into the open market. The public immediately watched for the open market operations, and after a day they simply said, "They have no intention of going into the open market."

Viner: Let me ask this question. Supposing that the banks felt - the Reserve Banks - that they were being pressed into the open market operations by the Treasury and had no heart in it; supposing, now, the initiative came from the Board itself, would they act differently?

Lochhead: No, the request came from the Board before.

H.M.Jr: The Board has less influence with them than we have. Is that right?

Upham: I would think that was true.

H.M.Jr: When I say the Board, I say certain elements there - they have less influence than we have.

Upham: I'd say that was correct.

H.M.Jr: I mean they'd do it quicker for me than for them.

White: Isn't there a fundamental conflict of interest when you ask the Reserve Banks to engage in open market operations? As you watched their operations the last time, wasn't that evident, from the day-to-day operations?

Viner: I didn't know.

Taylor: Only be interpreted one way, regardless of what scenery was given it at this time, Jake, and that would be that the Federal Reserve Bank had come to the rescue of the Government bond market.

Viner: That's the thing that I was - I hadn't thought of this at all, but that was the thing that I'm just wondering about - whether open market operations weren't the type of operations which are associated in the public mind with coming to the relief of the Treasury.

Taylor: Particularly at this time it would only be interpreted one way.

White: Whereas the Secretary's suggestion, which I am more in accord with, would have us coming to their aid with a lump sum.

Taylor: You can do it in terms of your figure of reserves that you're talking about - as the proper amount of reserves for the banks at this particular period. Let's say it's a billion dollars, if that's what you think. All right, you've got your 750; you know they're going to go down during the fall but that immediately after the first of the year they're going to come back. So you can take the amount which after the first of the year will give you your billion and be a little on the safe side and explain it in that way, and I think you'll get a good reaction from it.

White: Won't the Federal Reserve Board prefer the lump sum to the other?

Taylor: Oh yes, obviously, the lump sum is preferable to them.

White: Because that means the control remains in their hands.

Taylor: A week ago, why, simply desterilizing - I mean not sterilizing any more for a period might have been enough, but I don't think it's enough at the present time. I think you have to pick your lump sum, and you can arrive at your lump sum by the mathematics given.

H.M.Jr: Well, they've got to give us the mathematics, got to write the formula.

Taylor: Absolutely, and it's probably going to be somewhere between 250 or 300.

H.M.Jr: I'd recommend more, to be on the safe side.

Taylor: In terms of this billion reserves after the first of the year.

Viner: Perhaps it ought to be 800 or 1200; I don't pretend to be....

H.M.Jr: I mean whatever figure they did, I'd just tell them automatically to add a hundred million, just to be safe.

(On phone) Hello, Burgess. (Has conversation with Burgess, time 11:14)

God, that man was blue this morning.

Viner: Big selling from England, is that it?

H.M.Jr: They all knew General Motors was around - the biggest block next to Federal - What would they do with it, who was going to absorb it, could they take it? It's the damnedest underground thing; just as soon as they do something, they all call each other up. It's a great game.

Taylor: The telephone's a wonderful instrument.

H.M.Jr: What?

Taylor: The telephone's a wonderful instrument, isn't it?

H.M.Jr: Sure is.

(Miss Reynolds brings in charts and clippings)

Lochhead: Right after 11 o'clock the market turned down rather suddenly, so they were looking for heavy declines at the end of the second hour.

H.M.Jr: The 2-7/8s are up 4-32ds from the low and the 2-1/2s are up 2-32ds from the low.

Where were we?

Lochhead: We were speaking about using the open market operation. The other objection to the open market operation would be the reluctance of the System to add to their portfolio of Government bonds.

H.M.Jr: I don't - I want you fellows - if you would go and kind of clear the atmosphere. You (Riefler) still haven't talked, have you?

Riefler: Well, my feeling about the thing at long range is that I'd like to avoid a situation in which the Federal and the Treasury are constantly having to decide on policy. Now, if the sterilization is going to go on, it ought to go on very gladly; and let them handle their problem, and we're simply taking off this load automatically. And we should be proud of it if we're going to go on with it at all; if we're not going to go on with it or are worried about what it is doing to us, then this is a very good chance to get rid of it, it seems to me. That is my first....

H.M.Jr: I don't want to be noble about it, but I want to impress on you people that I think it would be a cowardly thing for us this moment to get rid of sterilization if I didn't in my own mind have

something to replace it which would be as good or better. I mean I don't want to use this particular emergency, when these Federal Reserve boys are down and depressed or they are not thinking - I mean I don't get the feeling that they are thinking - I don't want to jump them, in other words. I'd like from now on very much to be able, say, looking forward six months to a year, if possible - now, I'm not worried about this sterilization policy, and I have yet to hear someone tell me something that is as good. Now, when someone has got something that is good, all right. But I don't think the sterilization policy is up at this moment for consideration. It's the money market; that's the question. It's the money market situation in New York right now, and it's not the sterilization policy, and I'm not worried about it and I don't - I'm not thinking about it particularly. I mean that isn't the problem. The problem is, what can we do to help the Federal Reserve with the money market situation, and what is the best way to do it? And that's the problem. Now, is that stating it? Can I be any more honest with you people than that? Jake?

Viner: I think that's right.

H.M.Jr: Can I be any more honest?

Viner: No, and I think that's the proper point of view.

H.M.Jr: Isn't that complete intellectual honesty?

White: Feeling that it can stand on its own feet and feeling that if two or three months from now it should be stopped, you'd have the courage to do so.

H.M.Jr: I've demonstrated that I've got the courage to do the thing if we thought it was right. I mean we've done it here again and again. And the President has demonstrated his confidence in me in that he won't talk to me about it, he won't let anybody else talk to me about it.

White: I'm almost convinced, but let me ask one question.

H.M.Jr: That's the President's attitude. He won't talk, he won't let anybody else talk to me about it. He could start sending people over when they approach him - "Go see Morgenthau" - but he doesn't. Go ahead.

White: Supposing that the war situation in Europe gets worse - I mean the fears - and supposing you get within the next four months something like 200 or 300 million a month. Do you feel that at that time what you do now would matter, would prejudice you in what you could do then, that you could then in addition say that the time has come to stop the sterilization program?

H.M.Jr: My dear Harry, there is absolutely no correlation between the two things. They have nothing to do with each other.

White: Well, except that you are now taking this measure to reduce your inactive account at a time when you can say we did not do it to reduce our inactive account, but we did it for the monetary situation; whereas, if you do it later because too much gold is coming, then you might have other reasons.

H.M.Jr: Then my answer to you is, let's face the problem we face and do it openly and honestly. What?

Riefler: Let's put it this way. If the Federal Reserve should feel in a few months that the situation had turned very sharply and they wanted to reduce excess reserves by 500 million, would we resterilize....

H.M.Jr: Don't push me too hard.

Seltzer: Let them sell Governments.

H.M.Jr: That's pushing me too hard. He's got the answer. Let them sell some of their bonds.

Seltzer: That's just what I was saying. Let them sell their Governments.

H.M.Jr: You know I'll never bluff you fellows; I'll say I can't answer you. But if you wanted me then to take

back that 500 million, I don't think I - I think that's asking me to be a little bit too much of an angel.

White: That's why I ....

H.M.Jr: Don't you agree? Or a "sucker." Which would be the word? I think that would be pushing a little bit too hard.

White: It is desirable to stress, not too strongly, that you are doing this because they asked you.

H.M.Jr: Well, after I see this man I'd like to see you people at three o'clock. Then I'll tell you what he's got to say, and then we can secretly begin to draft our own statement the way we'd like to have it.

Haas: Can I put up a hypothetical question? I think it would help the thing. The way I've considered this is this, that if under the Treasury or under the Federal Reserve, or at least under one head all these powers were centered, then you have a list of them and you'd make your decision that you'd want some more excess reserves; under those conditions, which method would you choose? And I think that's the way.....

H.M.Jr: Excuse me. (Gives some instructions to messenger) Now could you repeat that?

Haas: Yes, I'll be glad to.

In my thinking of it I put myself in this hypothetical framework of assuming that all the powers which are now concentrated in the Federal Reserve and in the Treasury were under one person's control; then you have made up a decision, or I assume that you have already, that some increase must be made in excess reserves. You have then a list of the possible methods. Under those conditions, if I were the head, or any one of us here were the head, what would we do, what method would we pick out? It seems to me when you look at it that way there is only one method, and that is the one you suggest. I may be wrong on that, but most of Jake's arguments were to a large extent dependent on the existing

machinery. But I think we have to assume there is perfect cooperation. That's what we told the public, that we're working as if it were under one head, the cooperation is so perfect.

Viner: Well, I must say that my main argument for avoiding a drain on the inactive account, although I prefer that much to stopping sterilizing operations, was what you say, that I'd prefer as far as possible to keep internal credit control operations as Federal Reserve operations, and therefore I'd say I agree with you that if there was - I think I'd agree with you; I'd want to think a little more - that I'd prefer a drain on the inactive account to the other devices if the same authorities were operating all the devices.

H.M.Jr: Gentlemen, if you don't mind, would you continue discussing this, and I'll see you here at three o'clock, and at that time I'll let you know which way the land lies.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE September 8, 1937

TO Secretary Morgenthau

FROM Mr. Haas

Subject: Desirability of Treasury action to increase excess reserves

I. The Case for Action

1. Regardless of the fundamental merits of the increases in reserve requirements and the gold sterilization program, as general policies, under the circumstances in which they were adopted, the logic of events has since demonstrated that their full application is having an excessively harsh impact upon the progress of recovery.

To argue that predepression experience indicates that $750 millions of excess reserves is more than ample to maintain credit conditions favorable for business expansion is to ignore the concrete evidence about us. Bond prices have been declining, with only intermittent recoveries, since last December. Moody's Investment Service estimates that during the first seven months of 1937 new securities issues for new productive purposes by corporations and municipalities totaled $781 millions, as compared with about $2 billions during the first seven months of each of the years 1922 to 1927, inclusive.

The mere maintenance of the current level of business activity, to say nothing of the attainment of higher levels, would seem to require a substantial gain in the volume of new flotations for productive purposes. The experience of the past clearly indicates that a firm or rising bond market is required for substantial new flotations, for a falling market does not take new issues well. The fact of the matter is that for several months now the country has been undergoing a mild deflation. During the first six months of 1937, the aggregate demand deposits of all member banks declined by $1,753 millions. Commodity prices have been falling for some weeks. Short-term interest rates are stiffening.

2. At this stage of our business recovery and in view of our enormous volume of liquid resources, there would seem to be no good reason why anything approaching a credit stringency should be in prospect. Yet this is what faces us this winter. The greater part of the $750 millions of existing excess reserves is held by country

banks, whereas the New York City member banks, who comprise the primary money market of the United States, possess only $133 million (as of September 1st). Against the latter amount may be weighed the $2,353 million of bankers balances ($1,829 million of domestic banks) carried with the New York banks, balances which are subject to rapid withdrawal. The New York banks may be expected to suffer the main impact of the currency demands this fall and winter, which may exceed $500 million; and they may also be expected to face the larger part of such seasonal expansion in commercial loans as will take place. To meet these demands, the Federal Reserve officials propose that the New York banks employ the rediscounting facilities of the New York Reserve Bank, rather than liquidate securities; and the same is proposed for banks in other districts that experience strain this winter.

Rediscounting may indeed be resorted to, but it is difficult to conceive of a widespread resort to rediscounting in the face of (a) the general reluctance of bankers to go into debt; (b) the expensiveness of rediscounting - 1 to 1½ percent - when Treasury bills can be sold at a sacrifice of less than .75 percent in yield, when bankers bills can be sold at one half of 1 percent, and when Federal funds can be purchased at one quarter or one half of 1 percent. If rediscounting takes place in any volume it would seem inevitable that it would be accompanied by a noticeable firming of short-term interest rates and a continued weakness in bond prices.

3. If short-term interest rates do rise noticeably, New York City banks may expect further withdrawals of balances by their correspondents, adding to the strain on the principal money market.

4. The volume of excess reserves appropriate to the American banking system today is larger than that appropriate in the past for several reasons. (a) The prohibition against the payment of interest on demand deposits leads to a far less effective use of funds in the banking system, for it eliminates the strongest motive to send idle funds where they are most needed. Aggregate excess reserves of substantial amounts may therefore coexist with regional shortages, particularly in the primary money market. (b) The ratio of capital funds to deposit liabilities of

American banks is now at the lowest level since 1920. Larger reserves act as a safety factor in such a situation. (c) By reason of the doubling of reserve requirements each dollar of reserves now has only one half of the credit supporting power that it had previously. (d) The probability that commercial loans will not soon again regain their former volume and that a greater proportion of bank assets will therefore be held in the form of investments and longer term business loans likewise suggests that banks will need to maintain a larger volume of reserves for liquidity purposes.

5. For some time past, intelligent bankers have been very keenly aware that, under the programs being followed by the Treasury and the Reserve authorities, the credit situation could move and was moving in only one direction: tightness. They were told, in effect: "We shall mop up more than half of your excess reserves by administrative increases in requirements; we shall see that you get no new reserves as the result of gold imports or newly mined gold; we shall, indeed, reduce the volume of excess reserves every time a dollar of new gold is acquired; and a moderate credit expansion, plus the waste of some reserves by poor distribution, will quickly exhaust the power of the member banks to expand credit further without borrowing from the Reserve banks."

The answer of the New York banks was a net liquidation of $1,251 millions of Government securities between June 30, 1936, and September 1, 1937. Part of this selling was absorbed by interior banks, many of which, unfortunately, now show a loss on these purchases; a loss which may make them less willing to absorb further liquidation by the New York banks.

II. Alternative Methods

It seems clear that the factors making for this situation should be reversed as quickly as possible. Six alternatives appear to be open:

(1') The Federal Reserve Board could reduce the reserve requirements. There are two reasons why this method should not be resorted to now. Firstly, a reversal of the Federal Reserve policy so soon after its inauguration will mean a loss of prestige to the Board and an increase in the uncertainty with respect to future monetary policy. Nothing has happened since the Board has taken action which the Board could use as an excuse for this reversal. Nothing has happened that they might not have foreseen. Secondly, raising the reserve requirements is too powerful and crude an instrument to be used frequently. The Board itself has stated that if it becomes necessary to modify reserve requirements they would resort to the more delicate instrument of open market operations.

(2') The Federal Reserve banks may add to the System's excess reserves by purchasing Government securities in the open market. This would have the advantage from the Reserve banks' standpoint of simultaneously enlarging the power of the Reserve banks to contract bank reserves in the future. The fact that the operation would be so patently reversible would be a disadvantage from the market's standpoint. And the fact that this operation would do nothing to reduce the Treasury's interest-bearing debt would be a distinct disadvantage from the Government's standpoint.

(3') The Treasury could announce the temporary suspension of its gold sterilization program. This would have the double advantage of notifying the market that it would no longer be called upon to absorb Treasury securities issued to finance gold acquisitions, and of notifying the market that excess reserves would be increased by every dollar of newly acquired gold.

(4') The Treasury could transfer gold certificates representing some $300 millions or more of gold in the Inactive Gold Account to its balance with the Federal Reserve banks and proceed to employ these funds in lieu of additional bill issues; or, alternatively, for the redemption of special issues held by Government agencies and trust funds, which, in turn, could use the proceeds to purchase Government securities in the open market. This likewise would have the advantage of reducing the interest-bearing public debt. It would have the further advantage of permitting a definitely known addition to the excess reserves of the banking system (except, of course, for such amounts as will get into the hands of non-member banks).

(5') Combination of (3') and (4').

(6') Use of several hundred millions of the Stabilization Fund to purchase Government securities. The particular advantage of this method would be the fact that the operation would be reversible.

7. In sterlizing more than $1,300 millions of newly acquired gold, the Treasury has performed a highly expensive service to the Federal Reserve authorities. This service has involved the creation of additional interest-bearing debt of substantially the full amount of the sterilized gold and it has further involved a rise in interest rates on other Treasury borrowings by reason of the increased total demands of the Treasury upon the market. If, now, it is agreed that the banking system required an addition to the volume of excess reserves, sound public policy would seem to require that the Treasury should be the first to be relieved of the financial burden when the need for reducing excess reserves no longer exists.

Further, the public reaction to this source of supplying a needed increase in the volume of excess reserves would be far more favorable to an increase brought about by additions of Government securities to the portfolio of the Federal Reserve System.

September 8, 1937.
11:13 a.m.

Burgess: Things look a little better on our offering this morning.

H.M.Jr: They did?

B: Yes.

H.M.Jr: God you were low this morning.

B: What's that?

H.M.Jr: God you were low this morning.

B: Was I low this morning?

H.M.Jr: Oh boy, I - you sounded as though you had taken a dose of Pluto water and it hadn't worked.

B: No, is that so?

H.M.Jr: Yes.

B: I'm sorry.

H.M.Jr: (Laughs) All right.

B: I was feeling all right.

H.M.Jr: All right.

B: I've just been talking with the discount boys.

H.M.Jr: Yes.

B: (Laughs)

H.M.Jr: Well let's have it - what's happened.

B: Well the rights are still quoted 57 by some but they're quoted 67 by others.....

H.M.Jr: Yes.

B: .....and they've been moving at - at 5 and 6. There have been a number of buyers in the market; the Equitable's been buying, the Travelers insurance.....

H.M.Jr: They're buying the five years?

B: Yes, that's right, they're buying the five year stuff.

H.M.Jr: Fine.

B: So that's been moving; been some bank buying too.

H.M.Jr: Ah-ha.

B: Ah - this block of 26 million that the General Motors has.

H.M.Jr: Oh yes.

B: It's all cleaned up.

H.M.Jr: No?

B: Yes.

H.M.Jr: What's happened to it?

B: Well the Discount bought 5 million and moved it on to some other customer.....

H.M.Jr: Yes.

B: .....and the - ah - and the Bankers took the 20 million and sold it to one of their customers.

H.M.Jr: Ah - a commercial customer?

B: Well it was reported as a foreign customer.

H.M.Jr: A foreign customer.

B: A foreign account - no one would know just who it would be but the report was that they were going to convert it into 2's.

H.M.Jr: Into 2's.

B: Now our biggest.....

H.M.Jr: So I mean that - that General Motors is out of the way?

B : That's cleaned up, yes.

H.M.Jr: They sold all their stuff.

B: That's right - that's right.

H.M.Jr: Ah-ha.

B: And the rights, as I say, look a little better. These one and three quarter bonds.

H.M.Jr: Yes.

B: One and three quarter notes for June - ah - March.....

H.M.Jr: Yes.

B: .....ah - look a little bit better. They'll quote at 27 - 29 - that's up 2/32d's.

H.M.Jr: I see.

B: And the bond market looks just a little bit better.

H.M.Jr: Ah-ha.

B: So that - ah - there's a little better feeling now.

H.M.Jr: Well isn't that fine.

B: Yep.

H.M.Jr: Isn't that fine.

B: A little more cheerful. Now our figures on conversions here.

H.M.Jr: Yes.

B: I haven't got the last minute but the figures show 37 on the short and 28 on the long.

H.M.Jr: Yes.

B: I'm expecting some more figures in just a minute on that.

H.M.Jr: Ah-ha.

B: The - the First National Bank converted its 8 million into long.

H.M.Jr: Ah-ha.

B: National City 15 short, five long.

H.M.Jr: Ah-ha.

B: So that's more on the long, a better balance on the long.....

H.M.Jr: What are you going to do with your - ah - 78 million again?

B: We got 70 million.

H.M.Jr: What are you going to do with that?

B: We'll do 50-50 again.

H.M.Jr: Ah-ha.

B: We're holding off till we saw how it went and so on.

H.M.Jr: (Hearty laughter)

B: Well no I mean whether.....

