

TREASURY DEPARTMENT

WASHINGTON

APR 7 1938

TO MR. TAYLOR:

In submitting this memorandum on the estimated financial requirements for the next 15 months, I have made the following assumptions for the fiscal year 1939:

1. That the business recession will cause a reduction in revenue of at least \$519,000,000 below the estimates contained in the 1939 budget;

2. That for the same reason it will be necessary to increase emergency expenditures by \$962,000,000; to a total of \$2,100,000,000;

3. That other expenditures will have to be increased because of the failure of Congress to adopt the recommendation of the President for reduction in the 1939 road program, the passage of the CCC bill, and other miscellaneous increases, such as for the Army and Navy, aggregating \$288,000,000, or a total increase in the budget of \$1,769,000,000, making a total estimated net deficit of \$2,719,000,000;

4. That the latest estimated deposits in the Unemployment Trust Fund for the fiscal year 1939 will amount to \$791,000,000 and that the estimated withdrawals will amount to \$381,000,000, leaving \$410,000,000 available with which to help finance the above-mentioned deficit;

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5. That our balances during this period will range between 700 and 900 million dollars;

6. That there will be no further sale of public debt obligations for the purpose of purchasing gold for deposit in the inactive gold fund; and

7. That the financial requirements of the Commodity Credit Corporation and the Reconstruction Finance Corporation will be made through the sale of their own obligations in the market and the Treasury relieved of supplying these two organizations with cash.

Based on these assumptions there is set out below, by quarters, a statement showing the total estimated Treasury financing which will be required for the 15 months ending June 30, 1939, and also the proposed methods of meeting these financial requirements.

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TABLE

(In millions of dollars)

	F. Y.	Fiscal Year 1939			
	1938	Last Qtr.	First Qtr.	Second Qtr.	Third Qtr.
Total Treasury financing	\$2,478	\$2,631	\$2,923	\$3,292	\$3,874
Proposed method of meeting Treasury financial requirements					
Refunding Operations -					
Treasury bills (regular)	1,400	1,550	1,550	1,550	1,550
Treasury notes	600	580	420	900	1,150
	2,000	2,130	1,970	2,450	2,700
Cash Operations -					
Unemployment Trust Fund	130	110	100	100	100
U.S. Savings bonds	80	75	90	200	80
General fund balance	18	16	13	42	144
Treasury bills (special)	250	300	250	200	250
Major Operations	-	-	500	300	600
	478	501	953	842	1,174
	2,478	2,631	2,923	3,292	3,874

A glance at this table will show, aside from the refunding operations, that for the last quarter of 1938, the amount of market operations will be \$250,000,000; for the first quarter of 1939, \$300,000,000; second quarter, \$750,000,000; third quarter \$500,000,000, and the fourth quarter \$850,000,000. It will be seen, therefore, that the Treasury does not have any serious financial problem until we reach the third and fourth quarters of 1939 and then only because of the large maturing issues of Treasury notes. Assuming that the special Treasury bill program shown in this statement will be carried out the major financial operations, including refunding of maturing Treasury notes, for December 1938 will be \$920,000,000; for March, 1939 will be \$1,200,000,000 and for June, 1939, \$1,750,000,000. The last two are rather large financial operations to carry out at one time, although it can be done with favorable market conditions. It may be, however, that the Treasury should consider in its next two financing periods as to whether it would not be wise to raise additional cash money through note or bond issues so as to eliminate all or a part of the cash requirements in the second and third quarters and have only at that time refunding issues. Particularly, we should give consideration to this phase of the matter so far as it concerns the fourth quarter which involves a major financing operation of \$1,750,000,000.

Use of Treasury Gold:

As of March 31, 1938 the Treasury held gold in the inactive account in the amount of \$1,183,000,000 and free gold in the working balance of \$210,000,000, or total gold available for creating credits with the Federal reserve banks thereby increasing our cash balance, if the Secretary deems it wise, in the amount of \$1,393,000,000. There are, of course, other resources such as the Exchange Stabilization Fund of \$1,800,000,000, the balance of the increment resulting from the reduction in the weight of the gold dollar of \$142,000,000, making a total of other gold resources of \$1,942,000,000. Then there is \$457,000,000 of silver bullion in the Treasury which could be revalued and against which a face amount of silver certificates of more than \$900,000,000 could be issued. For the purpose of this statement, however, I am leaving out the last three mentioned items.

The \$210,000,000 now in the working balance could be deposited at any time and increase our cash balance by that amount, thus reducing our financial requirements from the market over the next 15 months. We could, of course, deposit any part of the inactive fund which would, however, reduce the reserve that the Treasury has built up to meet any foreign demand for gold. If there is an export of gold during the period the Treasury will

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get the use of the proceeds of the sale of such gold. This would also reduce the amount of the cash required from the market. If for example, there is an export of \$500,000,000 of this inactive gold, the proceeds thereof together with the \$210,000,000 free gold in the working balance, would reduce our major cash financing operations from about \$1,400,000,000 to \$690,000,000.

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TREASURY DEPARTMENT

. INTER OFFICE COMMUNICATION

DATE April 7, 1938.

TO Mr. Taylor
 FROM Mr. White

Subject: Shall excess reserves be increased, and if so, how?

Summary

1. A decisive monetary move to greatly increase excess reserves at this time is, in our opinion, unquestionably desirable.

2. We do not believe that an increase in excess reserves undertaken alone can be relied upon at this stage in the recession to initiate and sustain an upturn in business.

However, the step would be desirable even (a) a spontaneous upturn in business were to take place, or (b) even if increasing excess reserves were the sole government measure taken to combat the recession. It would be much more effective -- and even necessary -- if a broad program is to be undertaken which includes government spending, lending and encouragement of private construction of durable goods.

3. The methods of raising excess reserves consist of:

- (a) Reducing reserve requirements.
- (b) Desterilizing gold.
- (c) Open market operations.
- (d) Combinations of these.

4. Each of these methods has its special advantages. We believe that a strong case can be made for only two of the procedures: namely,

- (a) Lowering reserve requirements, or
- (b) Desterilization of gold.

Neither of these two methods appears to have -- all factors carefully considered -- a great advantage over the other. However, we are of the opinion that on the whole a somewhat stronger case can be made for desterilization of gold as the step to be taken now to raise excess reserves.

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Subject: Shall excess reserves be increased, and if so, how?

1. If there is no change in our monetary practice excess reserves will gradually increase from the present level of \$1,550 million to about \$1,700 million by the end of the year, provided, of course, there is no significant change in business activity, or in the international situation abroad.

This increase in excess reserves of \$150 million over a period of nine months will have a negligible effect on either business conditions or business psychology.

In the monetary field only more drastic action can be hoped to achieve results.

2. The advantage of action taken to greatly increase excess reserves at this time is that it will facilitate a sustained upturn in business.

(a) The large increase in idle bank funds should reduce the reluctance of banks to extend loans to industry and Government.

(b) Borrowing rates for industry and Government will be eased.

(c) It will be a spectacular pronouncement of a Government policy which the public would interpret as expansionist, and therefore contribute toward the development of a psychology favorable to expansion. It would strengthen the expectation of rising prices because it would be evidence that the Administration proposes to take aggressive steps to reverse the present deflationary trend.

(d) Such action would fit in with the recent Presidential statement with respect to price policy.

These desirable effects of increased excess reserves may be of considerable importance and might even provide a stimulus for the upturn especially if accompanied by measures taken to increase directly investment and expenditures. But we do not believe that an increase in excess reserves undertaken alone can be relied upon at this stage in the recession to initiate and sustain an upward trend in business.

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3. However, there is adequate justification for raising excess reserves now, irrespective of other plans for the recovery program.

(a) If business is in any case going to improve, the increase in excess reserves will help to sustain the upturn.

(b) If business fails to improve and excess reserves are not increased now, they will have to be taken later. It is one of the preliminary monetary measures which become increasingly difficult to resist as the recession lengthens. Since it will be done sooner or later, it would be better to do it now.