H.M.Jr: Oh (More hearty laughter)

B: .....you need help on something.

H.M.Jr: Oh (still laughing)

B: For your benefit.

H.M.Jr: Yes.

B: You wouldn't think we'd really just do it for our own benefit, would you?

H.M.Jr: Oh no. (Laughing)

B: We wouldn't do anything like that.

H.M.Jr: Oh no. (Increased laughing)

B: (Hearty laughter)

H.M.Jr: (Very hearty laughter)

H.M.Jr: You (laughing so much he can't talk) all right, Randolph.

B: (Hearty laughter) Well we haven't had to support your market. It's been taking care of itself nicely.

H.M.Jr: I see.

B: Those - those little orders that you sent down from Government Life and so on were nice and we used them to advantage.

H.M.Jr: Did you use them all up?

B: Not quite yet, no.

H.M.Jr: Want some more?

B: Ah - we don't need them specially.

H.M.Jr: Ah-ha.

B: And your all right.

H.M.Jr: All right.

B: I think there's advantage in not having too big a premium quoted here on these because you get better distribution in Insurance Companies. They like to buy them around - a little over par whereas if they were quoted a quarter or half a point premium they'd probably stay out.

H.M.Jr: Ah-ha. Well I wasn't down at any time but it's nice to hear you give me that stuff.

B: Well I think - I think by tonight we'll have a pretty good report.

H.M.Jr: And that sort of information spreads very rapidly, doesn't it ?

B: Oh you bet your life.

H.M.Jr: Ah-ha.

B: Yep. Of course, the stock market is behaving better to-day.

H.M.Jr: It is.

B: It's about the same as last night, really.

H.M.Jr: Well what about all those sharks who told you we'd have another reaction?

B: Well no they said - they said that you hadn't reached the selling climax yet.....

H.M.Jr: I see.

B: .....and wouldn't unless you had a drop to-day.

H.M.Jr: Ah-ha. There was big selling from England yesterday.

B: I guess there was.

H.M.Jr: Yes.

B: Don't know why.

H.M.Jr: Ah-ha.

B: Didn't make any sense to me anyway.

H.M.Jr: Ah-ha. Well I'll talk to you again a little later.

B: All right, sir.

H.M.Jr: Thank you very much.

B: Yes sir.

H.M.Jr: Goodbye.

B: Goodbye.

September 8, 1937.
2:40 p.m.

H.M.Jr: Hello

O: Dr. Burgess.

Burgess: Hello sir.

H.M.Jr: Well how did you close up?

B: Why - ah - it closed pretty well.

H.M.Jr: Ah-ha.

B: The - the bonds were just a touch better; there was a little covering there I think.

H.M.Jr: Yes.

B: And the Devine's were splurging around a little bit.

H.M.Jr: Devine is.

B: The notes were a little better than last night right through the list.

H.M.Jr: Yes.

B: And our notes - our rights have closed 68.

H.M.Jr: Well that's not bad.

B: A thirty-second up from this morning and from last night's close.

H.M.Jr: Ah-ha.

B: Quite a number of transactions going on. I've got the figures here for 3 o'clock.

H.M.Jr: Yes.

B: They show on the short bill 77 million.....

H.M.Jr: Yes.

B: .....and on the long one 58.

H.M.Jr: Well what do you know about that.

B: It's pretty darned close.

H.M.Jr: 58 of the long.

B: Yes.

H.M.Jr: And how much of the short?

B: 77.

H.M.Jr: Oh. Well I imagine - that's just New York, isn't it?

B: That's just New York, yes.

H.M.Jr: Yes.

B: And, of course, that's very incomplete so far. There will be more coming in.

H.M.Jr: Yes - yes.

B: But it's pretty good, I think. The Metropolitan Insurance had 17-1/2 of the short and 10 of the long.

H.M.Jr: Ah-ha.

B: The Prudential came in for 10 of the short and 9 of the long.

H.M.Jr: Ah-ha.

B: And the others, I think, they're gaining this morning.

H.M.Jr: Well are those conversions or purchases?

B: Those are - well they're both.

H.M.Jr: Both.

B: They're part one and part the other.

H.M.Jr: Ah-ha. Well I don't think we have much to worry about now.

B: I think we're pretty much on ice now.

H.M.Jr: After all with the.....

B: Unless we have something terrible happen tomorrow.....

H.M.Jr: Yes.

B: .....I think we're all right.

H.M.Jr: Well I don't see what worse could happen.

B: (Laughs) Well if they shoot somebody over there or something - looks as bad as war or something like that.

H.M.Jr: The stock market seemed to behave pretty well.

B: It behaved better, yes.

H.M.Jr: Yes.

B: Quite a lot better.

H.M.Jr: I sent you down an order for 5 million just to have it - ah - in case of need.

B: Yes we're glad to get that; we won't need to use it right away I think.

H.M.Jr: Well I - I didn't want you to use it.....

B: No.

H.M.Jr: .....except in case - ah - just to have it there.

B: Yes that's what Wayne said.

H.M.Jr: Yes.

B: Yes.

H. M. Jr: All right.

B: Very useful though. It's nice to know you have it.

H.M.Jr: That's right.

B: Yep.

H.M.Jr: Well unless something that - how late will you be there tonight?

B: Oh I'll be here till five or something - 5:30.

H.M.Jr: Well I'll call you. I'm going to go - try to go for a horseback ride about 4:15 which is 5:15 your time.

B: Yes.

H.M.Jr: I'll see whether we can get our figures by then and then I'll.call you.

B: Very good.

H.M.Jr: All right.

B: Well I think - I think it's pretty satisfactory.

H.M.Jr: I think so, I'm very well satisfied.

B: Yep, that's good.

H.M.Jr: I think for the - for the market to behave the way it did entirely on it's own speaks for.....

B: Yes, that's right.

H.M.Jr: .....ah - with everything else I think shows remarkable strength.

B: I think so.

H.M.Jr: Yes - yes. All right.

B: First rate.

H.M.Jr: Goodbye.

B: Goodbye.

RE TIGHT MONEY MARKET

September 8, 1937
3:00 p.m.

Present: Mr. Taylor
Mr. Lochhead
Mr. White
Mr. Haas
Mr. Seltzer
Mr. Riefler
Dr. Viner
Mr. Upham
Mr. Gaston

H.M.Jr: To boil down the gist of my conversation with Mr. Ransom, it was that he and Mr. Eccles as of today feel that there are four* devices which can be used, and one is using open market operations and the other is putting a block of desterilized gold into the picture. And the way the matter stands as of today, they are very anxious to use open market operation, because Mr. Eccles feels that if - What are they there for? What does the Federal Reserve exist for? - and that this is the device to use, and if they can't persuade their agents in New York to use this method, it is about time that they knew it. I told him I'd like to have two or three days to think it over; that I had decided that as between stopping sterilization and using a block of gold, I was for a block of gold, because there was no reason at this time to bring up the sterilization program, which pleased them very much.

I also told them that I thought the situation was sufficiently serious that I hoped they wouldn't use this crisis - I didn't use the word "crisis" - this situation as a battleground to decide who is going to win out as between the New York Bank and the Federal Reserve Board. I said I thought it was a very unfortunate time to pick to have a fight now. I said, "You know very well you can't settle that in two days; it's a matter of weeks or months." I said, "Eventually you will undoubtedly win out, but I think it's a pretty poor time to pick to have a battle between New York and yourself."

I said, "Furthermore, the device that you should use is to change the action which you took, namely, raising your requirements; of course you lower it."

* Secretary evidently meant <u>two</u>.

"Well, the public, and so forth." I said, "Well, that's just the way I feel about the open market operation, buying a couple hundred million dollars worth of bonds. Everybody is going to interpret it that you do it because we asked you to." He said, "Of course, we ought to be able to use it any time, and people shouldn't take it that way." He said, "It's all true, but it's a matter of cooperation." Extremely friendly.

Mr. Eccles is leaving some time tonight, will get in some time tomorrow; I'll see him. They called a meeting of the Board for Friday morning, called the Open Market Committee here for Saturday in case they decide to do the open market. But you can see they very much want to do the open market way. But at least it looks as though, if the situation calls for that, we are down to one of two ways, which makes life much simpler.

Did you gentlemen have a chance to see the memorandum left with me? Everybody see it? Yes or no.

White: I didn't.

H.M.Jr: Pass it around to anybody who hasn't seen it.

(Gaston comes in)

Now as to the immediate thing - I don't know whether you people know it or not, but it's closed pretty well today; our rights are a little bit better than they were yesterday. We've got some very big institutions buying, insurance companies and banks - I mean Metropolitan Life, the Equitable, First National of New York - people like that are buying. Lot of them are buying the five-years too. And the market is taking care of itself.

Now you've had two or three or four hours to think this thing over. What do you gents think? What do you (Riefler) think?

Riefler: I think that we came down pretty much to those two alternatives; they seem to be the ones in the picture. And of the two - they put funds in the market in about the same place.

H.M.Jr: A little louder.

Riefler: Desterilizing half a billion or buying open market - the net advantage of desterilizing is that it would at the same time decrease the published figure of the public debt, which would have a constructive influence. And Wayne feels that if you use the funds to take up the Sinking Fund, you could use them on longer term bonds, leaving the amount of bills in the market unchanged, which would seem to be quite important. I don't think we ought to be decreasing the amount of short-terms at the present time with the proportion of long-terms, but that the proportion of long-terms ought to be decreased rather than short.

Viner: You're taking for granted that the Federal Reserve would buy bills if they....

Riefler: Well, I don't know if they would....

Viner: ...buy bills.

H.M.Jr: I think so.

Riefler: Yes.

Viner: A lot of bills to buy.

Riefler: It would drive the rate down to zero. I think it needs if anything more bills and fewer bonds.

H.M.Jr: Well, may I ask you this? As to the fundamental situation, have you come to the conclusion something should be done? That's the first question.

Riefler: Me personally?

H.M.Jr: You personally. I mean have you been here long enough?

Riefler: No, I'm not convinced that something has to be done. I think it will do no harm to do something. I mean that's about the way my feeling is.

H.M.Jr: Oh gosh, now.....

Riefler: I feel that the business situation is going to remain sluggish for about six months. I think there are a great many fundamental factors to do that. And when you put in your gesture of ease to pick the thing up - it seems to me somewhat of a toss-up; if you do it now you will have a - I think what I would expect is you would have a moderate balancing off during the fall, without any strong pick-up, because I don't think the underlying situation will be with you; if you did it after Christmas, I think the underlying situation will be more with you, you get more striking results from what you do. I think it is something of a toss-up personally.

H.M.Jr: Well now, listen, if New York banks go down to minus, that's not helping anything.

Viner: What about financing? Aside from business activity, what about financing?

Riefler: New financing? I don't expect a great deal this fall.

Viner: But whatever might occur.....

Riefler: I think you get your pressure now. The financing - if you postponed it three months, took it when the business situation was more apt to take a turn, concentrating the financing of that period, after a period of three months in the fall which is pretty rocky, you would then have a more sudden turn for the better. I don't think you're going to get a great turn for the better this fall in any case.

H.M.Jr: Well, I'll put it - the way you feel now, supposing we did nothing.

Riefler: If you do nothing, I think you'll have a - you'll have as critical a - a critical period in the money market until short-term rates come up to the point where they do come into the Federal over the discount rate; I would expect them to come in and stabilize at that level. As you said this morning, there is no occasion yet for them to be coming in, so you've got a readjustment of the short-term rate going on.

H.M.Jr: I couldn't help smile a little bit when Mr. Ransom said Mr. Eccles had one of the most flexible minds he knew. To show you how flexible he is, he's got this idea that if he fixes the upper and lower limits, the money rates will have to stay fitted into those brackets. Well, I didn't want to say anything. I mean he's so flexible, he gets this fixed idea that if he says for three months it should be so much on the 90-day bill, it's got to stay there. Well, you just can't do it - I don't think. And he's got that.

And I think that the two of them will get their heads together and I think they're going to come in with the idea to bull this through and have it out with New York. I don't want the details and I don't want to know it, but they've just got another one of these misunderstandings with George Harrison.

Riefler: What does New York want?

H.M.Jr: Harrison came in here. He says he's got an understanding with New York banks that they won't sell any of their long-terms, but if they need any money they'll sell their bills. I took it like that. I said, "Now listen, any such understanding, if it ever got out, would do the Treasury tremendous harm, and the thought that the banks can't sell when they want to must not be permitted to get out." And I said, "Furthermore, no bank is going to live up to it." I said, "They must feel that the Government is thoroughly liquid." Do I quote it about right or overstate it, Wayne?

Taylor: (Nods no)

H.M.Jr: And I'm just fearful that these boys want to bull this thing through because they are sore. I don't know - Wayne can tell you - but something happened again between Harrison - Harrison said he said one thing and they said he said the other. I mean the important thing is the misunderstanding has again left soreness there - am I right? - and I think he's coming back after having three weeks of a rotten time and being on the phone a couple hours a day, and just try to fight. He's not going to take it out on me.

Riefler: What does Harrison want to do?

H.M.Jr: He doesn't want to do anything.

Riefler: Oh, he doesn't want to do anything.

H.M.Jr: No one has discussed this thing. We very carefully kept it out. But when he came down here, Harrison felt - and the only New York bank I talked to - he didn't seem particularly worried at this time, although three months ago he was very anxious to have 90-day bills, saying that the 90-day bill would permit him to get in and out more easily. And now he - that was in June; well, if they worried in June, they ought to worry a great deal more in September.

I read your memorandum, George, all through; got lots of time these days.

Well, here's a memorandum from Herbert Gaston, from Herbert Swope. Do you mind if I read it?

Gaston: Not at all.

H.M.Jr: "Herbert Swope called me to ask me to pass on to you his belief that the Federal Reserve Board ought to scale down reserve requirements immediately, reversing its previous action.

"He has talked to a considerable number of men, not speculators, he says, including his brother Gerard and several members of the board of the stock exchange who are not of the speculative element. He had also talked to B. Baruch.

"Gerard Swope told him G E was receiving cancellations showing the stock market scare had already spread into industry. H B S said some pretty wild stories are afloat including one that the Administration feels sure we will get into war and for that reason is saying little about the general situation.

"He said he realized this was purely a Reserve Board matter but said the business world looked to you to be able to bring about level-headed action in a crisis.

"He said he would make still further inquiries and call me again. He thought the psychological effect would be good rather than bad because it would show that the Government has controls which can be used either way and does not hesitate to use them to restrain a break as well as to stop a rise."

Now, on top of that, in addition to that, Gay has had several talks - of the stock exchange - with Thingumabob* on reducing the marginal requirements. And of course, I didn't say much but I listened. But it seems to me that the stock exchange has got nothing to do with this thing, and frankly - I mean I know I can talk to you people - I mean I think that right now I don't know if you - they seem to kind of have their tail between their legs, they want to fight somebody, want to justify themselves. I mean it isn't a very healthy atmosphere to think in. I think we've got to be awful careful. Am I right? I'm talking about the Reserve Board.

Taylor: Yes, the thing is - this beginning of new difficulty between the New York Bank and the Board is very apparent.

H.M.Jr: And here comes Ray Tucker, whom I have not seen, with a lot of stuff about Eccles and the Federal Reserve, and Eccles put all these things across while I was out of town. Well, all of that stuff we didn't mingle with.

"Now that crops are moving and private industry expanding, the banks have been flooded with demands for short-time loans. But because of the increased reserve requirements, they have been selling Government bonds instead of borrowing from the reserve or other institutions on their commercial paper. That has depressed the price of Federal securities and hampered the Treasury's early Fall financing. So the frown on the Morgenthau countenance was deeper than the Grand Canyon when he landed at the capital after a fast flight from San Francisco." (From the National Whirligig, by Ray Tucker, September 8)

Well, all that won't help Mr. Eccles' temperament. There's a lot of truth in it. So I guess we've just

* Probably Governor Ransom

got to sit, and he'll be in here tomorrow afternoon, tomorrow night. Certainly, even for Mr. Viner's piece of mind, I can't be more philosophical, judicial, unique, unusual, unrecognizable.

Viner: I must say I'd be inclined, if at all possible, to let them make a free and uninfluenced choice as to the methods they want to use, even if they prefer some other methods.

H.M.Jr: Wait a minute, Jake, that's where we differ. If it were the 15th of August I'd agree with you a hundred percent, but it's the 15th of September. Now, all right, they have the thing; then - let's say they get it through the Board to do an open market operation - and then they start to fight.

Viner: That's no method at all.

H.M.Jr: Pardon me?

Viner: That's no method at all.

H.M.Jr: But I'm willing to wager two to one that's what they'll do. Then they begin to fight, and that thing spreads. And I think it's part of the thing. Those things get out.

Now can we go any further? Let me put the question this way. Who favors a block of gold from the sterilization fund?

(All raise hands except Viner)

H.M.Jr: Which way are you (Riefler)?

Riefler: I think I favor the block of gold.

H.M.Jr: Who favors open market operation?

Viner: As compared with the block of gold.

H.M.Jr: I'll put the question another way. Who favors the block of gold as the most effective method?

(All raise hands except Viner)

H.M.Jr: Who favors the open market as the most effective? (Nobody)

Who favors the Viner method?

Upham: I think I'd go about half.

H.M.Jr: I don't know what the Viner method is.

Viner: Reserve requirements - that's what I prefer.

H.M.Jr: Oh, reserve requirements.

Riefler: This is on the assumption of no difference between the Federal Reserve and the Treasury.

H.M.Jr: I said it just out of devilment. The reserve requirements - I said it first just out of devilment.

Viner: I'm not surprised. They won't do it.

H.M.Jr: It's unheard of! - the public, and the public, and the public!

Viner: Then I'd say this too, that the question isn't as simple - if we were to release the block of gold and buy long terms, I think I'd prefer that to open market operations by buying bills; and you may say that's the real choice, and there I'd be inclined to say the gold block.

H.M.Jr: Use gold and buy long-terms - we?

Viner: We, yes, for the Sinking Fund.

H.M.Jr: You mean of an equal amount.

Riefler: Put the money in that way. Put the money in the market that way.

Viner: That's Wayne's way.

Riefler: That's what I was voting for.

H.M.Jr: You mean instead of spending it....

Viner: Instead of using it to buy bills.

H.M.Jr: Why do you have to do.....

Viner: Or stop the flotation of bills - just put it into the cash balance and let bills run off. What else would you do with it?

H.M.Jr: Nothing.

Taylor: The market needs the bills.

Viner: Keep on floating the bills.

H.M.Jr: This is a new thought.

Seltzer: Of course there is some question as to whether the market is going to need more bills this fall.

Taylor: It needs them anyhow.

Viner: That is a fifth variant, anyhow.

H.M.Jr: You mean instead of letting bills run off, buy long-terms.

Taylor: Eases pressure on the market.

Viner: I don't think it relieves pressure on the market, but it eases the market certainly and makes it sweeter.

Taylor: And you use that amount of gold to retire the debt. When you said you were going to sterilize it, why, you.....

White: Mr. Secretary, I'd like to raise.....

Gaston: We were careful not to say bills, you know, but to say obligations.

White: Mr. Secretary, there is a question I'd like to raise. At the time the bill was passed with respect to the Stabilization Fund, the specific powers were given that when you did need the funds you could invest them in bonds. The argument, I think, that had been advanced here was that you

never did that because it would increase excess reserves to an extent which wasn't desirable at the time. In view of the situation, couldn't a reexamination of that take place and you completely, on your own, or with consultation with them, decide that now is a good time to invest some of those funds in long-term bonds without raising the question of the other matters at all.

Taylor: Harry, you have to deposit that gold in the Fed in order to get the money with which to invest in bonds. It's the same thing.