(c) If the Government is going to embark on a comprehensive program designed to restore recovery -- whatever the elements of the program be -- an increase in excess reserves must be part of the program, else a tightened money market will jeopardize its success.

The one danger of taking action now independent of other measures is that it may not be followed by business improvement and the consequent reaction to an unsuccessful Government measure may serve to diminish the psychological value of subsequent measures.

In some quarters it has been held that an increase in excess reserves greatly increases the danger of inflation. It is held that once a boom starts, popular demand for its continuance makes restrictive action by the Federal Reserve Board very difficult. In the light of the current situation and the deflationary powers held and exercised by monetary authorities, this fear -- even were it well-founded -- should be wholly subordinate to the more immediate urgency of getting out of the recession.

4. If excess reserves are to be increased, shall it be:

- (a) By reducing reserve requirements?
- (b) By desterilizing gold?
- (c) By open market operations?
- (d) Or by a combination of these?

(The increase of excess reserves by the issue of silver certificates can be dismissed at once as a feasible method because it has no advantage over desterilization of gold and

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does have serious disadvantages. If necessary, as a later and supplementary measure after all the gold has been de-sterilized -- either through internal or external outflow -- it may have merit, but not now.)

5. The advantages of increasing reserves by reducing reserve requirements as against increasing reserves by desterilization of gold are as follows:

(a) Alteration in reserve requirements would have a sudden and spectacular effect upon excess reserves. At one stroke excess reserves could be doubled or tripled (depending upon the requirements selected). In contrast, excess reserves could be only gradually increased -- over a period of several months (depending upon the rate of deficit expenditure) -- by a desterilization program and the psychological impact might not be as potent if the increase in excess reserves is spread out over several months.

(b) The maximum increase in excess reserves by use of altering reserve requirements is roughly \$3 billion and by use of the Inactive Account only about \$1.2 billion.

(c) Whereas a decrease in reserve requirements would immediately increase the excess reserves of all banks in the System substantially, desterilization of gold would operate unevenly and possibly towards an undesired distribution.

(d) The alteration in the reserve requirements is probably more easily reversible. Resterilization of desterilized gold could take place only by employing current revenue not for the purpose of expenditure, nor for the purpose of reducing outstanding debt, but for the purpose of purchasing back gold certificates from the Federal reserve bank.

(e) The less gold in the Inactive Account, the less insulated is our domestic economy from outflows of gold. However, in evaluating this point, it must not be overlooked that the monetary authorities have virtually unlimited powers to offset the mechanical deflationary effects of outflows of gold.

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6. The advantages of increasing excess reserves by de-sterilizing gold instead of lowering reserve requirements are:

(a) The outstanding debt and, consequently, the interest burden to the Government is reduced. This is particularly desirable now in view of the likely addition to the outstanding debt involved in the proposed recovery program.

The reduction of debt involved in this step will be consistent with the Treasury objective of pursuing a fiscal policy as conservative as conditions permit. Such a policy necessarily includes economy in the carrying charges of Government debts wherever feasible.

(b) It would remove criticism against the Treasury for borrowing while "needlessly" sterilizing gold. This criticism might grow worse were reserve requirements to be lowered while the Inactive Account was maintained. Some critics would say that the Administration was favoring the banks as against the taxpayers.

(c) A reduction in the reserve requirements will leave the member banks with the uneasy feeling that as soon as business turns up the reserve requirements will again be increased. Thus the member banks may not feel justified in counting on the increase in their excess reserves as a portion of their loanable idle funds. If the bankers do react that way much of the hoped-for effect would be lost.

(d) The removal of earning assets, (Treasury bills and notes-\$618 millions 2-7/8-percent-maturing June 15) from the portfolios of banks and investors cannot help but be some stimulus to the investment of funds in industry and commerce.

(e) Inasmuch as the Treasury cannot reasonably accept the burden of maintaining the Inactive Account indefinitely, it is better to get rid of it during a recession. If we wait until an upswing additions to excess reserves may be considered unwise, and then desterilization could be undertaken only if offset by some other monetary action.