Lochhead: It's the same thing.

H.M.Jr: One of the strengths of the Stabilization Fund is that every once in a while some crackpot says we should use it to stabilize the Government bond market, and I always tell them "No." I think it is one of the strengths of the Fund. I mean I've been terribly tempted at times to dip in, but I never gave in. And this thing that Wayne - this makes good sense, but I can't....

Lochhead: Another thing, it would deplete the Stabilization Fund if you tie it up in Government bonds - makes it ineffective.

H.M.Jr: Well, this thing would make a very pretty mixture - oh boy! - and it would do it so much nicer than the other thing.

Viner: What did Ransom have in mind? He had in mind that you buy bills with it, I think.

H.M.Jr: He didn't think that through any more than I had.

White: We were talking this morning and we felt that the magnitude of the sums involved, in view of the general situation, ought to be at least a half a billion dollars, and that any attempt to talk in terms of 200 or 300 would put the whole matter on a plane which is not justified by the present situation.

H.M.Jr: Well, I told them I'd let them mention the sum, but I just suggested that they be generous. I said they'd have to mention the sum.

Riefler: I think they'll decrease the sum, if possible. The thing that affects the bond market is the long-term rate, and the rise in short-term rate doesn't bother anybody unless it impinges on the long-term rate.

H.M.Jr: I think I'll call Ransom, because he talks to Eccles every hour; I'll say this has been suggested to me and if he talks to Eccles he can pass it along.

(On phone) Mr. Ransom, please.

Is that your (Taylor) idea?

Taylor: I think so.

Viner: That's where I heard it.

H.M.Jr: That's the beauty of talking these things over. You keep improving all the time. And that's the disadvantage of Eccles' flying in here after being up all night, and trying to decide this thing tomorrow afternoon.

Viner: Well, I don't think the urgency is such that he couldn't have a full day's rest.

H.M.Jr: Oh yes, but unfortunately I am due at Hyde Park Friday afternoon and our annual picnic for the President is on Saturday, so I wouldn't get back here again until Monday. I mean it's unfortunate for Eccles, not for me. But their whole damn staff is away.

(On phone) Hello. (Conversation with Ransom follows:)

September 8, 1937.
3:30 p.m.

H.M.Jr: Hello.

O: Governor Ransom. Go ahead.

H.M.Jr: Hello

Ronald Ransom: I've just finished talking to Marriner and he's coming in on the plane that gets here about 10:30 tomorrow morning and he asked if he could have an appointment with you at 3 o'clock. His reason for doing that was his fear that the plane might be a little late and that he wanted to have a chance to run over the situation with his own staff here.

H.M.Jr: That's all right.

R: That suit you?

H.M.Jr: 3 o'clock it is.

R: He and I will see you at 3 tomorrow afternoon.

H.M.Jr: Now I just want to - are you going to talk to him again?

R: No, not unless it is necessary.

H.M.Jr: Well there has been a suggestion made to me which is very interesting and if you could get it to him so that you and he could be thinking about it, see?

R: Hello

H.M.Jr: Hello

R: Yes.

H.M.Jr: There's been a suggestion made.....

R: Yes.

H.M.Jr: .....which is very interesting.....

R: Yes.

H.M.Jr: .....and that is this, that if we use the device of the block of gold, see.....

R: Yes.

H.M.Jr: .....that instead of letting - ah - not borrowing more money through bills, you see.....

R: Yes.

H.M.Jr: .....that we use that money - that gold.....

R: Yes.

H.M.Jr: .....by buying long-term government.

R: I see.

H.M.Jr: For sinking fund purposes.

R: Use the gold to buy long-term governments.

H.M.Jr: For sinking fund purposes.

R: Yes.

H.M.Jr: You see?

R: Yes.

H.M.Jr: Retirement.

R: Yes.

H.M.Jr: You see?

R: Yes.

H.M.Jr: And then continue the same amount of bills outstanding.

R: Yes. And continue the same amount of bills outstanding.

H.M.Jr: Yep.

R: All right. I'll get that idea to him because it's well worth thinking over.

H.M.Jr: You - you see what I mean?

R: Yes.

H.M.Jr: We put out - ah - several hundred million dollars worth of gold - now how are we going to put it to work?

R: Yes.

H.M.Jr: We could either let our bills run off and stop borrowing or we could take this money and buy long-time governments for the sinking fund.....

R: Yes.

H.M.Jr: .....retire them and continue to borrow our short term money.

R: You could continue to borrow your short-term money using less gold for the purpose of buying long-term governments for your sinking fund retirement.....

H.M.Jr: That's right.

R: .....and get it to work that way.

H.M.Jr: That's right.

R: Well there was one other suggestion that developed in my conversation with Marriner, which I have just finished having, that you have free gold now in your working balance of about 180 million.....

H.M.Jr: Yes.

R: .....and someone had suggested the possibility that that might be utilized - ah - for the purposes we had in mind. I haven't had a chance to suggest that to you for consideration.

H.M.Jr: Well only 100 million of that is free gold in the sense that it didn't come from gold through devaluation....

R: Yes.

H.M.Jr: .....and all the gold we have acquired through devaluation is ear-marked for debt retirement.....

R: Yes.

H.M.Jr: .....eventually.....

R: Yes.

H.M.Jr: You see?

R: Yes.

H.M.Jr: And.....

R: All the gold that you have - that you have acquired.....

H.M.Jr: By devaluation.

R: By devaluation.

H.M.Jr: I'm pledged to use that for debt retirement.

R: You're pledged to use that for debt retirement.

H.M.Jr: Yes. Now of that 180 there is only 100 of it as what we call really free gold.

R: Only 100 that's free. Well that - that puts a somewhat different complexion on it. Marriner didn't think much of the suggestion. It came from one of the other Membmers of he Board.

H.M.Jr: Yes.

R: He just didn't - he had an idea that it was darned less than 180. That was the figure that appeared on the writing.

H.M.Jr: Well - ah - but of that, only 100 is what we call - which is gold.....

R: I see.

H.M.Jr: .....which has not been acquired through devaluation.

R: I - I see.

H.M.Jr: But this other idea - I mean I just got it and I wanted you to have as much time to digest these things.

R: Yes, thank you very much and I will put that in the.....

H.M.Jr: And you can see what that would do to long-term government markets.

R: Yes, well let me think that one over and I'll have him thinking it over on his way back.

H.M.Jr: That's right and then I'll see you and Marriner at 3 tomorrow.

R: 3 tomorrow - fine.

H.M.Jr: Thank you.

R: Goodbye.

H.M.Jr: Might as well give him all the time necessary.

Haas: I think the Sinking Fund is about 600 millions behind too now. Isn't that right?

Taylor: Yes.

Viner: And there's been some criticism recently.

White: Maybe that figure would be a reasonable one to establish as the amount - what the Sinking Fund is behind; be a good reason for selecting 600 rather than....

Viner: Edging it up.

Haas: Gives you a logical reason for getting that much.

H.M.Jr: Well, what else has anybody got?

Taylor: Did a little work on the bills this morning. I think - now soon going to be ready there, Harry?

Haas: Whenever the Secretary wants it. Do you want it before you go?

H.M.Jr: Don't need to rush you - I mean I think we ought to kind of concentrate on this thing.

Taylor: You're as far as you can go on this one now, until we hear from the boys.

H.M.Jr: What?

Taylor: We have gone as far as we can, I think.

H.M.Jr: It seems so to me. I don't think we can go any further, do you (Viner)?

Viner: Haven't gone anywhere at all. I'm not even up on the question.

H.M.Jr: What question?

Viner: The bills.

H.M.Jr: No, we don't mean bills.

Taylor: We're talking about the gold.

H.M.Jr: What I would like from you people - if you have a little time, to work out an agenda for me for Sir Frederick Phillips.

White: I have one.

H.M.Jr: You ready, Harry? I wish you'd show it to these gentlemen. I'd like that.

Taylor: By the way, Trentham called me.

H.M.Jr: Just so you don't run out of....

Viner: Run out of talk.

H.M.Jr: ...gas.

Taylor: He's coming in a minute tomorrow morning to talk about Sir Frederick's visit.

H.M.Jr: Yes. I think that's about all.

September 8, 1937.
3:30 p.m.

H.M.Jr: Hello.

O: Governor Ransom. Go ahead.

H.M.Jr: Hello

Ronald Ransom: I've just finished talking to Marriner and he's coming in on the plane that gets here about 10:30 tomorrow morning and he asked if he could have an appointment with you at 3 o'clock. His reason for doing that was his fear that the plane might be a little late and that he wanted to have a chance to run over the situation with his own staff here.

H.M.Jr: That's all right.

R: That suit you?

H.M.Jr: 3 o'clock it is.

R: He and I will see you at 3 tomorrow afternoon.

H.M.Jr: Now I just want to - are you going to talk to him again?

R: No, not unless it is necessary.

H.M.Jr: Well there has been a suggestion made to me which is very interesting and if you could get it to him so that you and he could be thinking about it, see?

R: Hello

H.M.Jr: Hello

R: Yes.

H.M.Jr: There's been a suggestion made.....

R: Yes.

H.M.Jr: .....which is very interesting.....

R: Yes.

H.M.Jr: .....and that is this, that if we use the device of the block of gold, see.....

R: Yes.

H.M.Jr: .....that instead of letting - ah - not borrowing more money through bills, you see.....

R: Yes.

H.M.Jr: .....that we use that money - that gold.....

R: Yes.

H.M.Jr: .....by buying long-term government.

R: I see.

H.M.Jr: For sinking fund purposes.

R: Use the gold to buy long-term governments.

H.M.Jr: For sinking fund purposes.

R: Yes.

H.M.Jr: You see?

R: Yes.

H.M.Jr: Retirement.

R: Yes.

H.M.Jr: You see?

R: Yes.

H.M.Jr: And then continue the same amount of bills outstanding.

R: Yes. And continue the same amount of bills outstanding.

H.M.Jr: Yep.

R: All right. I'll get that idea to him because it's well worth thinking over.

H.M.Jr: You - you see what I mean?

R: Yes.

H.M.Jr: We put out - ah - several hundred million dollars worth of gold - now how are we going to put it to work?

R: Yes.

H.M.Jr: We could either let our bills run off and stop borrowing or we could take this money and buy long-time governments for the sinking fund.....

R: Yes.

H.M.Jr: .....retire them and continue to borrow our short term money.

R: You could continue to borrow your short-term money using less gold for the purpose of buying long-term governments for your sinking fund retirement.....

H.M.Jr: That's right.

R: .....and get it to work that way.

H.M.Jr: That's right.

R: Well there was one other suggestion that developed in my conversation with Marriner, which I have just finished having, that you have free gold now in your working balance of about 180 million.....

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H.M.Jr: That's right and then I'll see you and Marriner at 3 tomorrow.

R: 3 tomorrow - fine.

H.M.Jr: Thank you.

R: Goodbye.

Fin

September 8, 1937.
4:13 p.m.

H.M.Jr: Hello

O: Dr. Burgess. Go ahead.

H.M.Jr: Hello Randolph.

B: Yes sir.

H.M.Jr: Kilby's just brought the stuff in four banks yet to be heard from.

B: Yes.

H.M.Jr: The shorts are 123 the long 97 - total 220.

B: Long 97 - very good, isn't it?

H.M.Jr: I think it's very good and I should think that as we hear from Kansas City and St. Louis, Cleveland and Atlanta it might bring up the long.

B: Yes, I should too.

H.M.Jr: Yes.

B: Well I think that's very good. One of the banks that sold us tonight didn't hang out the flag.

H.M.Jr: They did?

B: I think that's a little favor to them.

H.M.Jr: What bank was that.

B: That was Frederick Gill of Manhattan.

H.M.Jr: Oh really.

B: Yes so this picture is all right.

H.M.Jr: Ah-ha.

B: But the market behaved beautifully all day.

H.M.Jr: And how was it towards night.

B: Well it - it was better.

H.M.Jr: Better.

B: Just a touch better.

H.M.Jr: Just a touch better.

B: Ah - these things are selling at 68; there are a few sales at 7.

H.M.Jr: Pardon me?

B: Your two bids are out at 7.....

H.M.Jr: Good.

B: For the rights.

H.M.Jr: Good. Well I'm - I'm cheerful.

B: Well so am I.

H.M.Jr: All right.

B: I think it's very nice.

H.M.Jr: Ah - goodbye.

B: Goodbye.

Extra Copy

September 5, 1937

Secretary Morgenthau

Mr. Haas

Subject: Desirability of Treasury action to increase excess reserves.

I. The Case for Action

1. Regardless of the fundamental merits of the increases in reserve requirements and the gold sterilization program, as general policies, under the circumstances in which they were adopted, the logic of events has since demonstrated that their full application is having an excessively harsh impact upon the progress of recovery.

To argue that predepression experience indicates that $750 millions of excess reserves is more than ample to maintain credit conditions favorable for business expansion is to ignore the concrete evidence about us. Bond prices have been declining, with only intermittent recoveries, since last December. Moody's Investment Service estimates that during the first seven months of 1937 new securities issues for new productive purposes by corporations and municipalities totaled $781 millions, as compared with about $2 billions during the first seven months of each of the years 1922 to 1927, inclusive.

The mere maintenance of the current level of business activity, to say nothing of the attainment of higher levels, would seem to require a substantial gain in the volume of new flotations for productive purposes. The experience of the past clearly indicates that a firm or rising bond market is required for substantial new flotations, for a falling market does not take new issues well. The fact of the matter is that for several months now the country has been undergoing a mild deflation. During the first six months of 1937, the aggregate demand deposits of all member banks declined by $1,753 millions. Commodity prices have been falling for some weeks. Short-term interest rates are stiffening.

2. At this stage of our business recovery and in view of our enormous volume of liquid resources, there would seem to be no good reason why anything approaching a credit stringency should be in prospect. Yet this is what faces us this winter. The greater part of the $750 millions of existing excess reserves is held by country

banks, whereas the New York City member banks, who comprise the primary money market of the United States, possess only $133 million (as of September 1st). Against the latter amount may be weighed the $2,353 million of bankers balances ($1,829 million of domestic banks) carried with the New York banks, balances which are subject to rapid withdrawal. The New York banks may be expected to suffer the main impact of the currency demands this fall and winter, which may exceed $500 million; and they may also be expected to face the larger part of such seasonal expansion in commercial loans as will take place. To meet these demands, the Federal Reserve officials propose that the New York banks employ the rediscounting facilities of the New York Reserve Bank, rather than liquidate securities; and the same is proposed for banks in other districts that experience strain this winter.

Rediscounting may indeed be resorted to, but it is difficult to conceive of a widespread resort to rediscounting in the face of (a) the general reluctance of bankers to go into debt; (b) the expensiveness of rediscounting - 1 to 1½ percent - when Treasury bills can be sold at a sacrifice of less than .75 percent in yield, when bankers bills can be sold at one half of 1 percent, and when Federal funds can be purchased at one quarter or one half of 1 percent. If rediscounting takes place in any volume it would seem inevitable that it would be accompanied by a noticeable firming of short-term interest rates and a continued weakness in bond prices.

3. If short-term interest rates do rise noticeably, New York City banks may expect further withdrawals of balances by their correspondents, adding to the strain on the principal money market.

4. The volume of excess reserves appropriate to the American banking system today is larger than that appropriate in the past for several reasons. (a) The prohibition against the payment of interest on demand deposits leads to a far less effective use of funds in the banking system, for it eliminates the strongest motive to send idle funds where they are most needed. Aggregate excess reserves of substantial amounts may therefore coexist with regional shortages, particularly in the primary money market. (b) The ratio of capital funds to deposit liabilities of

American banks is now at the lowest level since 1920. Larger reserves act as a safety factor in such a situation. (c) By reason of the doubling of reserve requirements each dollar of reserves now has only one half of the credit supporting power that it had previously. (d) The probability that commercial loans will not soon again regain their former volume and that a greater proportion of bank assets will therefore be held in the form of investments and longer term business loans likewise suggests that banks will need to maintain a larger volume of reserves for liquidity purposes.

5. For some time past, intelligent bankers have been very keenly aware that, under the programs being followed by the Treasury and the Reserve authorities, the credit situation could move and was moving in only one direction: tightness. They were told, in effect: "We shall mop up more than half of your excess reserves by administrative increases in requirements; we shall see that you get no new reserves as the result of gold imports or newly mined gold; we shall, indeed, reduce the volume of excess reserves every time a dollar of new gold is acquired; and a moderate credit expansion, plus the waste of some reserves by poor distribution, will quickly exhaust the power of the member banks to expand credit further without borrowing from the Reserve banks."

The answer of the New York banks was a net liquidation of $1,251 millions of Government securities between June 30, 1936, and September 1, 1937. Part of this selling was absorbed by interior banks, many of which, unfortunately, now show a loss on these purchases; a loss which may make them less willing to absorb further liquidation by the New York banks.

6. It seems clear that the factors making for this situation should be reversed as quickly as possible. Six alternatives appear to be open:

(1') The Federal Reserve Board could reduce the reserve requirements. There are two reasons why this method should not be resorted to now. Firstly, a reversal of the Federal Reserve policy so soon after its inauguration will mean a loss of prestige to the Board and an increase in the uncertainty with respect to future monetary policy. Nothing has happened since the Board has taken action which the Board could use as an excuse for this reversal. Nothing has happened that they might not have foreseen. Secondly, raising the reserve requirements is too powerful and crude an instrument to be used frequently. The Board itself has stated that if it becomes necessary to modify reserve requirements they would resort to the more delicate instrument of open market operations.

(2') The Federal Reserve banks may add to the System's excess reserves by purchasing Government securities in the open market. This would have the advantage from the Reserve banks' standpoint of simultaneously enlarging the power of the Reserve banks to contract bank reserves in the future. The fact that the operation would be so patently reversible would be a disadvantage from the market's standpoint. And the fact that this operation would do nothing to reduce the Treasury's interest-bearing debt would be a distinct disadvantage from the Government's standpoint.

(3') The Treasury could announce the temporary suspension of its gold sterilization program. This would have the double advantage of notifying the market that it would no longer be called upon to absorb Treasury securities issued to finance gold acquisitions, and of notifying the market that excess reserves would be increased by every dollar of newly acquired gold.

(4') The Treasury could transfer gold certificates representing some $300 millions or more of gold in the Inactive Gold Account to its balance with the Federal Reserve banks and proceed to employ these funds in lieu of additional bill issues; or, alternatively, for the redemption of special issues held by Government agencies and trust funds, which, in turn, could use the proceeds to purchase Government securities in the open market. This likewise would have the advantage of reducing the interest-bearing public debt. It would have the further advantage of permitting a definitely known addition to the excess reserves of the banking system (except, of course, for such amounts as will get into the hands of non-member banks).

(5') Combination of (3') and (4').

(6') Use of several hundred millions of the Stabilization Fund to purchase Government securities. The particular advantage of this method would be the fact that the operation would be reversible.

7. In sterilizing more than $1,300 millions of newly acquired gold, the Treasury has performed a highly expensive service to the Federal Reserve authorities. This service has involved the creation of additional interest-bearing debt of substantially the full amount of the sterilized gold and it has further involved a rise in interest rates on other Treasury borrowings by reason of the increased total demands of the Treasury upon the market. If, now, it is agreed that the banking system required an addition to the volume of excess reserves, sound public policy would seem to require that the Treasury should be the first to be relieved of the financial burden when the need for reducing excess reserves no longer exists.

Further, the public reaction to this source of supplying a needed increase in the volume of excess reserves would be far more favorable to an increase brought about by additions of Government securities to the portfolio of the Federal Reserve System.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE
Sept. 8, 1937.

TO Secretary Morgenthau

FROM Mr. Haas

Subject: Japan's gold shipments to the United States, and Japan's and China's balances in the United States

Japan

1. Net gold imports from Japan from January 1 to September 1, 1937..... $130,000,000
   Gold on the water 23,000,000

2. How much gold has Japan left to ship?

Probably about $340 million. We do not know exactly. We know only the last published figures of the Bank of Japan which for August 7 were $395 million. Since then, they have shipped to us $61 million, and have probably received from domestic mines and hoards about $6 million, leaving a net figure of $340 million.

3. The Bank of Japan has no balance with the Federal Reserve Bank of New York, nor does it have any gold on earmark here.

4. Far Eastern deposits as reported by the New York agencies of Japanese banks as of August 25 are 7,525,000

   The Yokohama Specie Bank showed an overdraft of 8,085,000

According to Lochhead, as far as he can learn from New York there are virtually no Japanese balances other than those indicated above held in New York. The weekly reports submitted by banks, bankers and brokers to the Treasury give only the balance for the whole "Far East" (which includes China, Japan, Netherlands, East Indies, Straits Settlement, and Philippine Islands). These show a total balance with United States banks other than in the Federal Reserve Bank of New York of about $168,000,000. During the past month this total has risen about $15,000,000.

Secretary Morgenthau - 2

China

1. Central Bank of China's balance with the Federal Reserve Bank of New York, September 1 ..... $ 18,066,000

Balance with the Federal Reserve Bank of New York has increased slightly - about $150,000 - during August.

2. Gold held for earmark for the Central Bank of China, September 1 49,946,000

Gold held on earmark for the Central Bank of China has been unchanged during the past two months.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE September 8, 1937

TO Secretary Morgenthau

FROM Mr. Haas

Subject: The war and our trade with China and Japan.

Conclusions

1. We will lose most of our trade with China during the war, but the loss of that trade is unimportant to the United States.

2. In the absence of application of the Neutrality Act, or of a boycott against Japanese goods, our trade with Japan will increase.

3. We don't need Japanese products but Japan must have the goods she buys from us.

4. A sharp reduction in our purchases from Japan, particularly of raw silk, would seriously injure Japan at this time.

5. Retaliation on our trade by Japan would not hurt us much.

6. An embargo by the United States on Japanese imports, or a widespread boycott by the public, would not hurt Japan enough to cause her to cease military operations in China, but it would go a long way toward destroying her ability to wage a prolonged campaign.

The War and our trade with China and Japan

We will probably lose most of our trade with China during the duration of the war. Japan can and probably will completely blockade China's ports. She may permit non-military items to enter in foreign ships, but China will not be able to spend any of her precious foreign exchange assets on goods not needed for the conduct of the war.

1. Our trade with China is unimportant to us.

China takes 2 percent of our exports - $47 million out of $2.5 billions. The chief items we sell to China are aircraft, leaf tobacco, petroleum products, iron and steel manufactures, chemical products, machinery and automobiles, but the amount of those items that China buys from us is so small a proportion to our total exports of those commodities (with the exception of our aircraft which in 1936 amounted to $7 million out of a total export of $23 million), and so insignificant a portion of our total production that the loss of the Chinese trade should have no disturbing effect on business here. Our cotton exports to China which were important five years ago have gradually declined to the vanishing point. Last year they totalled about $1 million. A few firms may be hard hit, but the loss of the entire Chinese market will hardly be noticed in our total trade.

Our imports from China are likewise unimportant to us. They constitute only 3 percent of our total imports and none of the items are essential to our industry. Tung oil, furs and skins, bristles, carpet wool, raw silk and oilseeds are important items of import. All of these can be obtained elsewhere or have satisfactory substitutes. Antimony and tungsten - two important minerals - are produced chiefly in China. We do not import large amounts, yet they are essential to our steel industry. These two minerals are produced chiefly in southeastern China, and exports should be easily shipped out of China by rail through French-Indo China.

2. Japan takes about 8 percent of our total exports.

The war will most likely increase our trade with Japan unless the United States takes steps to restrict it either by an unofficial boycott, or the application of the Neutrality Act.

The chief item is raw cotton. It makes up almost half our exports to Japan - $88 millions out of $204 million in 1936. Other important items are oil, iron and steel products, machinery, automobiles, copper, and chemicals. These are items which Japan will use in greater abundance during war time.

3. We are Japan's best customer.

Our purchases from Japan are more than double those of her next best customer. In 1936 the United States took 22 percent of all Japan's exports; British India took 10 percent; China, 6 percent; Great Britain, 5.5 percent, and Germany, 1.3 percent.

Our chief purchase from Japan is raw silk, which constitutes 55 percent of our total imports from Japan (our imports of rayon from Japan are negligible). The other items are relatively small.

Below is a list of the leading items that we buy from Japan:

Perilla oil	5 mil.	dollars	Camphor	1 mil.	dollars
Tea	3 "	"	Materials for hats and bonnets	1 "	"
Cotton cloth	5 "	"	China and porcelain	2 "	"
Crabmeat	2½ "	"	Rapeseed oil	1 "	"
Tunafish	1 "	"	Earthenware	1.3 "	"

4. Can we get along without Japanese goods?

Yes. Aside from silk, there are two items that are indispensible to us. One is Agar-Agar, used in a culture medium in bacteriological work. The amount of imports is only $600,000, but there seems to be no satisfactory substitute and Japan has a complete monopoly of the seaweed out of which it is made. The other item is Ho Oil - which comes from camphor trees found only in Formosa, used in the making of perfumes. Natural camphor still is a Japanese monopoly, but since 1933 a synthetic camphor has been developed which is interchangeable with the natural projects.

Of course, there is a host of low-priced novelties and trinkets, Christmas decorations, and very cheap rubber and knit goods which do not bulk large in total value, but play an important role in Woolworths. Deprivation of these items would doubtless be annoying to the children but might be a boon to the parents.

Raw silk is the one item of major importance to us that we get from Japan. Over 90 percent of our raw silk comes from Japan. The silk industry (including silk knit goods, hosiery) employs over a quarter of million people, and the value of their product 3/4 billion dollars. However, the bulk of the labor and equipment could be adapted after a while to rayon yarn. Rayon yarn could be imported from numerous countries until production here was stepped up. The net loss to labor and the silk industry would not be nearly so great as appears at first blush. The chief sufferers will be those who adore real silk hosiery and underwear.

5. Would the loss of the United States market hurt Japan seriously?

Yes. It would strike Japan a severe blow. We take more than one fifth of Japan's exports, and about all of the items we buy from Japan we can get along without. For the most part, what Japan doesn't sell to us, she won't sell to other countries. Better quality (and higher-priced) American products will almost wholly replace Japanese goods used here except for silk, the substitute of which would be the cheaper rayon and cotton.

The loss to Japan of the American market for her silk will be particularly harmful to Japanese economy. Though raw silk constitutes only 15 percent of Japan's exports, silk culture is so important in Japanese agriculture that an embargo on raw silk would seriously curtail the already extremely low standard of living of Japanese farmers. Two million families in Japan depend upon silk raising for a substantial part of their cash income.

The loss to Japan of much needed foreign exchange added to the blow to her farmers would hurt her considerably. She would, of course, retaliate.

6. Would retaliation by Japan hurt us seriously?

Retaliation by the Japanese would take the form of increased restrictions on our goods, but since most of our exports to Japan are essential to her such restrictions would be expensive to her. Doubtless American exporters would lose substantial business in Japan, but a large part of what they lose in their sales to Japan will be made up in additional sales to other countries. Japan must have cotton, oil, scrap iron and copper, and if she increases her purchase of these items elsewhere, the United States will share in the increased sale of those commodities indirectly.

Nearly one-half of Japan's cotton comes from the United States and were other countries able to supply Japan with her cotton needs it would be a serious blow to American cotton growers, as Japan takes more than one-fourth of our raw cotton exports. But there are no other major sources of long staple cotton which can supply Japan during the next year without leaving some other countries' needs that would have to be satisfied by American cotton. The total consumption of cotton may decline a little notwithstanding Japan's need for raw cotton for export and for army needs. Japan would substitute silk for cotton consumption at home, probably more than Americans would substitute cotton for silk. Unless subsidized by the government some loss would unquestionably be sustained by our cotton growers, yet there is no validity in the claim that the loss of the Japanese market would curtail our cotton exports by anything like Japan's present purchases of American cotton.

Altogether, a cessation or sharp reduction of our trade with Japan would hurt Japan critically but would constitute only a minor loss to the United States.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE
September 6, 1937.

TO Secretary Morgenthau

FROM Mr. Haas

Subject: Does the Neutrality Act affect purchases of gold from Japan or the sale of dollars to China?

In the event of a declaration by the President of the United States of a state of war between China and Japan:

1. Can the Federal Reserve Bank of New York, acting for the Treasury, provide dollars in exchange for yuan in accordance with the terms agreed upon in July, 1937?

Section 3 (a) of S. J. Resolution 51, as amended May 1, 1937 states that:

> "..... it shall thereafter be unlawful for any person within the United States to purchase, sell, or exchange bonds, securities, or other obligations of the government of any belligerent state ..... named in such proclamation ..... or to make any loan or extend any credit to any such government, political subdivision ....." etc.

There are two — and possibly three — reasons why it appears to me to be perfectly legal for the transaction indicated above to take place.

(a) The Act applies specifically to a "person" and person is defined in the Act to include "partnership, company, association, or corporation as well as a natural person". It would seem (to a layman) that the Treasury Department does not fall under any of those categories.

(b) The transaction described in our agreement with China does not constitute a loan, nor does it constitute an extension of credit. It is, in fact, as well as nominally, a sale of dollars for yuan. As a protection against any possibilities of an exchange loss, gold is required to be left here as collateral. It is an exchange transaction which, though of assistance to China, would seem to be neither a "loan" nor an "extension of credit".

(c) The Act provides that: "If the President shall find such action will serve to protect the commercial or other interests of the United States or its citizens, he may ..... except from the operation of this Section ordinary commercial credits and short time obligations in aid of legal transactions and of a character customarily used in normal peace time commercial transactions". It may be held that even if the purchase of yuan exchange is regarded as a loan or extension of credit that such loan or extension of credit is of a type which the President under the above conditions may except. Much depends upon the use of the dollars obtained by China.

The interpretation of the law by the legal staff should have, naturally, much more weight than our opinion.

Assuming legality, whether or not we should sell China dollars under the terms indicated is a matter in which the decisive considerations are political and not economic. The economic aspects are relatively unimportant.

2. Can we purchase gold from Japan?

There appears to be nothing in the Neutrality Act which prohibits the purchase by the Treasury of gold from a belligerent country. The Act does prohibit the extension of credit by a bank to a belligerent in anticipation of receipt of gold.

The important non-legal fact to bear in mind with respect to purchases of gold from Japan is that any restriction upon the international movement of gold to the United States at this time cannot help but have an adverse psychological influence on the usefulness and value of gold as a medium of international payments. Were the United States to refuse to accept gold from a belligerent country it might accentuate the uneasiness felt by holders of gold toward the future value of gold as a medium of international payments.

It would be a matter of very little concern to Japan whether she is able to sell her gold in this market or not. If Japan cannot sell her gold to us, she can with very little extra charge ship the gold to London and sell it there. Should she wish it, she could always buy dollars with the sterling so acquired.

FEDERAL RESERVE BANK
OF NEW YORK

Mr. Lochhead

OFFICE CORRESPONDENCE

300

TO: CONFIDENTIAL FILES

DATE: September 8, 1937.

SUBJECT: TELEPHONE CONVERSATION WITH BANK OF ENGLAND.

FROM: L. W. Knoke

Mr. Bolton called me at 11:40 today and stated that things were a little bit quieter in London today. There was practically no local demand for dollars and only small inquiries came from the continent. His sales today were about a half million dollars, so that he had a much easier day than yesterday.

Bolton spoke at some length about the situation in the Far East and seemed to be interested in the working of our Neutrality Act. I explained to him that, as far as I knew, this act would become effective only upon issuance by the President of a proclamation. I mentioned that, as far as I could observe, feeling in this country was very definitely anti-Japanese. Bolton said the same applied to London and that people held most pessimistic views regarding the financial situation in Japan. I referred to this morning's Tribune which stated that British banks had refused to extend further loans to Japan against shipments of gold. Bolton did not think that this was correct simply because British banks had never made such advances against gold, so that there could be no question of refusing to continue them. I stated that I was under the impression that some of the banks here had made advances to the local office of the Yokohama Specie [against gold in transit to San Francisco]. Bolton replied that in that way the Japanese had probably raised credits in London too. Today it was difficult to get rid of any Japanese bills at all. A house bill such as, for instance, Mitsui on Mitsui, could probably not be placed even on a 2 1/2% basis. Credit to Japan seemed to have disappeared in the market completely. I mentioned that I had, in a recent number of the Statist

or Economist, seem the total of Japanese bills given at $5,000,000. This figure, Bolton thought, was probably an underestimate. Foreign exchange contracts for forward delivery, Bolton said, were no longer accepted in the London market from Japanese banks.

I then inquired what the Japanese were doing with the sterling which they were now acquiring with the proceeds of the gold shipped to us. Did they use it to build up balances or to repay accumulated indebtedness, or just what? Bolton replied that they had no information at all. If they asked the Yokohama Specie they probably would not get the true answer anyhow. However, he suspected that the Japanese needed most of the proceeds of the gold shipments for the purpose of meeting current requirements. In other words, that these sterling amounts were used by the Japanese exchange control which was faced with an enormous pressure on the exchange due to the large Japanese purchases of raw material. Besides meeting current requirements, Bolton thought the Japanese had also been forced to reduce their indebtedness in the London market. The longer this war in China continued, the more quickly Japan would have to trade on a cash basis in London. I mentioned that the Japanese had quite recently again stepped up their gold shipments and that we had, within the last few days, been notified of three additional shipments of close to $6,000,000 each, which had left Japan on September 4, September 7 and September 8, respectively. I inquired

FEDERAL RESERVE BANK
OF NEW YORK

OFFICE CORRESPONDENCE

DATE September 8, 1937.

TO CONFIDENTIAL FILES

SUBJECT: TELEPHONE CONVERSATION WITH BANK OF ENGLAND.

FROM L. W. Knoke

whether his arrangements with the Japanese with regard to the dollar sales by the latter were still in force and Bolton replied that the Japanese continued to give him first call on any dollars that they had for sale. This arrangement, he continued, had enabled him to keep most of the Japanese dollars out of the London market.

LWK:KMC

September 8, 1937.

Dear Dr. Kung:

I returned to the office after my vacation to find your letter of July 13th awaiting me, and also the beautiful set of porcelain bowls which I am most happy to have as a memento of your visit. I am particularly pleased, however, by your own photograph and that of President Chiang Kai-shek, and I want to thank you for all these courtesies.

You may be sure that I share your warm good wishes for the continued friendship between our two countries.

I hope that your visit was a pleasant one and that you will return soon.

With all good wishes,

Sincerely,

(Signed) H. Morgenthau, Jr.

Dr. H. H. Kung,
Central Bank of China,
15 The Bund,
Shanghai, China.

GHF/dbs

Photos will be framed.

Cc to HS

The Waldorf Astoria
New York City.
July 13, 1937.

The Honourable Henry Morgenthau, Jr.
Secretary of Treasury
Washington, D. C.

Dear Mr. Secretary,

On the eve of my departure from your country, I wish to thank you for the courtesy and hospitality which you were good enough to extend to me during my recent visits in Washington. I appreciate deeply the delightful opportunity of meeting you and of exchanging views with you personally on matters concerning the common interests of our two countries.

My Government and people are indebted to you for the ready cooperation you have in the past extended to us which has contributed to the success of our monetary reform. Such cooperation, adopted in the interests of both nations, has already resulted in an appreciable increase of Sino-American trade.

I have now to thank you for making possible further progress in our cooperation through the new arrangements which you and I had the satisfaction to make. May I express the hope that this will further enhance the happy friendship existing between our two peoples and contribute to the movement for international monetary stability which your Government champions.

Under separate cover, I take pleasure in sending you a copy of my photograph and, on behalf of President Chiang Kai-shek, a copy of his photograph, which I hope will serve as momentos of my enjoyable visits with you. I am sending you also a set of four Chinese porcelain bowls with covers. With these tokens of remembrance, please accept my best wishes and highest considerations.

Sincerely yours,

H. H. Kung.

GROUP MEETING

September 9, 1937
9:30 a.m.

Present: Mr. Magill
Mr. Oliphant
Mr. Taylor
Mr. Gaston
Mr. Haas
Mr. Upham
Mr. Bell
Mr. McReynolds
Mr. Lochhead
Mr. Riefler
Dr. Viner

H.M.Jr: Good speech.

Taylor: Thanks.

H.M.Jr: Now, Wayne's going - you're going down to your home tomorrow?

Taylor: I think so.

H.M.Jr: Possible for you to stay (to Magill)?

Magill: Sure. When?

H.M.Jr: This week-end.

Magill: Sure. Want me to stay over the week-end?

H.M.Jr: I'd like you to be here until Saturday noon.

Magill: All right.

H.M.Jr: Till Saturday noon - till 12 o'clock.

Magill: All right.

H.M.Jr: Is there a one o'clock train?

Magill: I'm sure there is.

H.M.Jr: I want Wayne to get away.

My plans are these. I'm seeing the President tomorrow afternoon, I'm seeing him Saturday afternoon. Very confidentially, he's considering coming back Sunday night, so maybe I can see him on the train. If he comes back Sunday night,

chances are I'll have a chance to see him three times.

Herbert?

Gaston: My ex-boss (Herbert Swope) called me up again late yesterday afternoon, and more of the same thing. He had gone back and asked some other people whether they thought there would be a bad psychological reaction from any drastic action on reserves, whether they might think that the Administration took a very serious view of the situation. He said no responsible man took that view of the situation at all; they all thought it would be very helpful if the Federal Reserve Board would cut reserve requirements to the 75 percent point of last March. And he also said that it would be very helpful - of course, knew that we had nothing to do with that - it would also be very helpful if the S.E.C. would reduce the margin requirements from 55 to 45, because he said about 80 percent of brokers' accounts were frozen and that was withholding from the market a very considerable buying demand of people who would otherwise average up their accounts.

H.M.Jr: Well, the Federal Reserve said, so that you people, for your general information - see, this morning, I'm working with Bell - have an interruption for press conference; forgot about that.

Bell: What time is the press conference?

H.M.Jr: 10:30.

Bell: Want to start before that?

H.M.Jr: What do you think?

Bell: It's up to you.

H.M.Jr: Start right after it.

Bell: No more than get started. Start about 11.

H.M.Jr: Quarter of 11 sharp, how's that?

Bell: Very good.

H.M.Jr: Sharp quarter of 11. Then I'm having Jesse Jones for lunch; I'd like Mr. Taylor there please. And three o'clock Mr. Eccles. So that's the program for today.

Gaston: I suppose you noticed that the Tribune had a story that four out of six Government economists took an unfavorable view of the fall situation; that Leon Henderson, who is quoted at some length, was the only one who would be quoted as pessimistic.

H.M.Jr: I don't know how many economists here are talking.

Gaston: They're all anonymous anyway; they preserve their anonymity.

Viner: Why, Henderson isn't an economist.

H.M.Jr: What is Henderson?

Viner: He's a social worker - Sage Foundation.

Bell: Was Secretary Wallace one of them?

Gaston: If he is, he's one of the six anonymous.

Bell: He announced a 16 million bale program and said that the exports are good.

H.M.Jr: Now, did anybody get any different thoughts before I see Mr. Eccles? Anybody got any different thoughts other than what we talked about last night?

Let me sketch it for the benefit particularly of Bell. The way we feel - first place, we're going to ask him what he's got to say, see? Then, the plan that the Treasury likes the most is for us to deposit X hundreds of millions of dollars worth of gold, sterilized gold, and then not borrow, and spend it through not borrowing any new money. See?