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(f) The Federal Reserve Board would probably prefer desterilization, partly because it does not involve an obvious reversal of policy on its part.

(g) Desterilization of gold can be justified on budgetary grounds as an appropriate step independent of the problem of excess reserves. For that reason it can be used as a first step. If later it be found desirable to still further increase excess reserves the lowering of reserve requirements could be then undertaken without so great a risk of giving rise to undue fears that devaluation is contemplated.

(h) The effect on the price of Government securities of continued deficit financing will be offset and hence the stability of Government bond prices maintained without the aid of open market operations.

(i) The desterilization of gold would have the advantage of slightly increasing the prestige of gold both here and abroad.

7. Increasing excess reserves through open market operations.

Increased purchases by the Federal reserve banks of Government securities has the following disadvantages compared with the other methods:

(a) It is less spectacular and therefore the psychological effect would be less.

(b) A successful open market program on a large scale depends upon continued and sympathetic cooperation of the Open Market Committee. In view of past experiences such cooperation can hardly be unhesitatingly relied upon.

(c) As against desterilization of gold, there is the criticism that open market purchases increase the earnings of the Federal reserve banks at the expense of the taxpayer.

(d) The Open Market Committee's purchase of securities may be dictated more by what they regard as a proper distribution of their portfolio than by the exigencies of the economic situation.

(e) Large-scale reversal might have a more direct depressing effect on bond prices than may be the case with altering reserve requirements.

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The sole advantage of open market operations is that such action would not be a confessed reversal of the steps taken last year, hence it would involve no loss of "face" and therefore arouse less objection on the part of certain members of the Board. (Desterilization of gold has this advantage as well.)

8. None of these methods of increasing excess reserves is mutually exclusive, but it would be unwise to use more than one method at this time.

All three procedures could be undertaken at the same time or successively. Undertaken at the same time they would combine the advantages of each with the additional advantage of making the move much more spectacular and hence psychologically more powerful.

The disadvantage of undertaking more than one procedure at the same time is a serious one. It would create fears both here and abroad, that if the move did not prove successful in creating an upturn in business, the Government would adopt more drastic monetary measures, specifically, further devaluation of the dollar.

Excerpt from Herman Oliphant's weekly report to the Secretary dated April 7, 1938:

Construction Contracts. In connection with the "Rackets" Committee, Procurement has made certain changes, effective April 1, in the general terms and conditions applicable to its construction contracts to combat practices, in the mechanical trades, tending unjustifiably to increase prices. The revised provisions require complete information from successful contractors, subcontractors, etc., relative to the preparation of their bids and require them to certify that they have not participated in any collusive agreement having the effect of restricting competition or controlling prices. Any contract or sub-contract may be terminated if the representation of any contractor or subcontractor is found to be false. Efforts are being made to work out a satisfactory formula for imposing an additional sanction in the nature of a liquidated damage provision

TREASURY DEPARTMENT

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INTER OFFICE COMMUNICATION

DATE April 8, 1938.

TO Secretary Morgenthau

FROM Mr. Haas

Subject: Is increased Government spending necessary for business recovery?

Conclusions

I. While increased Government spending for relief purposes will be required this year, we are not convinced that additional expenditures for pump priming purposes will be essential for business recovery. We are led to this conclusion by the following facts:

- a. Present business and psychological conditions seem ready to respond to other methods of a confidence-restoring nature, which we believe would be more immediately effective.
- b. Business activity recently has been stable with an improving tendency, and appears to have a sound foundation for a rising trend. The only real source of anxiety is in the possible effect on business of recent declines in security and commodity prices, accompanying changed political conditions in Europe. This anxiety would be overcome, we believe, by moderate inflationary moves as suggested below, in connection with adequate provision for relief needs.

II. Pump priming as a business remedy would have certain disadvantages:

- a. It would create new problems of financing, and tend to unsettle confidence in the fiscal position of the Government.
- b. It would be slow in getting under way.
- c. It would be difficult to curtail in proportion to diminishing need.