Bell: (Nods yes)

H.M.Jr: That is contrary to the suggestion made that we use it to buy long-term Governments. Now, the reason I don't like that is this - for sinking fund purposes -: after thinking it over, we would use artifical support

of the Government market. If, let's say, we buy 300 million dollars worth of long-term Governments, then we've got to start in borrowing new money through selling more long-term Governments. It just doesn't make sense.

Haas: And pay premiums to sell them.

H.M.Jr: It just doesn't make sense.

Bell: You're making the premium by buying.

Haas: Give selling commission to sell them.

H.M.Jr: The reason - some of you might be interested - why I threw aside the idea of stopping sterilization, was that I felt that this was a tight money market problem and had nothing to do with sterilization, and that if we stopped sterilizing then the question of sterilization is up, good, bad, or indifferent. I don't want to raise it; it isn't on the firing line. On the other hand, if we simply deposit a block of gold, we are doing that to help out the money market situation, which is the problem. And why meet that problem by bringing up another problem?

Gaston: It also demonstrates more clearly that the Government has controls which it can use in an emergency and is willing to use them.

H.M.Jr: I mean this is the way I look at it. If my memory serves me right, your (Bell) program called for 300 million dollars worth of new money between now and the 15th of December.

Bell: That's right.

H.M.Jr: Is that right?

Bell: Yes, sir.

H.M.Jr: Well, they will ask for 300 million dollars worth of gold at least, so that would mean we have to borrow no new money between now and the 15th of December, and we spend it that way. Check? I mean instead of borrowing new money, we'd spend 300 million dollars worth of sterilized gold, and all you'd have to do is

turn over this 50 million a week.

Bell: Check on that.

H.M.Jr: I've been thinking of this thing. Then I think if we don't have to borrow any new money that's the most natural way to let the market recover, of itself rather than going in and buying 300 million dollars worth of long-term Governments. The more I think, Wayne, about this, the more I prefer this way. Don't you?

Taylor: Well, I can still see other reactions that you might get. I mean I merely pulled this other one out of a hat because it was....

H.M.Jr: I know, but this thing - let's put it on the positive side; you don't see any objections?

Taylor: No, no. Your only objection would be that you were using the sterilized gold instead of financing, see, and somebody's going to say that. Well, that's up to you.

H.M.Jr: Well, that's all right. That's the worst they can say.

Taylor: I think that's the worst they can say, and of all the other things I think that's the least objectionable thing.

H.M.Jr: But we're not using gold from the devaluation part of it. Herbert, don't you think that's about the least thing they can shoot at us on that, the least criticism, if we do it this way?

Gaston: I think so, yes.

Viner: I don't think there's going to be any worry about criticism. I think they generally expect you to take a control move. You've got a mechanism, why not use it?

Bell: I don't think anybody's worrying about sterilized gold or desterilized gold.

H.M.Jr: But this is a result of many conferences during the

last few days and you get it fresh. How does it sound to you?

Bell: Well, I'd prefer to stop sterilization and use the 200 million dollars worth in the General Fund - free gold, working balance.

H.M.Jr: But, Dan, of that you haven't got over a hundred million dollars of gold that was not from devaluation.

Bell: But the hundred million increase since you started devaluation is the result of retirement of National Bank notes, which you said you earmarked for that purpose, and you are entitled to put that back into the market.

H.M.Jr: But, Dan, if I stop sterilizing now - that's an entirely different problem.

Bell: Well, I think it shows you have a flexible program on sterilization which you can stop or start any time you want to.

H.M.Jr: Perfectly true, but the problem right now.....

Bell: We talked about desterilizing as gold went out of the country.

H.M.Jr: But, Dan, the problem right now is one of action of the Federal Reserve Board, tight money market.

Bell: Do you really think tightness of the money market is causing this situation? After all, there is between 800 and 900 million of excess reserves. There was only one person at our conferences in New York who said the reserves were a factor in the market.

H.M.Jr: Sure, they want a tight money market.

Bell: Well, after all, the bond dealers want action.

H.M.Jr: They want tight money.

Bell: Well, that's just the way it strikes me.

H.M.Jr: That's what I brought it up for. Take your time on it. This Federal Reserve Board will never make up their mind this week, see, and they may insist on using

open market operation. Well, if they do, I don't know what I can do about it.

Bell: I'll tell you what they should do; it's their problem - the reserves.

H.M.Jr: True.

Bell: It's their problem.

H.M.Jr: True, but they've got it down now - they say there's one of two ways, either open market or a block of gold.

Oliphant: They have?

H.M.Jr: Yes. That is, talking to Eccles and Ransom, those two. But, Herman, do you get my idea of not bringing up the sterilization problem at this time?

Oliphant: Oh, I see a real advantage in this way of doing it. If you do it by buying bonds, it looks too much like an open market operation. But this way you've got a perfect control of the amount and the timing, and I think that answers the objection of Wayne.

Taylor: I don't think it's a serious objection.

Oliphant: You borrowed this money and bought the gold. In effect you're spending your balance. Suppose you run your balance down; nobody would say that was smart.

H.M.Jr: I think we get the minimum of criticism and I think a lot of people will pat us on the back.

Taylor: I think it is terribly important to use the block rather than to stop sterilizing, Dan.

H.M.Jr: Well, Dan has to have time to think it over.

Taylor: I'll argue with you about that.

Bell: Well, you've got in principle some of the same elements in your sterilization and depositing of the gold that you have in desterilizing and buying Governments, see?

Taylor: The main thing is that they don't know how much it will be.

Bell: Well, you've got some of the same elements in both, because if you desterilize and buy Governments, you've got to borrow again to replace the Governments; now, if you desterilize, you've got to use some of the same funds to buy back Governments. Some of the same elements.

H.M.Jr: Well, Dan, it isn't fair to just throw it at you.

Bell: That's just the way it strikes me.

H.M.Jr: Cy, what do you think about it? Had time to think about it?

Upham: I'm inclined to be pretty thoroughly in agreement with you, although I still think that Federal Reserve ought to reduce reserve requirements. But if that's impossible, why, I think this is all right.

H.M.Jr: I think that we should all stop war too. I think they are both just about - got an equal chance on both.

Upham: That is probably true.

H.M.Jr: I think they are both logical too. But lacking that - I mean they just haven't got the courage to face the public and say, "We're going to reduce reserve requirements." Just won't do it.

Oliphant: I want to amend what I said; that is my basic thought. I think that the Administration has made one major financial blunder and that wasn't made by the Treasury, it was made by Federal Reserve; that's where you ought to start.

H.M.Jr: Well, you can't - it's impossible; as I say, it's just like - it is also very logical we should stop fighting - I mean war.

Archie?

Lochhead: About this program?

H.M.Jr: About this program.

Lochhead: Of course, the way it shapes up, I'd rather see the block of gold. I think you'll probably end up with the authorization to increase open market purchases, the way it's shaping up to me. It's always hard to get a decision to do something. It's always easy to do nothing, to get the authorization. I don't think you're going to get much further with the Board.

H.M.Jr: Well - I mean they don't quite realize that they're dealing with a new person, and I think they'll find it's quite different. I mean it's absolutely clear in my mind what the proper thing to do is. I mean they can't argue with me, they can't fight with me. I mean if they want to mess around on this thing - I mean I just - now that it's clear I'm going to talk to the President, and if they're going to start fooling around like that I'll tell them that the President of the United States will take the responsibility, and let them mess around. If he wants to take the responsibility, let them fool around with open market operations. They've had this authorization since what, March? Any child, any mathematician, could see that this thing was coming. I mean why wait until the 9th of September to discuss this thing? It should have been started the first of August. Hun?

Taylor: I think that would have been a nice time to start it.

H.M.Jr: Sure. I mean I'm just going to tell the President, "If you want these people to mess around, if you want a real reversal, all right." But I can say - considering the human element, I think - leaving Dan out for the moment, I think we can say we've got a pretty uniform opinion that this is the best method. Leaving out the fact that the technically correct thing would be to lower the reserve requirements - barring that, this is, we think, the best. Right?

Viner: I'd prefer open market operations, but I'm not very strong - but I'd prefer a Federal Reserve operation; that's the point. I think there ought to be some attempt to present it as a Federal Reserve problem - in fact, the Treasury, if possible, not involved, not mentioned, etc. This situation has developed certainly

not because of Treasury operations, and it is their function to correct it, and as far as possible I'd prefer a device which gives it all the atmosphere of a Federal Reserve operation. But you can handle your method so that the Federal Reserve is brought very clearly into the picture, and they certainly would do it that way so as to give the impression as bluntly as you can that this is done as a Federal Reserve measure.

H.M.Jr: Now, in that memorandum, one of the things you put on your list - those that are working on this thing - I want to ask Phillips what the English are going to do about the 40 million pounds French railroad loan. I mean that ought to be on that list. See? I mean that's very important. What are the English going to do about that?

Lochhead: In connection with this memorandum that went out just now, francs have been under pressure all morning. About 372 yesterday, down to 368½ today. Knoke was speaking to the Bank of England just before it went out, and he said they have had an impression France had lost about five million dollars in that market the first two hours, that the pressure was not particularly new. While he was talking he had news that they had broken another point and France advised they had lost another five million dollars besides of gold in the London market and four million dollars worth of dollars - they don't know how it would be translated yet - and he felt that the crisis was developing - felt that a major crisis was developing; had no news of outstanding events, but the pressure was becoming strong.

H.M.Jr: That's like spring and autumn; every Decoration Day and every September we have that. It's true. I mean I can't get - we - you can't help the French help themselves; that's the main problem.

Taylor: All that means is, down she goes.

Lochhead: It means also, of course, that there is going to be more gold coming here; now the turn will be coming.

Taylor: They're backing away from it fairly fast if you let it break that fast.

Lochhead: Until they do stop it, it means - any support they give means more gold coming that way.

H.M.Jr: George, will you get me the articles of Mr. Brandt of the London Times, on gold; I'd like to have them.

I don't like these people dropping in and - I can talk business, but Herbert Feis broke in on me last night and.....

Viner: What time did they stay?

H.M.Jr: At 10:30 I stood up, pulled an Oliphant on them. Except I was one hour late.

Oliphant: Yes, one hour late.

H.M.Jr: Herbert Feis, after you fellows left, wanted to use my little sitting room as a place to pump Mr. Brandt on the foreign policy of Great Britain, and I wasn't interested.

Mac?

McR: (Nods nothing) I can't tell you what - I wouldn't bother you now.

Bell: How about silver?

H.M.Jr: It's very easy. We can start loaning them money and taking their paper.

Bell: Mac, you're only interested in silver.

H.M.Jr: Dan, sharp quarter of 11. Mr. Oliphant, would you stay a minute.

September 9, 1937.
9:35 a.m.

H.M.Jr: Oh I'm fine.

Burgess: That's good.

H.M.Jr: How are you?

B: Fine. Everything looks rosy this morning.

H.M.Jr: Ah-ha.

B: The rights are quoted 7-9.

H.M.Jr: Yes.

B: Ah - the stocks and bonds - the notes and the bonds are both fractionally higher .....

H.M.Jr: Ah-ha.

B: ..... the stock market is very much more cheerful .....

H.M.Jr: Ah-ha.

B: ..... so everything looks all right.

H.M.Jr: Good. Well I think it's safe at my Press Conference, which is in an hour, to say that the issue is a success, wouldn't you say so?

B: Ah - well I - I'm not sure I'd say it yet. It's - it's almost surely that.

H.M.Jr: Well what would you say?

B: I'd simply say it looks - it looks all right.

H.M.Jr: It's going well?

B: Yes, going well.

H.M.Jr: It's going well.

B: Yes.

H.M.Jr: What?

B: Yes, that would be a little restrained.

H.M.Jr: All right.

B: Take it as a matter of course it's going very nicely.

H.M.Jr: It's going satisfactorily?

B: Yes, that's all right.

H.M.Jr: How's that?

B: (Hearty laughter) Very good.

H.M.Jr: What? It's going satisfactorily.

B: With that little gesture, you know.

H.M.Jr: What?

B: With that little gesture, you know. (Laughs)

H.M.Jr: And can I also say it's the first time in three days that Burgess has laughed?

B: (Laughs) No, I've been laughing every day. (Laughs)

H.M.Jr: Up your sleeve.

B: I feel better this morning though.

H.M.Jr: Up your sleeve, though.

B: (Laughs) No.

H.M.Jr: All right, Randolph.

B: Say you know the Board's having a meeting Saturday, did you?

H.M.Jr: Yes.

B: Of the Committee?

H.M.Jr: Yes.

B: And so on.

H.M.Jr: Yes.

B: Yes.

H.M.Jr: I may want to talk to you later in the day.

B: All right, very good.

H.M.Jr: Yes.

B: Fine.

H.M.Jr: Thank you.

B: Goodbye.

September 9, 1937.
10:26 a.m.

H.M.Jr: Hello

O: Dr. Burgess. Go ahead.

H.M.Jr: Hello

Burgess: Hello sir.

H.M.Jr: Ah - I just - I'm having my Press Conference in three minutes and I wanted to check with you once more.

B: Yes.

H.M.Jr: Ah - I - I'm going to say that the - the conversion is going satisfactorily.

B: Yes.

H.M.Jr: Can I say more than that? I don't think it's necessary.

B: I think that's all right.

H.M.Jr: Yes.

B: As a matter of fact the - ah - maturing notes are now worth a quarter of a point.

H.M.Jr: Well why don't I be a little bit more enthusiastic?

B: Ah - well I don't think I'd be too enthusiastic.

H.M.Jr: All right I'll - I'll say it - it - the conversion is going - ah - ah - satisfactorily.

B: I think that's the way to do it.

H.M.Jr: I think so.

B: If you look too joyful it looks as though you were surprised.

H.M.Jr: No, it's going satisfactorily.

B: (Laughs)

H.M.Jr: Ah - I'd be glad to see my March - you know the thing that surprised me in this break is that those March 42's didn't go down further.

B: I thought they would - I thought they'd lose as much as half a point maybe.

H.M.Jr: Yes. Ah - who's doing the buying to-day?

B: Ah - of the rights you mean?

H.M.Jr: Well yes.

B: Well the - the Travellers Insurance just bought five million of each; I think a number of banks are buying;.....

H.M.Jr: Yes.

B: ..... a number of insurance companies.

H.M.Jr: Yes.

B: Everybody knows now that it's - ah - that it's probably going to be all right .....

H.M.Jr: Yes.

B: ..... and they made up their minds to that over night.....

H.M.Jr: Yes.

B: ..... so - on the basis of what happened yesterday - so that now they think they're desirable.

H.M.Jr: Yes. All right - ah - ah - I'll be talking to you later.

B: Fine.

H.M.Jr: Thank you.

B: Goodbye.

H.M.Jr: Goodbye.

Fin

September 9, 1937.
11:40 a.m.

H.M.Jr: Hello.

O: Dr. Burgess.

Burgess: Hello sir.

H.M.Jr: Well how does she look right now?

B: Well it's just a little bit easier.

H.M.Jr: Ah-ha.

B: There's nothing to be concerned about, I think.

H.M.Jr: Ah-ha. Ah - .....

B: The rights have eased off.

H.M.Jr: What's that?

B: The rights have eased off to 7-9.

H.M.Jr: Yes.

B: They were 8-9.

H.M.Jr: Well -

B: But it's all right.

H.M.Jr: What I said didn't hurt, did it?

B: No - that's all right.

H.M.Jr: Perfectly dignified.

B: I think so, yes.

H.M.Jr: Yes.

B: Yep.

H.M.Jr: And - ah - how are the March 42 notes?

B: Ah - they're doing very nicely. They're 30 to par.

H.M.Jr: 30 to par. Well that's all right.

B: And I know there's some .

H.M.Jr: Now - ah - still some buying going on?

B: I think so, yes.

H.M.Jr: Ah-ha. Ah - we'll get our usual conversion, won't we?

B: I think we're bound to now, yes.

H.M.Jr: Did you - you didn't buy any bonds for us to-day.

B: Nope - not yet.

H.M.Jr: And actually you never bought any rights; you never had to - you made that one swap, didn't you?

B: We made one swap - a million and a half.

H.M.Jr: Yes and that's all.

B: Now there's one block that a dealer is holding that I'm watching a little bit. If that gets heavy we may take that over but .....

H.M.Jr: A block of rights?

B: Yes.

H.M.Jr: How much has he got?

B: He's got about 12 million.

H.M.Jr: Really?

B: I think he'll sell them though. He'd be better if he sold them in the market.

H.M.Jr: Would you mind telling me which dealer?

B: That's Sullivan.

H.M.Jr: I see - 12 million?

B: Yep.

H.M.Jr: You want him to sell them?

B: I think it's better to sell them. I think it's better - ah - for the market to be just as natural as possible and then nobody can accuse us of .....

H.M.Jr: That's right.

B: ..... of having padded it up, you see?

H.M.Jr: Well can't he sell 12 million?

B: I think he can, yes.

H.M.Jr: Ah - you don't turn yours in until the last hour, do you?

B: No we'll - we'll put them in this afternoon.

H.M.Jr: Ah-ha. Are there many coming in?

B: Ah - well here's the sheet I just go up to 12 o'clock.

H.M.Jr: Yes.

B: Ah - not very many yet; eight million of the short and four of the long this morning.

H.M.Jr: I see.

B: Brings us up to 91 on the short and 74 on the long.

H.M.Jr: I see.

B: It's a pretty good relationship, isn't it?

H.M.Jr: Yes. Well they never turn them in till the last minute, do they?

B: Oh no, they just trot them in the last minute.

H.M.Jr: They wait till the last hour, eh?

B: That's right, yes.

H.M.Jr: I see - 12 - we've got two more hours to go.

B: Yes.

H.M.Jr: Yes. All right.

B: Very good.

H.M.Jr: Thank you.

September 9, 1937.
12:39 p.m.

H.M.Jr: Hello.

O: Mr. Madison. Go ahead.

H.M.Jr: Hello

Madison: Hello.

H.M.Jr: This is the Secretary speaking.

M: Hello Mr. Secretary.

H.M.Jr: How are you?

M: Fine, thank you. Did you have a nice vacation?

H.M.Jr: Oh a wonderful vacation.

M: I always wanted to go out there.

H.M.Jr: I asked for you if Burgess was at lunch. I wondered how this has been going the last hour.

M: Ah - the last figure I had is one o'clock.....

H.M.Jr: Yes.

M: .... and they had a total of 116 million of the shorts and 90 million of the long.

H.M.Jr: Ah-ha.

M: At 200 and . . Ah - they're coming in - they're speeding up a little bit but we know that they're waiting until the last minute.

H.M.Jr: Well what I want you to tell Dr. Burgess as soon as he comes back - the last 15 minutes of the market watch it - that it don't play any tricks on us.

M: I didn't quite get that.

H.M.Jr: The last 15 minutes that the market is open .....

M: Yes.

H.M.Jr: .... from a quarter to three to three watch it very closely. Now you've got orders there.....

M: Oh yes.

H.M.Jr: You've got orders - I - I want the bond market to - to close firm.....

M: Yes. I'm - I'm in a fine position now and - ah.....

H.M.Jr: How is that?

M: Well I've got this 5 million additional.

H.M.Jr: Yes, well that's what I'm calling up about and I want you to use it - I mean I - I don't want a sloppy bond market the last 15 minutes.....

M: I'll watch that very carefully.

H.M.Jr: ..... because they sell 50 or 100 bonds and they go off two or three thirty-seconds and it has an influence on the whole thing.

M: Oh yes. I'll watch that very carefully and I'll keep an open wire.

H.M.Jr: I mean I'd like - I'd like to keep it - I mean don't hesitate to use that the last 15 minutes.

M: No sir, I'll not.

H.M.Jr: I mean I'd - I'd like it to close up a thirty-second, if possible.

M: Yep.

H.M.Jr: See?

M: Yep.

H.M.Jr: Ahd - ah has Solomon Brothers got rid of any of their rights?

M: No they've got - they've got about 6-1/2 left.

H.M.Jr: Well an hour ago they had 12.

M: Yes - yes - that's what he told me just a few minutes ago.

H.M.Jr: Ah-ha.

M: Ah - I don't think it will hurt him to take the - ah - to take the - to take the short note.

H.M.Jr: Yes. What are the rights bid right now?

M: Ah- 7 is the - is the general bid.

H.M.Jr: Seven.

M: Seven, yes.

H.M.Jr: And any - any - what are they bidding on the short and long - the new one?

M: Ah - six generally.

H.M.Jr: Six.

M: Yes.

H.M.Jr: Well don't you think that's a comfortable margin?

M: Yes, I - I - we're very much pleased that they've stayed above that price. We felt that if they - that if they went lower or any higher that - ah - there would be influences that wouldn't make the issue look quite as good .....

H.M.Jr: I see.

M: ..... in the actual . Don't you agree with that?

H.M.Jr: Well - ah - that's getting down to pretty technical fine points - I don't know.

M: Well, yes.

H.M.Jr: I mean I wouldn't weep if it had gone up another three or four thirty-seconds.

M: Yes - yes.

H.M.Jr: But - ah - your perfectly happy as it stands now.

M: Oh yes, perfectly happy and it's going nice and the sentiment is good and we're getting more of the 2% notes than we got. Here in New York we get 56% of our subscriptions in the short and 44% in the long which I - up to now which I think is quite satisfactory.

H.M.Jr: Yes and the country will most likely .....

M: The rest of the country will even it up.

H.M.Jr: Right, which I think is very good. But don't hesitate to use that 5 million the last 15 minutes.

M: All right, sir.

H.M.Jr: And I'd rather use it and have them criticize us tomorrow but use it.

M: That's all right.

H.M.Jr: You understand what I mean.

M: I - I understand you, sir.

H.M.Jr: Thank you.

M: All right sir.

H.M.Jr: Goodbye.

Fin

September 9, 1937.
2:03 p.m.

H.M.Jr: Hello

O: Dr. Burgess.

H.M.Jr: Thank you.

O: Go ahead.

H.M.Jr: Hello

B: Hello sir.

H.M.Jr: Yes Burgess.

B: It's most all right.

H.M.Jr: Swell.

B: They're up one to three from last night.

H.M.Jr: Oh grand.

B: And the rights closed 6-8.

H.M.Jr: Swell.

B: So everything's all right.

H.M.Jr: Well I can't tell you how much I appreciate your assistance.

B: Well sir that's all right we're silent partners.

H.M.Jr: No - no this isn't jesting I really mean it, Randolph, tremendously.

B: Well thank you very much, Henry.

H.M.Jr: Because we're really very short-handed here and I always get first-class men. After all I have no Under Secretary.....

B: Yes.

H.M.Jr: .....and I lean very heavily on you and it's been a tremendous.....

B: Well I'm delighted that you do and glad that you feel that way.

H.M.Jr: Yes -and - ah - well this one's behind us.

B: And I congratulate you officially now (laughs)

H.M.Jr: Well -

B: It was .

H.M.Jr: Well it was - ah - as I told Wayne this morning we never leave a stone unturned.....

B: That's right, yes.

H.M.Jr: .....and then the Morgenthau luck - ah - still is with us - I mean.....

B: Well it wasn't luck; you did the right thing.

H.M.Jr: No well now - I mean in this way - we did the right thing but supposing we had the 8 point drop to-day instead of Tuesday.

B: That's right, yes.

H.M.Jr: That's what I mean.

B: Yes, that's right.

H.M.Jr: I mean we could have done everything we wanted to.

B: I'd a lot rather have the worst day first.

H.M.Jr: Yes. Supposing we had the 8 point drop to-day.

B: Yes that would have been bad.

H.M.Jr: It would have been very bad.

B: Yep - yep.

H.M.Jr: Well again thank you very much.

B: Well sir you're very welcome.

H.M.Jr: Good night.

B: Goodnight.

RE TIGHT MONEY MARKET

September 9, 1937
3:00 p.m.

Present: Mr. Taylor
Mr. Haas
Mr. Riefler
Dr. Viner
Mr. Eccles
Mr. Ransom

H.M.Jr: The reason I phoned was I was hoping to get away from here at four to go up to the country to make my appointment with the President, see? So.....

Ransom: I've tried to bring him up-to-date as completely as I could by telephone and again this morning. I don't know just what point.....

H.M.Jr: I asked these gentlemen to meet with me from the Treasury so we'd save time. In the first place, I want their judgment. You know them all and you have as much confidence as I have, if not more so. And it saves a little time if we can have the discussion face to face instead of my talking to you and going out to talk to them.

Eccles: That's all right. You're going away anyway.

H.M.Jr: I'm leaving at four o'clock.

Eccles: And as I understand it, you won't be back until Monday.

(Harris comes in)

Harris: There is no change in the market since the close. Still same good tone. New issues are quoted on the inside six to seven. Of course most of them are not quoting their rights now because you can't get delivery on them. And the total in New York that they have gotten so far today is 178 million plus 152 million last night, which makes 330 million; and that doesn't include the System, 71 million. That would make about 400 million in New York.

Ransom: May I ask how they are divided between the two maturities?

Harris: Yes. Today it's been 104 on the short and 74 million on the two's. And last night was about 72 on the short and about 50 million on the long.

Eccles: How much on the short?

Harris: 72 and 50. And that makes it probably two-thirds against the one-third on the 100 percent. 104 and 75.

Taylor: That's pretty good.

Eccles: How did the stock market do?

Harris: Closed up about three points.

H.M.Jr: And all the Government bonds were up, some of them quite considerable.

(Harris leaves)

Eccles: Well, Ronald has - I've been in touch with him Saturday and then Tuesday - Sunday and Monday were holidays - twice Tuesday and twice yesterday. I left last night at 8:40 this time.

Now, as you know, we - after talking to him about the situation, it appeared to both of us that we ought to have a meeting of the Board, also the full Open Market Committee - the sooner we did it the better. What I'd like to discuss today, preliminary to those meetings, would be to have you give us what program that you would like to carry out, and we can discuss that, so that - I'd like to be able to go before the Board and also the Committee and discuss it thoroughly and fully, so that we can - I assume that you would be available, I can get you on the phone, or couldn't I, on Saturday or Sunday?

H.M.Jr: Yes, Beacon 211.

Eccles: If need be, so that we would be ready by Monday to make such announcement as was agreed upon.

H.M.Jr: Well, I don't - the way I feel, I think, if you don't mind, I don't want to - "My dear Alphonse" - but Mr. Ransom asked to talk to me on Sunday about this money market situation. Now, you people have got the information and I really think that in this

case the initiative should come from you folks. I mean, granted that it ought to be a joint operation and a joint move, and something which we both agree is good for the country.

Eccles: Yes, I think that should be the approach by all means.

H.M.Jr: But as to the basic needs of this, I think that the facts have to be established by the Federal Reserve System - first as to basic needs and then as to the alternatives. I really think that you should set something up.

Eccles: All right.

H.M.Jr: I'm not sparring, but I mean I feel that.....

Eccles: Well, neither am I.

H.M.Jr: I think that's the way it ought to come. I mean we haven't got the machinery, unless we went to the Federal Reserve System and said, "What is the money market situation, what are the needs between now and the first of January?" I think I know, but first I think you want to establish your facts and then the methods of handling it afterwards. Now, I don't know whether you people have got your facts here or not.

Ransom: Well, I think, Mr. Secretary, that I covered it in a preliminary way with you Sunday morning and then by the memorandum prepared by Mr. Piser which I left with you yesterday, gives us a pretty clear picture of what we can expect.

H.M.Jr: Why don't you sum up our conversations, if you would.

Ransom: Yes. So far as excess reserve positions.....

H.M.Jr: Why don't you sum up our talks, what you have said to me, where we stand, where we arrived at.

Ransom: On Sunday morning I called to the Secretary's attention the fact that our survey of the situation indicated that we could expect a definite decline in the excess reserve position of the banks of the country during the period between now and the end of the year. I pointed out that that would perhaps

be relatively more acute in New York, as the money center, than it would be in the rest of the country, and that we had to recognize the fact that that had a bearing on the Treasury refinancing which was then under discussion, and also a bearing on the question of the policy to be followed by the Board and perhaps by the Treasury also in the intervening period between now and the first of the year.

The Secretary pointed out to me that he was very glad to have an opportunity to discuss that; that a good many of the same thoughts had occurred to him and that he was considering, in relation to that situation as it developed, the advisability or not of a discontinuance of the sterilization program.

I then suggested to him that both you and I, Mr. Eccles, had had in mind the fact that some mechanism should be devised which would meet that situation as it developed, and informed him that on Saturday morning, in the meeting of the Executive Committee of the Open Market Committee, I had myself suggested action on a proposed resolution which I had prepared which than 200 million dollars in shortion of not less term maturities for the purpose primarily of supplying the lack of excess reserves which we knew would develop - believed would develop - and also of putting a ceiling on the bill rate for the purpose of maintaining a more orderly condition in the market during that period. And he and I discussed the possibility of that as a mechanism and the discontinuance of the sterilization program as a mechanism which might achieve the same objective.

Later on and after another conversation with him and several telephone conversations with you, I found that both you and he had reached this much of a common ground: that as between a discontinuance of the sterilization program and a program which would desterilize a certain block of the sterilized gold, you both felt that you would prefer the desterilization rather than a discontinuance of the policy, for reasons which I think all of us are thoroughly familiar with. And on yesterday, in the

further discussion with the Secretary, he and I agreed that we were down to the point where we were to choose between two alternatives, either that program of a desterilization of a certain amount of the gold by the Treasury, or an open market operation, about which I think he had some mental reservations both as to effectiveness and also as to perhaps the wisdom of the move at this particular time.

So that when I telephoned you last on yesterday I could report to you that we at least had reached the point where we were considering a choice between these two, and also pointed out to you that the Secretary felt that he should make any announcement he made on the subject not later than Monday. And I found a rather interesting - in a rather interesting way to me, that you had reached the same conclusion independently of him, and that you both felt that there was no reason to delay a decision on this matter longer than that; that we might as well decide before the event rather than after the event and come to some sort of a conclusion about it.

Now, I have not felt at liberty, in view of what the Secretary said to me, to discuss it with anybody other than the members of the Board and the chiefs of our divisions, because I did not feel that at the time the Secretary wanted it carried to the Open Market Committee, and I haven't.....

H.M.Jr: And I haven't talked to anybody outside of the Treasury, because I didn't want any rumors while the financing was going on, I didn't want to muddy the waters; and so, outside of the small intimate group in the Treasury, nobody knows anything about it.

Ransom: So I would say that both you - that the Secretary and you, Mr. Eccles, and I have all felt that this was just as appropriate a time as any other to consider this problem and decide whether we could adopt a mechanism which would meet a situation which inevitably is going to develop.

H.M.Jr: To show you that there isn't even a whisper of a leak, I had my press conference at 10:30 this morning, and not a word about the Federal Reserve or ourselves - not a question.

Ransom: Well, it is rather amusing that this might have caused some newspaper comment except for the fact that the press construed Mr. Eccles' return as related to whether or not the Board would reduce the marginal requirements on the stock market, and they were perfectly satisfied with that. But a lot of people are still puzzled to....

Eccles: New York is very curious; they are very anxious to find out.

H.M.Jr: They tried to do a little pumping with me, but they got nowhere.

Ransom: Tried it with me. Does that sum up.....

H.M.Jr: I would say that you could get a job with the Associated Press at any time as a star reporter.

Ransom: Thank you.

H.M.Jr: The only thing I'd say is this. In our conversation that we first had on Saturday - Sunday - in Mr. Magill's room, if you remember, you did say - you first said that frankly you were worried, you and Mr. Eccles, and that you thought it should be an open market operation.

Ransom: Yes.

H.M.Jr: Then I said, "Well, we've tried that now various times and the great trouble is that they always carry it out without any enthusiasm, and I am fearful that at this time it can't be done fast enough to get the effect that it needs, and therefore I think that doing something with gold would be more effective." I mean I think that's the only possible - is that right?

Ransom: Yes.

H.M.Jr: And you said, in talking for yourself, that you more or less, without committing yourself, agreed with me.

And then the other thing, which entered into the only other discussion, was....

Ransom: Certainly agreed with you, if I may interrupt, that I thought the open market operation was one about which we had to make up our minds to act and to act with decision in the future if we were going to have it effective; that it was always the problem of getting it effective and I thought that this time we could make it effective.

H.M.Jr: The only other thing, I think in discussing it yesterday - I think you mentioned the fact that if you couldn't make the open market operation, what was the use of having a Federal Reserve Board, and I said that I felt that this time might be a little unwise to use as a battleground to reach as important a decision as whether the Federal Reserve Board was worth while or not, but I thought maybe some time when things weren't quite so critical that the battle would have less reverberations; that is, I thought it wasn't an awfully good time to pitch a battle.

I think that's the whole thing, and as we brought it along we discussed the thing, and, considering the human elements, I think that my crowd and myself are largely in agreement. Each one has a way that they think they'd rather see it done if you could eliminate the human element, but inasmuch as we are what we are, we are pretty much in agreement that the choice lies between those two methods. Now.....

Eccles: Well....

H.M.Jr: And I might just add one other thing. The reason that I put aside the question of stopping sterilization of gold was that I felt that the question of sterilizing or not sterilizing isn't the problem; that the problem right now is that we are facing a tight money market, and the question of gold sterilization isn't up. And that's why - I mean if we stopped sterilizing at this time, why, then we'd be handling two problems, and I think if we handle one problem at a time it's enough.

Ransom: Yes, and if you stop sterilizing, you'd obviously be using a long-range mechanism for a short-range purpose.

H.M.Jr: True. I mean the question of to sterilize or not to sterilize - that question isn't up.

Taylor: And it might be six months before you - all other things being equal, before you got the amount in there that was necessary to do the job, whereas this way you can put in whatever it is that you want to put in, if you decide to use that mechanism, then go ahead and accumulate again.

H.M.Jr: Then, if we stop sterilizing, it adds another uncertainty, and that's the last thing we want to do. Now, that's the whole thing.

Eccles: Well, I've thought a good deal about it continually, and, just briefly reviewing the background, because after all I think that always has a bearing on the problem, at the time that the Treasury started sterilization, at the time we increased reserve requirements, shortly thereafter, we knew that it would create a situation with the banks whereby the excess reserve that was left in the System after our increase in reserve requirements, with your sterilization program in effect, would fluctuate only with the increase or decrease in the amount of currency in circulation and the increase or decrease in the amount of credit extended by the banks. In other words, we had sort of shut the doors. We recognized that during a year's period the amount of reserves would fluctuate due to, very largely, those two factors: at the quarterly periods, where it would be more, and the fall and holiday period, which would be the periods when there would be a lack of stability in the short-term market, in the short-term rate; and that the open market function was a device - either that or the establishment of a Government bill-buying rate, which we have been discussing for some time and which I haven't gotten very far up to date, would tend to meet this situation; that is, a bill-buying rate or an open market rate that was more or less mandatory in nature, based upon a formula.

Now, just speaking in this room, you know that particularly the Reserve Bank people, and New York in particular, are - resist in every way possible, or are extremely loath to take away from them discretionary power, which the establishment of a bill-buying rate would tend to do.

By establishing the bill-buying rate what I had in mind was that it would be like the acceptance rate, only it would apply to Government bills. The justification for that is that we don't have any large amount of acceptances - that is, the banks don't - and what acceptances do exist are owned largely in New York, and are owned by a small - even a small number of the banks in New York. And therefore, in the absence of a large amount of acceptances, establishment of a bill-buying rate - we put a top upon the interest rate; the banks would not have to show borrowings, which there is apparently a great loathness - a great objection to at this time. If we established, say, a bill-buying rate of a half of one percent on paper with a certain maturity - possibly a 3/8 - and paper of a lower maturity, that would put a top on the rate on bills and would put the banks throughout the country in a position of selling bills to the Reserve System at a rate that we would assume would be satisfactory to the Treasury and would assure at all times an ample supply whenever a supply of funds was needed for the short-term market, and it would more or less work automatically.

Now, that was the one thought. Now, the other one - I recognize that the open market has not worked well, as you have indicated, the way we have worked it in the past. To go into the open market and buy particular issues of bonds that are weak tends to put into the Reserve System long-term securities which, in view of the amount they have, is not desirable because it would tend to freeze the portfolio beyond a point that I think it might be advisable to do. Excess reserves can be created by the purchase of short-term bills, and they could - these bills would be - if we could buy directly from the Treasury as most central banks can, why,

we could take care of that; we could buy directly and give such funds at such rate as we desired and then let those securities - sell them at the market as the reserves increased, when currency came back into circulation. That's what the Bank of England does, but we can't do it so we've got to go to the market and do it.

The proposal that Mr. Ransom and Piser discussed was this, in the general principle: that we would instruct the New York Bank, acting for the Open Market Committee, to buy bills not exceeding a certain maturity until such time as the reserve in New York City - the excess reserves, that gives you the money market picture, which after all is your short-term market - until such time as the excess reserve would not be less than, say, 200 million; and that would be for any week, it wouldn't mean that it was a question of - it would have to average that for the week, or until the rate was not exceeding one-half of one percent or less. The difference between that and the bill-buying rate would of course be that it would apply immediately to the money market.

That is, of course, in effect an open market operation. It is a little bit different than an open market operation left up to the discretion of the managers to buy as and when they want, and such issues as they want, and it doesn't relate to the rate. Now, after all, the rate is the important thing in the short-term market, and to try to talk about artificial - about normal rates in the short-term market at a time when you are proposing an easy money policy is, it seems to me, perfectly ridiculous. There isn't a normal rate; you make the rate in the short-term market by the amount of reserves. That's what tends to make the rate.

So that we could definitely fix a top to your short-term rate that would be, I think, satisfactory, and it would work immediately and it would work effectively, if we could get it through. Now, I don't know that we can.

H.M.Jr: It just doesn't ring a bell here at all.

Eccles: Well, I'm just giving you the.....

H.M.Jr: I don't think you can do it. If you don't mind my saying, I don't think you can do a single thing that you say. What is this putting a limit on a rate business? My god, you reduced the rate a half of one percent; it was absolutely meaningless. And this thing - you think you can put money - the bill market in a narrow groove and it's going to stick there.

Eccles: You can buy bills and fix your rate.

H.M.Jr: Well, the rates on our bills - up to - what was it, three weeks ago - we were selling these tax dates at around a fifth of one percent, and it began to shorten.

Eccles: It began to shorten when the excess reserves dropped down to somewhere less than a hundred million.

H.M.Jr: May I ask a question? Have you just closed your mind to this question of putting in a definite amount of gold?

Eccles: No, I haven't closed my mind. I'll argue both sides of it.

H.M.Jr: I mean have you just put it to one side?

Eccles: My mind isn't closed on it at all, and it may be the desirable thing to do. It has some arguments in favor of it. And don't think for a minute that in my arguing or presenting these other ideas that I am doing it with the idea of eliminating the question of desterilizing a certain amount of gold. I am merely reviewing and pointing out the consideration that we have given to the question of maintaining a top to the short-term bill rate, which after all is the money market instrument today, in the absence of our ability to buy bills directly. It is more or less of a getting around that prohibition.