III. We suggest that three moves be taken immediately, while business is in a seasonal upward trend, to increase business confidence and lead to an expansion of private spending.

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- a. The President's relief message, incorporating a request for a liberal relief appropriation, presented to Congress.
- b. De-sterilization of gold in the inactive gold fund.
- c. Restoration of reserve requirements to the level existing immediately before the May 1, 1937, increase.

These moves would be moderately inflationary; they would lead to an improvement in business sentiment without impairing confidence in the fiscal position of the Government; they would involve no expenditures; and added to the present tendency toward business improvement they might be sufficient to restore business recovery without recourse to pump priming.

IV. In the meantime, effort should be made to work out all details of an efficient pump priming program, in order that it could be put into effect immediately if this should be found necessary.

V. Private spending should also be encouraged by working out plans for eliminating conditions in individual industries that are tending to restrict buying.

Methods other than pump priming
should first be used

We know that additional Government spending will be required this year to provide for relief requirements. This, in itself, will represent an inflationary factor that will tend to overcome current deflationary influences. In preference to a further expansion of Government spending through a pump priming program, we believe that use should first be made of other methods available to the Government for a moderate inflation of prices that would tend to stimulate private spending and thereby turn business upward.

Public psychology at present appears favorable for such action to be effective. After five years of experience, the public have been sold on the managed economy of the New Deal, and have learned to look to the Government to take the lead in directing business trends. They are now waiting for the Government to take action to reverse the deflationary trend. The immediate response of commodity and security prices on the statement of the Administration's price policy in February indicated a readiness to follow the leadership of the Government in a constructive business program.

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The business situation likewise appears favorable for such action to be effective. The decline in business activity has flattened out, and during the past three months has been maintained at a stable level, improving somewhat during March in line with the normal seasonal trend. Such a flattening out of a business decline usually indicates that industrial production has adjusted itself to the lower levels of demand. Normally one could expect a gradual business improvement from present levels. Tending to confirm this expectation is the fact that industrial production has for a number of months been running well below the apparent level of demand.

In recent weeks, however, the outlook has become impaired by world developments that have led to declining prices for commodities and securities at a time in the business cycle when rising prices were to be expected. This has led to a general loss of confidence and a fear that lower levels of business are in prospect, which has caused consumers to withhold purchases until the outlook becomes clearer. Unless business improves from these levels, there is a very real possibility that the continuing shrinkage in security values may lead to a new financial crisis, with the many problems which that would involve.

The more immediate requirement therefore appears to be not so much that of making work through Government spending as in (1) preventing a further price deflation, and (2) stimulating private spending. Both of these would be accomplished, we believe, through moderately inflationary moves aimed directly at raising prices and restoring business confidence. We therefore suggest that these moves be made first.

If these should not prove sufficient, they will have served the purpose of preparing the ground both psychologically and technically (through strengthening the underlying conditions of the bond market) for the successful carrying through of a deficit spending program.

Objections to pump priming

We feel that a pump priming program should be avoided, if possible, for the following reasons:

1. A considerable time would probably be required to get such a program under way.
2. The deficit financing for such a program would tend to unsettle public confidence in the fiscal position of the Government, creating an uncertainty that might act as a restraint on capital goods expansion and private initiative.

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Once a spending program is launched, business adjusts itself to it, and can only with difficulty change back. This difficulty was clearly apparent in 1937, and might be even more pronounced following another period of Government spending, which would probably lead to an even greater dependence of business on Government funds.

The failure to make an effective transition in 1937 must in large measure, however, be charged against the drastic increase in reserve requirements and other features of the Government's financial program which tended to restrict the capital markets at a time when they were most needed to finance private expansion. In place of these restrictions on the capital markets, the transition from Government to private spending required that monetary and credit policies be directed toward encouraging a flow of private capital to take the place of Government spending.