Now, getting to the question of desterilization, so far as the Treasury is concerned I have a good deal of sympathy with your position, and I think I might feel exactly the same way if I was in your position. So long as you are sterilizing gold you are increasing, of course, the debt, and it appears in the amount of the deficit. Politically and publicly, that tends to create a position which is not altogether desirable.

The portfolio at the present time is two billion five hundred million.

H.M.Jr: Marriner, may I interrupt you again? You don't see it from my standpoint at all. I'm not worrying about my position; my position is all right. We are not worrying about the gold. I'm not worrying about the debt. There is no heat on me. I mean I don't - I mean, that is, if the heat's on me, which it isn't - the heat isn't on me. The heat's on - if you want to call it that, the heat's on the Federal Reserve Board because you created this situation.

Now, we're not worrying about the public debt. I've just concluded another financing, made two percent for five years; that's not exorbitant. I mean I'm not worrying about my position at all. I can go on and raise my money. I don't have to raise much money between now and December, and I can raise what I need in December. I'm all right.

Taylor: Just to interrupt you, we're trying to look at this - your approach and the Treasury's approach should be as if all these instruments belonged in the same place. Then, what do you do? Which is going to have the best effect?

H.M.Jr: But it isn't a question of the shoe pinching the Treasury, because it isn't.

Eccles: Well, it isn't pinching the Reserve System.

Viner: I think the problem is what ought to be done for the national credit structure, and it's primarily a Federal Reserve problem. We want to cooperate.

Eccles: Well, outside of the question of Treasury financing, there is no pinch in the short-term money market.

H.M.Jr: Marriner, I don't think you know what conditions are.

Eccles: Oh yes I do.

H.M.Jr: I don't think you do.

Eccles: The bank rates today are by far the lowest they have ever been, and now they are - so far as commercial borrowing is concerned, agricultural borrowing is concerned, or any borrowing for business purposes - collateral loans - the call rate is one percent - there's no problem with reference to commercial paper or commercial borrowing or agricultural borrowing of any kind today. The rates today are not a deterrent in any sense of the word.

So far as the Treasury is concerned, I recognize that the one percent discount rate in New York and one and a half outside has hardly been touched, and the Treasury short-term debt is high. It is perfectly natural that banks are not going to buy Treasury bills at a half or three quarters and discount at one or one and a half percent. And the rate is high for the purpose of Treasury financing, especially at a time when you have to - when the debt is increasing. Therefore, the problem is not the problem of the need of credit for business generally, as far as commercial bank or bank credit is concerned.

Haas: How about capital?

Eccles: Well, that....

H.M.Jr: Now, Marriner.....

Viner: Let's hear what the problem is.

Eccles: Capital is a very different problem from this, and I want to say something on the question of capital market which doesn't necessarily relate to this problem. You can't provide a capital market through - which means long-term credit - what capital market

means - through having the pressure of excess reserves so great that banks will increase their holdings of long-term securities, especially because that puts them in a position - the banks increase their holdings of long-term securities then because there is nothing else to do, at a rate that later on may show them a very substantial loss, which would create a problem not only for the Reserve System, for the F. D. I. C., but for the Treasury.

Therefore, I think that the thing that we've got to consider is, after all, the short-term bill rate and the commercial paper rate, etc., and the question of the discount; one percent and one and a half percent is an effective discount rate so far as commercial borrowings are concerned, or agricultural borrowings.

H.M.Jr: But nobody uses them.

Eccles: They don't have to use.....

H.M.Jr: I mean why not make it three-quarters of one percent, make it a half of one percent, and get down to realities. I mean as long as commercial paper is sold at a half of one percent, what different does the discount rate make at one half percent or one and a half or five percent?

Eccles: Well, commercial paper is sold at three-quarters or - the best paper - and a good deal of the paper is at one percent.

H.M.Jr: The banks are selling their own paper at a half of one percent - over Labor Day.

Viner: Bankers' acceptances.

Eccles: Bankers' acceptances - an acceptance rate of one half of one percent. And bankers will sell those acceptances when they get under pressure for reserves, rather than the discount rate. They have darn few acceptances. But if you had a rate for bills like you have for acceptances, they would sell bills and it would assure you a bill market.

H.M.Jr: Marriner, why don't we face this thing?

Eccles: I think I am.

H.M.Jr: Well - and talk about the reserve requirements. I mean that's what started this whole thing.

Eccles: All right, I'll do that. If today we hadn't used all of the power we had to increase reserve requirements, there isn't the slightest question but what we would have long since been under pressure to use that power in order to sterilize gold rather than have the Government borrow to sterilize gold. By using the reserve requirements that we have used, we have put on the banks the expense of sterilization; that is what we have done to the fullest extent that we can.

H.M.Jr: I don't get that at all. The Treasury's paying the expense of sterilization.

Eccles: No, we have - the banks are paying it to the extent that we have sterilized gold up to three billion dollars.

H.M.Jr: They're not paying any of it. They're not paying any of it.

Eccles: Maybe we can clear it this way. They are paying it in that their reserve requirements - they've got less money by the amount of the increased reserve requirements than they had before; that much money is tied up, so they're paying it. The banks are paying it.

H.M.Jr: Well, that doesn't.....

Eccles: We talked a while ago about increasing reserves on foreign balances. Why? Why would we have any justification to increase reserves on foreign balances as long as we had not increased reserves entirely on domestic balances? We wouldn't go to Congress for legislation for power to increase reserves on foreign balances, which we feel justified in doing in order to be able to sterilize part of the incoming gold without having to borrow to do it.

Viner: I think there are more weighty reasons.

Eccles: What is it?

Viner: There are more weighty reasons than that for having these increased reserves against foreign deposits.

Eccles: What were they?

Viner: Partly to discourage their coming here.

Eccles: That wouldn't discourage them.

Ransom: They don't pay this bill.

Eccles: The bank pays it. They wouldn't unless you put it up to a hundred percent. It would force it out of the banks into the market.

H.M.Jr: Look, I'm finding myself doing something I don't want to do; I don't want to argue about this thing. I mean there isn't any use arguing. I've gone just as far as - in a very calm way with Mr. Ransom as I could go. There is no use going any further. It's down to one of two choices. I don't want to - it would irritate you, Marriner, and I don't want to irritate myself.

In the discussions that Ransom has had with me and I've had with him - I understand he's checked them all - reported them all to you; and as far as we went it was down to a question of a choice of one of two things. Is that right?

Ransom: That's correct. I think it might be helpful, Mr. Secretary....

H.M.Jr: I don't see what's to be gained in my irritating Marriner or his irritating me.

Eccles: I don't see why we should irritate each other by merely discussing this thing.

H.M.Jr: Well, it always ends up that way, unfortunately, and I suppose it's my fault.

Ransom: I think the.....

H.M.Jr: But it just - we've got a very critical situation; I told Ransom I'm not going to sit here and argue about this thing for a month; I'm just not going to do it. I'm not going to get irritated about it.

Ransom: I think it might throw some light on the situation, as long as Mr. Eccles hasn't been here, if you would run over the critical situation just as you see it, as you have with me.

H.M.Jr: It's just that I think that these things, the way I see them, are always a question of state of mind; it's what people are afraid of. You can't any more today get a man in Wall Street to tell you why he's got the worst case of the jitters he's had in two or three years - he can't explain it, but the fact is he's got it. And I believe that the people there - that they are worried about this thing, that they are smart enough that they see that these New York banks are going down to zero in their reserve requirements and that they're going to get themselves in shape, and they've sold - there's this constant selling of Governments, and there's no bottom to it, there's nothing that any of us can do, following the methods that we have. There is this constant selling by the banks. I think they've sold over a billion dollars, isn't it, in the last 12 months, and they will continue to sell. And I don't believe that by going in and buying one or two hundred million dollars worth of bills you're going to have any effect, because I don't believe it's going to reestablish the confidence in the Federal Government and I think we've got to do something which is going to give them confidence.

And I think that the thing, as near as I can make it - that one of the things that they're as much frightened about as anything else is this constant tightening of money, selling of governments, more selling of governments; and it's just a vicious circle and it goes around. The thing that I think we have to do is to do something promptly, something that we can agree is of economic value, nothing foolish, something that we can defend, something that the public will accept or something that they won't interpret wrong due to lack of education, and to give these people back some confidence.

Now, I think it's one of the - as I say, it's a bad case and I think talking about some new device or of putting these various bills into a framework and thinking that they are going to stay there or talking about something like that - I just don't think the people are - I don't think it's going to have any effect at this time.

When Mr. Eccles spoke to me about this thing six months ago, I said, "It's very interesting; let's try it." He couldn't get it across, and I don't think that at this time if we simply did that and then told the people in New York to go ahead - my god, you've had orders down there to buy and they've always got a good excuse not to buy, and if you do buy they just say you're supporting the Government bond market. Now, you can't make an unwilling horse drink.

Ransom: I might say the thing that would make that unwilling horse drink quickest was the idea that the Treasury was going to desterilize. I think the mere suggestion of that would be more effective in obtaining a result from an open market operation inaugurated by the Board and carried through by the Open Market Committee than perhaps any argument which the Chairman or I or anybody else had available to us last spring when we were discussing it.

Viner: Do you mean that if the Treasury were to say that "unless you do that, we'll do this"?

Ransom: Yes. Well, I don't - let's don't put it that way, Dr. Viner. Let's say that the Treasury and the Board are considering which of these mechanisms will produce the best result, and so far as Mr. Eccles and I are concerned - I don't hesitate to speak for myself and say that I think the New York market needs and is going to need excess reserves that they haven't got between now and the year end.

Viner: That's the problem, isn't it?

Eccles: I agree with you. I have recognized that for a long time.

Ransom: That, I know, is Mr. Eccles' view of it.

Eccles: That they should maintain these excess reserves at a stable amount throughout the year and that these periods should be met by flexibility, and that the excess reserves should not be allowed to fluctuate widely in the money market.

...

Taylor: Why don't you do it this way, Marriner? You've got four choices which are up for consideration when you talk to your Board and when you talk to your Open Market Committee. One is straight open market. Two is this bill rate.

Ransom: Which can be tied with it, can be joined.

Taylor: They are part of the same thing.

Then, putting in a block of gold or stopping sterilization.

Eccles: Or a combination.

Ransom: Still another.

Viner: There's another.

Taylor: And the last one the Treasury doesn't want to do. Of course, your other one is changing your reserve requirements.

H.M.Jr: Which should be Number One.

Ransom: Just as soon put it at the head of the list, because I'd like to discard it first.

H.M.Jr: That's Number One - change the reserve requirements.

Eccles: If we did that you certainly couldn't go and ask for power to increase reserve requirements on foreign balances; neither could you justify a continued sterilization at the expense of the Treasury rather than pass it over to the banks by increasing reserve requirements.

Taylor: Well, all right.....

Eccles: Do you agree?

Taylor: Well, I don't think it's necessary to comment on it. I think if you list your - say, five choices, or six choices, saying - granting that something ought to be done: all right, pick it.

Viner: In other words, which would you rather do, and what would you do if you were a free agent to choose from all of these devices?

Taylor: If you had all five of them instead of having three of them, let's say.

H.M.Jr: Simply call me up and say, "Henry, we have had a two-day session - or three days or four days - and this is the conclusion we have come to."

Taylor: The Treasury agrees that something has - ought to be done and is prepared to cooperate.

Viner: I think the position is this, as I understand. The Treasury, as it sees the picture, believes the Federal Reserve ought to do something. If it is decided that what ought to be done is something that we happen to have under our control, and if they request us, we'll be glad to do it.

H.M.Jr: Well, I take it that Marriner Eccles wouldn't come here if he didn't think that something should be done.

Eccles: Well, I have felt right along that something should be done. You won't get any argument with me on that. I feel that these reserves that we have should be maintained where they are and that there should be excess reserves in that New York money market at all times of a sufficient amount to insure a low rate on your short-term financing. I don't think there is any question about that.

Now, when you get to the question of your long-term financing, the New York banks, and I think banks in general, are not going to increase their holdings of bonds. I doubt very much if it is desirable for them to do so. The question is, will other big investors, the big investors in the capital market, buy bonds? Now, that depends upon several factors: first, the rate; next, the fiscal situation; and next, the general economic situation. The insurance companies and the savings banks and other institutions that have funds for investment are the ones that should

and must be relied upon largely - investing public generally - to furnish capital for the capital market; that would include your long-term bonds.

We as a reserve system are primarily interested in the short-term market for, first, the Treasury financing, which is first and foremost certainly at a time of deficits, and secondly, maintaining a rate that will help to stimulate and not retard commercial and agricultural borrowing.

Now, that is absolutely essential, and we would adopt - we are pledged to an easy money policy, and I haven't changed my view a bit in that regard.

Ransom: May I interrupt you to say that our problem has always been - since the Board reached the decision that an easy money policy was desirable, the Board's real problem has been to maintain it.

H.M.Jr: Well, I'm terribly glad you said that. I mean - if you don't mind, I've got to talk plainly - I mean you talk an easy money policy, but while you talk it the money rates get harder all the time.

Ransom: Correct; there is no argument. I would like to add as a postscript to what I have said that with a full conviction on my own part that it is essential for many reasons that we should do all we can to maintain an easy money policy at this time, I still think that the increase in reserve requirements was necessary at the time we made it, but that, having made it, we have then got to be advised of the fact that the situation is developing along certain lines from that point on, and meet those developments to the best of our ability, in cooperation with the Treasury, just as I feel that the Treasury has all along been trying to help us carry that policy through to execution.

H.M.Jr: Now, if you don't mind - personally, I like to do these things easily and gently, and so forth and so on; and, Marriner, if you don't mind, don't try me out as a sounding board but try out your own board, and it would be much easier on me and we can continue our friendship. But the trouble is - don't try me as a guinea pig.

Ransom: He's tried this on his own board.

H.M.Jr: Just don't use me as a guinea pig. I'm available, my phone is Beacon 211, we're there, and you fellows just go back and when you're ready to talk I'll be there. And the only advice that I've got, if I may, is that as far as I'm concerned I'm not going to push you, and if it is difficult to make up your mind, Tuesday is still there and Wednesday is still there. That's the only thing. As far as we are concerned, I think Monday would be a swell day, but if it's going to be difficult, the sun will still rise Monday, Tuesday and Wednesday.

Eccles: We can make it up just as well Monday as Tuesday and Wednesday.

H.M.Jr: All right, but I don't want you to feel that I've set any deadline. See, I haven't set any deadline.

Eccles: I'd just as soon have you set one.

H.M.Jr: Well, it's not up to me. If you fellows can't make up your mind by Sunday, God bless you, take Monday.

Eccles: I wish you'd set a deadline.

Ransom: May I ask a question and then have it omitted entirely from this memorandum, simply because it does influence my own personal decision. Suppose it is impossible to reach a decision, a Board decision, that is in line with what I know to be Mr. Eccles' and my own thought at the moment; that is, that something should be done. Suppose the Board should think that nothing should be done. Suppose the Federal Open Market Committee feels that nothing should be done - there may be differences of opinion - and in that event we report, as we would have to report, that, although Mr. Eccles and I might feel that action was highly desirable in this situation and at this time, there would be no action.

H.M.Jr: But that you and Mr. Eccles and I are in accord as individuals - would you add that?

Viner: If you reached a deadlock, would you be willing to report to us that as far as you two were concerned, your opinion was such and such?

Ransom: Yes. I can only speak for myself, not for Mr. Eccles.

Eccles: Yes, that is exactly the way I feel, and I told Ronald to tell you that.

Ransom: That's what I told you.

Viner: Would you do it for the record, for the internal record?

Taylor: You can't have a record of that.

Viner: No.

H.M.Jr: Ransom, I think what you're - to be fair to yourself and myself, if that situation should arise, it isn't very different than what it was before, except at that time Eccles was only speaking for himself; and he said to me, "Henry, if I can't get an agreement with the Board, I'll make a statement with you publicly as Marriner Eccles." Isn't that right?

Eccles: That's right. I told the Board that, I told the Open Market Committee that.

Ransom: Yes, and it produced results.

H.M.Jr: Ransom and Eccles and H.M.Jr can come to an agreement, if you want that card up your sleeve. But at that time I just - may just say, Eccles was very keen to do it publicly.

Eccles: Well, I think you have to, and I'd want you to do it publicly. I mean it doesn't do the country any good to have me say, "Henry, old boy, I'm with you, but for god's sake don't tell anybody."

Ransom: Well, if I'm with you I don't mind telling you.

H.M.Jr: Do you check with me, Wayne? Am I going too fast?

Taylor: Well, I think that's not quite necessary yet.

H.M.Jr: He wants this for trading purposes.

Ransom: I want one other thing.

H.M.Jr: I'll give you anything you want, God bless you.

Eccles: I did that before for trading purposes.

Ransom: This one question, I think, is very important. Do you feel that action is necessary in the present circumstances?

H.M.Jr: Yes, I do.

Ransom: That I understood from you Sunday.

Eccles: Well, I agree with that.

Ransom: I ~~understood~~ that when you called me Tuesday - not only was action necessary, but rather prompt action.

H.M.Jr: I do.

Ransom: Now, with that to back us up.....

H.M.Jr: How about you, Marriner?

Eccles: I agree. The trouble is that you haven't a tight situation because you have 700 million excess reserves - nearly 200 million in New York - but it's the constant propaganda that before the end of the year we're going to do nothing, nobody's going to do anything.

Viner: Mr. Eccles, money can be tight while cash is on hand if you think there's going to be a claim on that cash tomorrow.

Eccles: That's exactly right; that's what the situation is now.

H.M.Jr: Summing up, talking for myself, I feel that something should be done and done promptly. I didn't - the reason I said you don't have to do it Monday is that I don't want you people to feel - Eccles flies back overnight, takes the physical effort, and I don't want him to feel that I'm holding a pistol to his head, because I'm not; but I think the situation is.

Viner: But I don't think it's a Treasury situation basically. I think it's a general economy situation.

H.M.Jr: Well, I.....

Viner: I think that ought to be clear in this discussion: that the Treasury doesn't need any help at the moment.

H.M.Jr: Exactly, and - excuse me, did you want to say something else? I didn't mean to cut you off. Finish your thought.

Viner: It seems to me important that we should - I myself; I don't know what you think - but I don't think that the Treasury can't stand the rates now. The Treasury is financing on easy terms, your credit situation is going to ease, the budgetary estimates and so on are such that I don't see any prospects of a tight squeeze on the Treasury at all. But I do think that the economy needs certain action now and that therefore that is primarily a Federal Reserve responsibility; that the Treasury will have repercussions from any adverse effect on the economy and therefore has that secondary consideration, and therefore the Treasury should cooperate with you to the utmost, should welcome consultation in this way, and should welcome, if you so prefer, your saying in taking any action that you take it in consultation with the Treasury. But it is not an action directly intended to improve the situation for the Treasury. We don't need it.

Ransom: I might say, Mr. Secretary, that I am fully in agreement with Dr. Viner, and because I am so fully in agreement with him I have felt that we should use every effort that we can use to remedy this situation by an open market operation rather than a Treasury operation, if it can be done.

Viner: That's my position.

Ransom: Now, if it can't be done, then I'll say to you as a member of this Board that I think the Treasury would - be fully justified in taking action to relieve a situation which is not a question of a pinch on the Treasury or a problem of Treasury financing, but one which relates to the condition of the money market as it exists today.

Viner: Well, may I ask a question that may clarify it. Supposing that you try to get an open market operation through with the Board and fail. We have an instrument that we can use to meet a purpose which is primarily a Federal Reserve purpose. I don't think we ought to use it for that purpose until it is clear in every way that we are using it at the wish of the Federal Reserve Board. Now, you can probably carry a decision through the Board that you can't carry through the Open Market Committee. Shouldn't you then, as a resolution of the Board, ask us, or be authorized to enter into consultation with us about a desterilization operation?