Method of financing of fundamental importance

The effectiveness of a spending program depends to a great extent on the source of the funds, and not merely on the amount spent. If the money is raised by taxation it would have the minimum effect, since it would largely represent merely a replacement of private spending. Any spending program, whether for pump priming or for relief, should be so financed that it interferes least with private operations.

The following principal means of financing a spending program are available:

1. By taxes. This would be least effective, and probably a practical impossibility.
2. By deficit financing, involving borrowing from banks or borrowing from investors through bond issues. The former method would interfere least with private spending.
3. By using gold in the inactive gold account or the stabilization fund. This would have an inflationary psychological effect, and would in no way restrict private enterprise.
4. By coinage of silver and using the silver seigniorage. This would have an inflationary effect, but possibly an unfavorable public reaction.

5. By use of Thomas currency. While this would be strongly inflationary, it would cause a severe shock to financial confidence.

Suggested recovery program

An effective recovery program should be directed toward removing the present feeling of insecurity and toward breaking up the prevailing belief that business is going to decline. By reversing the deflationary psychology it should build up a feeling of confidence in the business outlook. The program should be started immediately in order to secure the advantage of the present rising seasonal trend.

In general terms, the following program is suggested:

1. Make conditions as favorable as possible for increased private spending, through increased business confidence. This is essential under any program.
2. Carry out the Government spending necessary to take care of relief needs.
3. Make and perfect plans now for a pump priming program to use if necessary, in order that it may be put into effect with the minimum delay.

Specific moves suggested

The following specific immediate moves are suggested:

1. A reduction in reserve requirements to the level existing immediately before the increase of May 1, 1937. This action, in the public mind, would be equivalent to removing the brakes and leaving business free to respond to favorable influences, since the high reserve requirements are now identified with depression conditions.
2. Transmittal to Congress of the President's relief message, incorporating a request for liberal relief appropriations, in stated amounts. This would serve immediately to relieve anxiety over the relief problem.

3. Announcement by the Treasury that the remaining gold in the inactive gold fund would be de-sterilized. This action would release into the general fund approximately \$1,100,000,000, the spending of which would have a definite inflationary effect, since it would (1) increase bank reserves, and (2) finance an extensive relief program without recourse to borrowing or taxation.

Other parts of a recovery program

1. Complete details of a pump priming program should be worked out over the next few months, sifting projects down to those which would provide the most immediate and most effective aid to business. In case the measures outlined above should not be sufficient to start business activity strongly upward, a pump priming program could then be put into effect with the minimum delay.
2. Private spending in the meantime should be encouraged by working toward analyzing and correcting conditions that are tending to restrict buying in certain important industries.
 - a. In the building industry, the F.H.A. loans have been very successful in stimulating consumer spending for residential construction. With this industry already on the upgrade, more could be done to speed up recovery by working for a reduction in prices of construction materials and toward eliminating costly rackets in the building field.
 - b. By working toward a clearing up of the railroad situation, spending for equipment would be encouraged.
 - c. A reduction in steel prices arrived at through some arrangement with labor for a temporary reduction in wages would stimulate buying of steel products.
 - d. Some mechanism should be perfected for preventing an increase in prices of certain products that are already high, which might tend to shut off a business recovery.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE April 8, 1938.

TO Secretary Morgenthau

FROM Mr. White

Subject: Should the Government initiate a recovery program now?

1. The present business situation and the prospects for the next six months do not, in our opinion, justify further waiting before taking decisive action.

Failure of business to make a substantial recovery before next October is fraught with grave danger to the stability of American institutions. So grave are the possibilities in the event of failure that the prospects of a business upturn must be almost certain to justify inaction this spring.

2. What are the possible objections to adopting a recovery program now?

(a) A spontaneous recovery is on the way in any case and a Government recovery program would counteract it.

In our opinion, the initiation of a comprehensive Government program can serve:

(1') Only to speed the recovery up, and

(2') To enable the Administration to claim that the measures undertaken were responsible. If recovery occurs spontaneously without a Government program, it is almost certain to be gradual, and critics of the Administration would allocate it to the modification of the tax program. It is against the capital gains and the undistributed profits tax that the critics have directed most of their fire. They will be able to "prove" that it was the modification of those two taxes and the blocking of other portions of the President's program which was responsible for the upturn.