Eccles: That should be between the Board and the Treasury, and.....

Viner: And not the Open Market Committee.

Eccles: We had no idea of bringing the Open Market Committee into that.

Viner: Rather than a personal statement by the two of you.

Eccles: I very, very much prefer it.

Ransom: Very much prefer it.

H.M.Jr: We're thinking alike, and I want to say this: that this is the time, again, when I think that the results will be accomplished if the Board and the Treasury present a united front. That was my plea all last March and we finally got it. And I think it's just as important now. And all these little squirts that write these articles about the differences between the two - I mean I just wipe them aside and don't pay any attention to them. I mean action counts louder than any columnist can write.

Ransom: Well, I think the record over the past year demonstrates the cooperation on the part of the Treasury with the Board and the Board with the Treasury; the record speaks louder than anybody else.

H.M.Jr: Riefler, did you want to say something?

Riefler: Jake has said most of what I wanted to say. It seems to me from the point of view - the Treasury financing is out of the way; if you did absolutely nothing, the bill rate would rise to the discount rate in New York, which would be one percent, and you are perfectly willing to pay one percent for any funds you need.

Eccles: But are you?

H.M.Jr: Sure.

Viner: Don't care at all on the short-term rate.

Riefler: There is a case for doing something, but - and I do think this, although I have had some doubts before: the situation has changed rapidly since last March, when somewhat restrictive action on an exuberant market was indicated. The business situation is sluggish, there's been no new financing; such regular demands for capital from your regular capital institutions - savings institutions - as come into the market are being met in general by buying bonds sold by the banks - Treasury bonds. And - I mean it is in that sense - the new financing that the market will be able to absorb - that you are helping the long-term market if you do something.

Eccles: Don't you think that the banks would continue to sell bonds when they get strong, as they go up, as the rate drops? With the general world picture, the banks prefer more short and less long.

Taylor: They should.

Eccles: Then what Win is talking about is a situation that we can't meet by open market operation. When the bonds get weak, as they are now, and you have a sufficient amount of funds and there isn't any pressure on the banks, they are less likely to sell bonds, of course. At the same time, when the bond market becomes strong again, they have profits in those bonds. Even though you have a substantial amount of reserves, the very banks with the reserves - now, we have plenty of instances of banks which have had an abundance of reserves selling bonds when they got up to a certain point because they felt that the long-term market did not justify continuing to hold bonds at those rates.

Now, that seems to me to be the situation. I think this, that a one percent rate on Treasury bills, even though the Treasury is willing to pay it, is undesirable because it would tend immediately to reflect itself in other rates, in the intermediate and in the long-term rates at this time, and the best way to take the pressure off of the intermediate or the longer securities would be to of course keep your short-term rate at this time on Treasury bills at lower than one percent.

I don't know whether you agree with me or not.

Viner: I don't disagree, but I'm not convinced; I don't see it as clearly as that. I think there are possibilities of operating on the rate so that you get a different rate structure, with the long-term rates kept down and any increase in interest rates which must occur being in the average rate over all the maturities. I think that the present differential seems to me offhand to be a rather abnormally large one, and that a return to more normal conditions could, I think, very well take place without any substantial stiffening of the long-term rate through a stiffening of the short-term rate.

Taylor: We thought that back in the spring and it didn't work that way.

H.M.Jr: Do you mind - excuse me - what I'd like, unless there is something else and unless Mr. Eccles wants to ask me something - now, you (Ransom) asked me two questions, I gave you cleancut answers, didn't I? You (Eccles) want to ask me something?

Eccles: Yes. I'd like to ask this. If we go before the Board, we've got to have a proposal. Now, Idon't know what I can propose other than the two methods that I have discussed here - the bill rate, and, say, the open market operation, or the open market rate along the line of making it a mandatory, automatic order so that they have to buy when a certain situation develops with reference to the reserves. In other words, when reserves in New York get to a certain point, they automatically buy; that is, they buy bills. Now, I don't know of anything

else to discuss in the way of a program with them now. I mean so far as we're concerned, if the problem is ours to meet the general business or economic needs, that is the way I would see we should undertake to meet it. I've seen that for some time.

If, on the other hand, the Treasury is anxious and very desirous of being relieved to some extent for a time - I'm just saying if that's the case - if that isn't, it's another story - if that isn't the case - as I understand, that isn't, that's not a factor.

What we do when we buy - we increase our portfolio to give the reserves.

H.M.Jr: What's the use, Marriner? Asking me a thing like that after an hour's conversation! There's never any use talking to you, Marriner. I try to be nice, and then after my telling you with all sincerity that that isn't my object, you've got the audacity to put it up to me that you want me to be relieved of some gold. I mean Jesus Christ, I sat here for one hour and talked to you man-to-man as intelligently as anybody could and after one hour you want to know whether I want to be relieved of some gold. I say it's an insult for you to ask me a question like that. It's an insult!

Eccles: You said to me that the proposal I make is unsatisfactory.

H.M.Jr: I say it's an insult to my intellectual honesty, after one hour, to ask me if I want to be relieved of any gold. This man (Ransom) can.....

Eccles: I proposed something and what did you say? You said it was unsatisfactory - both methods.

Viner: No, not the open market operation.

H.M.Jr: Marriner, we never understand.....

Viner: If you can work it satisfactorily, if you get it through for a reasonable amount, and.....

Eccles: The record will show that the Secretary said that it was unsatisfactory, that he didn't think it was fast enough, he didn't think it would do the job. And now, if that's the case and that is unsatisfactory to him, then what am I to do? Now, I can't - am I going to go before the Board and say that the Treasury is dissatisfied with an open market operation, that they want to desterilize a block of gold? That's what I want to know here. And there isn't any need of - these matters can't be settled in a few minutes, and it seems to me that if we're going to get along we've got to do it without passion and without getting irritated.

H.M.Jr: Well, why shouldn't I get irritated?

Eccles: There's no justification for it.

H.M.Jr: Oh yes there is.

Eccles: No there isn't. You get irritated every time I come over here and present anything, and I'm getting just as tired of it as anybody else.

H.M.Jr: Well, maybe it's.....

Eccles: Maybe the thing for me to do is get up and walk out, because I'm getting god-damn sick and tired of it.

Viner: You two fellows have got to agree whether you like it or not. I mean there's something more important than the feelings of either of you, and that is the good of the country.

Eccles: If I can't come over here and sit down and talk peaceably and quietly without having the Secretary jump all over me, then damned if I'm going to take it.

H.M.Jr: Well, may I ask you - after one hour's conversation and having every conversation that I have had with Mr. Ransom - after one hour you come back and say, "Is it that the Treasury wants to be relieved of some of this gold?"

Eccles: I didn't get the impression from Mr. Ransom to the effect that you didn't, and I wouldn't blame you if you did. There would be nothing amiss in it. As a matter of fact, it may be perfectly justified. In other words....

Viner: Mr. Eccles, I think possibly we might like to be relieved ordinarily. But I think we think that there is something more important than the convenience of the Treasury at stake, and that is the national economy.

Eccles: I am not arguing that it is being done solely for that purpose. What we need to do is get reserves. Now, the question is, do we want to get the reserves through the Treasury desterilizing 200 million or 300 million or some amount of gold, which builds up reserves, or do we want to get it by the System increasing its portfolio?

Taylor: That's your problem.

Viner: Mr. Eccles, as I understand the position here....

Eccles: Do you care, is the Treasury indifferent as to the method? Let me ask this. Are they indifferent as to the method?

Ransom: May I - let me interrupt everybody.

Taylor: It isn't a question of the Treasury wanting to be relieved of gold; it's a question of what the effect on the market would be.

Viner: Which would be the more effective device if you had nothing at all to consider but the mechanical effect?

Eccles: I think they would be equally effective.

Ransom: Marriner, let me put something in the record. I have talked to both you gentlemen - one over the telephone and one here in Washington.

Eccles: You talked to me here in Wshington this morning too.

Ransom: Yes, I did. I have a very definite impression that I think is correct that both of you gentlemen have exactly the same objective, that you both are facing

and trying to deal with identically the same problem understood alike by both of you; that the question of whether or not the method of relieving a situation does some subsidiary thing such as relieving the Treasury is relatively unimportant, because I am sure from what you have said to me today and over the telephone and what the Secretary has said to me that the problem is one of relieving a tight situation in the money market, which you want to relieve in the public interest.

Now, the devices by which that can be accomplished we have reduced to just two. Now, I don't take it from anything that the Secretary has ever said to me that he would be at all reluctant to say "God bless you" if we could say to him, "We can carry on an open market operation which will accomplish that result."

H.M.Jr: Absolutely.

Ransom: Yes. On the other hand, I know from having talked to you that you believed that if we can't accomplish it through an open market operation, you could say to the Treasury, "God bless you, desterilize part of this gold," and relieve the same problem. Now, there isn't any difference of opinion whatsoever between you.

H.M.Jr: The first - there is no difference, and the first day that you and I talked you said that this thing should be done through an open market operation. I said that we have tried it and I doubted whether it would do it on account of the people you had to work with, and I thought you'd have to do something about gold, and you said, speaking only for yourself, that you thought I was right. Now, if you people can do it and if you can get the results, I'd say, "God bless you." I haven't attempted - but the only thing that I am trying to get across here is - and I want to apologize to you, Marriner. Please!

Eccles: Well, all right.

H.M.Jr: I'm sorry. I was rude. Please accept my apology. I shouldn't do it.

I mean but at no time have I in any way intimated inside of this office, with my own crowd, that the gold problem was the thing. And the reason I switched away from the question of discontinuing the sterilization of gold - I said that thing was not up.

Now, if you people want - Marriner can call me up Sunday and say, "Henry, I can assure you that we can do this thing through open market operation" - fine! But I just said that on account of the human element - I have said I doubt whether you can jam it through, and I don't think you've got the time. And I even said to you I would regret to see, when the situation is so serious, that this would be the time to pitch this battle as between the Federal Reserve Board and New York. Now, that's the whole thing. But if you people think you can do it and you - we say that we believe it's your job to do it - and you think you've got the instrument to do it, there's only one thing that I can say and that is "O.K."

Viner: Mr. Secretary, may I ask one question?

H.M.Jr: I've really got to go. I'm fighting daylight. The sun sets at 6:17.

Viner: May I ask one question of you.

H.M.Jr: There's no lights on that field.

Viner: One question.

H.M.Jr: Yes.

Viner: If Mr. Eccles is unable to get, or is having difficulty with his Open Market Committee, would you authorize him to say that he has consulted with you and you have given him to understand that if the Board asks you to desterilize some gold you will be prepared to do it? That's a little stronger than the other way, where you were able to tell them that you have consulted in advance.

H.M.Jr: Mr. Eccles can tell the Board that he's been over here and that if he asks the Treasury will they desterilize a certain amount of gold, we'll be glad to comply with the request.

Eccles: Well, I can tell you now that I think the position that maybe a majority of the Committee will take - I think you (Ransom) will verify it - they will say that there is no need for an open market operation increasing the portfolio, and neither is there a need for desterilization; and that the Open Market Committee would refuse to carry out an open market operation, and possibly a majority of the Board - you may have difficulty getting them to take the responsibility of asking the Treasury to desterilize. Now, I think that that is very possible.

H.M.Jr: Marriner, when it comes to this question, if you agree in principle I'll do anything reasonable to bridge the gap.

Eccles: Now, the way I got this thing over before, and I think it's necessary now....

H.M.Jr: I'll bridge the gap any way that you suggest.

Eccles: ...is to say that I - or that Mr. Ransom and I and the Treasury, see, are not satisfied with the present money situation and don't think it meets the problem from a standpoint of the needs of the economy at the present time, and that we want to carry out this kind of an operation, think it should be done, and that if the Board and the Committee, or the Committee, feel that they don't want to do either, then the Treasury, together with ourselves, are going - or we are going to recommend, see, as the only means of meeting it - whether they'll do it or not is another story, but as the only means of meeting it the desterilization of a fixed amount of gold; and that we would like to join with the Treasury in a statement to the effect that they are doing this for a fixed amount in order to meet a situation, which is considered preferable, we'll say, or wise in lieu of increasing the portfolio. In other words, it's in lieu of that.

H.M.Jr: We're together and I can be gotten on the phone. I mean it's - this is going to be the same.....

Eccles: All I want to do is just get an understanding of where we are when we're here.

Taylor: I think you're going a little too far on that at this stage, Marriner, and I think it weakens your position to do it.

H.M.Jr: Wayne, I've got to go. If you fellows want to, you can go into Wayne's office.

Eccles: I think we should, and we should continue this discussion.

MEMORANDUM OF THE DAY'S ACTIVITIES

September 9, 1937

To: Secretary Morgenthau

From: Mr. Magill

1. Treaties on exchange of tax information

Mr. Eldon King discussed the present situation in respect to negotiations with foreign countries looking toward treaties providing for the exchange of information to assist in the improvement and collection of taxes. Canada has informally agreed to exchange information with us and to negotiate a treaty definitely providing for the exchange. Evasion of taxes by the nationals of the two countries will be made much more difficult if the two tax administrations assist each other in this way. France is interested in a similar treaty and Italy and the Netherlands have expressed some interest. I asked Mr. King to proceed with the preparation of a draft treaty with Canada; and to prepare a letter to Italy and the Netherlands looking toward negotiations and to follow up our last letter to France on the subject.

Mr. King would like to make a trip to Geneva to attend the meeting of the League of Nations Fiscal Committee on October 11th, at which time the model treaties looking toward the elimination of double taxation and the prevention of tax evasion will be considered. Although I think it would be desirable for us to obtain the information which could be had by informal discussions with the foreign representatives, I am not sure that Mr. King is the best man to represent us. The difficulty is that we probably have no other person in the Bureau who could be sent. I want to explore the possibility of utilizing such other representatives as the United States may have in Geneva.

2. Procedure on refunds

Messrs. Oliphant, Helvering, Shafroth, Ryan, and myself discussed the refund procedure, and in particular the steps which might be taken to eliminate duplication of effort between the Income Tax Unit and the General Counsel's Office. It was agreed by all that if settlement had been arranged by a taxpayer covering several tax years and if in one of them a refund was involved, the review division of the General Counsel's office should put the refund through without delay unless there were manifest errors on the face of the claim. It was further agreed that the review division should not attempt to review engineering or valuation questions not legal in character. Mr. Shafroth was instructed to hold a further conference with the Commissioner and Messrs. Mooney and Hathcock and to instruct the latter two men to draft an order for the division of labor between the two offices.

3. Capital gains

Mr. S. Stanwood Menken of New York called upon me this afternoon to say that he expected to see the President Monday and to urge upon him the repeal of the provisions of the income tax applicable to capital gains. Mr. Menken said that he understood from various friends of the President's that the President was favorable to the repeal. Mr. Menken's suggestion was that the loss of revenue should be made up by an increase in surtaxes applicable to unearned or investment income. He is to advise me later of the results of his conference with the President. I was noncommittal as to the Treasury's attitude.

RM

FEDERAL RESERVE BANK
OF NEW YORK

458

OFFICE CORRESPONDENCE

DATE September 9, 1937.

TO CONFIDENTIAL FILES

SUBJECT: TELEPHONE CONVERSATION WITH BANK OF ENGLAND.

FROM L. W. Knoke

I called Mr. Bolton at 10:20 today to inquire as to the cause of the weakness of the franc. There was nothing very different in the picture today, he thought, except that the refusal by Germany and Italy to attend tomorrow's conference in Switzerland had rather upset the European markets. The fact that, according to this morning's statement of the Bank of France, the Treasury had increased its borrowings from the Bank, also seemed to have displeased the market. (I pointed out that the amount was too insignificant to really cause disturbance; Bolton agreed but thought that it just showed how the bear operators were ready to make everything serve their purpose.) According to the European press there were a number of little strikes breaking out again in France, indicating general labor unrest and efforts for higher wages to meet the increased cost of living. This, he thought, might furnish another explanation for the weakness of the franc although it was difficult, of course, to put ones finger on any one factor. I mentioned that I just read a report on the French situation forecasting that next month's elections in France would show a further trend to the Left and that the Radical Socialist party would probably be the heaviest loser. Bolton seemed to agree that, caught between the Left and the Right, the Radical Socialists were doomed in France, just as the Center parties had disappeared in other European countries. Whether, however, France would swing to the Left or to the Right, he thought it very difficult to tell. Without wishing to criticise the French, Bolton thought their control operations had recently helped to increase the pressure against the franc in that substantial support had been given the French

FEDERAL RESERVE BANK
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FROM L. W. Knoke

government bond market and that the exchange market had utilized the additional funds, obtained from the French Treasury as a result of the latter's purchases of government bonds, to increase its purchases of foreign exchange. Whilst we were talking a major movement seemed to be developing in the market in London and Paris; at least Bolton interrupted to say that he had just received word that the French, in addition to the £1,000,000 spent early this morning in support of the franc, they had just spent another £1,000,000 within the last few minutes and that the British had been forced to sell dollars on a large scale, such sales amounting to about $4,000,000, in a very short while.

Discussing our markets, I mentioned that from preliminary reports available the recent weakness in the stock marked seemed in no way to have been caused by heavy selling from abroad, but emphasized that it was too early to form a definite opinion. Bolton replied that in London they were convinced that today American stocks were cheaper than ever before.

LWK:KMC

FEDERAL RESERVE BANK
OF NEW YORK

400

OFFICE CORRESPONDENCE

DATE September 9, 1927.

TO CONFIDENTIAL FILES

SUBJECT: TELEPHONE CONVERSATION WITH BANK OF FRANCE.

FROM L. W. Knoke

I called Mr. Cariguel at 10:57 today. They were having a hard day, he said. For several days there had been no evidence of commercial buying in the French market of foreign exchange; on the contrary, indications that the market activity was entirely of a speculative character had been increasing. As a result of this observation they had today come to the conclusion to let the market have the foreign exchange it wanted, but, at a price. Naturally, they could do this within a limit only. At the moment they were trying to get the market under control; it was quieter at 134 1/2 but he did not know how long that would last. Since opening this morning, they had sold over £5,000,000 of sterling in support of the franc. I asked whether the speculative activity had been caused by the international situation and Cariguel thought by the international as well as the internal. As a matter of fact, he added, he was now asking himself whether internal difficulties were not more important than the external.

Cariguel was too busy for me to keep him on the telephone for any length of time and I only made him promise that he would not forget to call me inmase something further of interest developed in Paris.

LWK:KMC

FS

CODAT

Paris

Dated September 9, 1937

Rec'd 12:53 p.m.

Secretary of State,

Washington.

RUSH

1263, September 9, 4 p.m.

FROM COCHRAN.

French control has yielded unusually big amount of sterling on chaotic exchange market today but did not hold the rate and selling of francs has increased as sterling passed 134. For a while intervention was through Societe Generale and Lazard and then through operations of Bank of France itself. At 3:30 intervention appeared to have been withdrawn. Spot franc is thus weak against all currencies and discount versus three months sterling has reached five and one fourth. Rentes down.

Bank of France statement as of September second showed further advance of eight hundred million francs to the state, deposits down over one billion and circulation up one and three-fourths billion; coverage fifty-two point naught one versus fifty-two point thirty-five.

While international situation has of course influenced Paris exchange market adversely the real cause of today's

weakness

FS 2-No. 1263, September 6, 4 p.m. from Paris

weakness is in my opinion domestic. To the unfavorable French internal factors which I have mentioned this week should be added the further revelation in the Bank of France statement that in spite of peak tourist season and increase in tax returns Treasury is now obliged to resort heavily each week to Bank of France to finance its current needs (with no unusual maturities to take care of just now).

RR:CSB

BULLITT