(3') The Government program can be quickly curtailed if a spontaneous recovery movement develops quickly enough.

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If Government action were capable of discouraging private investment as the critics of the Administration claim, the maximum discouragement has already been attained. The amount of expenditure on capital goods and on durable goods, plant expansion, renovation, new industries, etc., is at a negligible level now and has shown no sign of increase during the past six months. Therefore, a recovery program could not make matters worse.

(b) The Administration is merely repeating the pattern of 1934-1935.

In the first place, if we were sure we could repeat that upturn the measures should be undertaken. The general recovery which characterized 1934-1935-1936 is what we want. In the second place, we have learned something from past experience and can hope to be able to avoid the most serious errors made in 1936 and 1937.

(c) It will increase the national debt to an extent that will threaten the national credit.

There is always the danger that the national debt will be increased to too high a figure for the stability of the economic system. However, the present debt is still far from that contingency. The fact that our debt is lower, both absolutely and per capita, than that of England, for instance, is good evidence that our debt is not dangerously large. Furthermore, the low interest rates on government debts are a guarantee that we are still far from being on dangerous ground.

(d) Embarking on a large-scale government program now will threaten business confidence.

The greatest threat to business confidence is the shrinking purchasing power, the falling prices and the declining industrial activity. On the contrary, the recovery program will unquestionably revive business confidence.

Conclusion

It is clear that none of the possible objections to adopting a recovery program now have sufficient merit to possibly outweigh the advantages of initiating a recovery program at this time.

TREASURY DEPARTMENT

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INTER OFFICE COMMUNICATION

DATE April 8, 1938.

TO Secretary Morgenthau
FROM Mr. White

Subject: Does the present business situation call for a program for recovery, and if so, what should the program be?

Conclusion

1. A careful weighing of the significant factors of the business situation here and abroad leads us to the definite conclusion that prospects for substantial recovery before next fall are not sufficiently assured to justify inaction.

More than that, we believe that the evidence as a whole indicates that it is more likely that the recession will continue rather than the reverse.

2. We believe that a comprehensive recovery program should be started now.

3. We recommend a broad program on the following lines:

Monetary measures

Desterilization of all the gold in the Inactive Account as rapidly as maturing bills and notes and Government expenditure permit.

(As a second and alternative choice, reduction of the reserve requirements by 25 percent.)

Increased Government expenditure

(a) Increased expenditure on W. P. A. projects to supply additional jobs for the unemployed as rapidly as they can be put to useful work - up to 3 million persons.

(b) A public health program involving an expenditure during the next year of approximately \$240 million, as recommended by Dr. Parran, (a part of this project to be part of the W. P. A. projects)

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(c) It may be possible to speed up expenditures on the proposed increase in Army and Navy expenditures even to the extent of increasing Government stocks of material.

Self-liquidating expenditures

(a) P.W.A. extension of non-interest bearing loans to municipalities and States, amortized over a long period of years.

(b) Toll projects. Establishment of a Federal land and financing corporation to finance and build toll facilities where needed and justified, the projects to include bridges and tunnels, underground garages, airports, roads, etc., the financing of these projects to be guaranteed by Government debentures.

(c) The railroad plan now being studied should include a provision for the Government sponsorship of the immediate construction and leasing of new rolling stock and other necessary capital equipment to the amount of at least \$500 million this year (along the lines recently proposed, with modifications to insure the leasing and use of the equipment by the railroads).

(d) The plan now being studied of granting R.F.C. loans to small business should include provisions for use of loans for new capital construction, in part at least.

4. The total amount of expenditure involved in the above program is roughly \$4 billion. A large part of this expenditure will, of course, consist of recoverable assets. This \$4 billion should be financed roughly by:

- \$1 billion from the Inactive Account
- \$2 billion by repayment of recoverable assets of the R.F.C. (who would issue debentures on their account.
- \$1 billion issue of Treasury bills.

If a substantial upturn occurs this fall it should be possible to reduce the rate of expenditure very substantially.

TREASURY DEPARTMENT

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INTER OFFICE COMMUNICATION

DATE April 8, 1938.

TO Secretary Morgenthau

FROM Mr. White

Subject: What is the present business situation and what are the prospects?

1. Foreign trade.

(a) Our exports are holding up well. Preliminary March figures indicate a 5 to 10 percent increase over February. Though less than the usual seasonal increase, it indicates that foreign countries are not yet a drag on business conditions here but, on the contrary, constitute a sustaining influence.

(b) Imports likewise show a moderate increase for March over February, though they are less than 60 percent of last year's level. The larger part of this decline in imports cannot be allocated to the agricultural situation. It reflects the decreased domestic industrial activity and decline in world prices, and must inevitably operate to depress business abroad.

(c) The successful consummation of the British-American trade agreement will doubtless give some lift both psychologically and actually to our foreign trade.

(d) The index of the various aspects of our international competitive position remains more favorable than it was last year, but it has begun to turn down, and the prospects are that it will continue to do so though at a slow rate.

2. Foreign economic conditions.

Altogether the foreign economic picture is not encouraging. Taking it as a whole, the prospects, in our opinion, are more on the down side than the up side. Central and South America are particularly hard hit by the decline in their exports. England has had less than its usual seasonal increase in business activity in March. France shows no prospects of substantial improvement. The situation in Japan and China can grow only worse from an economic point of view. Germany's exports are declining and consequently

her power to purchase abroad is declining notwithstanding her increasing and high level of domestic activity; the conditions there cannot get better so far as their effect upon the rest of the world is concerned.

The fear of imminent recession dominates the business picture throughout the world, and the political situation only intensifies the general uncertainty.

3. Armament expenditures.

World armament expenditures during 1937 were reported to be at least \$1½ billion greater than the already high level of 1936. The actual increase was almost certainly much greater. For next year the estimates of expenditures to be made show an increase that will be even greater.

This is one factor that will help substantially to maintain the level of our exports and of business activity in leading foreign countries. However, the fact that so great an increase in armament expenditures throughout the world in 1937 did not succeed in preventing the recession in the United States, and has not increased the level of business activity in Europe during the first few months of 1938, indicates that the forces making for a depression are very powerful.

4. Agriculture.

Mr. Wheeler, of the Department of Agriculture, expressed the view to me (unofficially) that the agricultural picture, both here and abroad, looks on the whole bearish rather than bullish for the coming season. He stated that an improvement in business would, of course, change that picture but that the initial impetus for a business upturn was not, in his opinion, to be found in the agricultural outlook.

5. Unemployment and payrolls.

The disemployment since Labor Day has now reached 3,800,000. The preliminary figures of employment (unofficial) for the middle of March show a decline of 1 percent as against the usual seasonal increase of 1½ percent. Payrolls show a

Secretary Morgenthau - 3 -

decline of 1/2 percent. The relatively smaller decline in payrolls was ascribed to the fact that hours have already been drastically cut so that further reduction hits the number of employed more than payrolls.

6. Construction.

Construction is increasing and so far gives evidence of promise that last year's total of \$1.2 billion will be reached and possibly passed. (Opinion on the prospects for housing for the year varies. There are some informed persons who believe that the level to be attained in home construction ~~is~~ in the absence, of course, of any additional Government action -- will be less than last year's total.)

7. Industrial production.

Industrial production has shown no increase in the first three months of this year. Although there are indications of an upturn and indications of downturns in the future, the general picture seems to be that if there is an upturn it will not be of any substantial proportion.

8. Inventories.

Although there has unquestionably been a liquidation of surplus inventories during the last six months, inventories still remain very high compared to business activity. A recent report by Dun & Bradstreet, on the basis of an examination of the inventories of 17,000 firms, shows that inventories had a much larger increase than has usually been believed. They show an increase in inventories during 1936 in manufacturing, wholesaling and retailing of over \$2 billion, and in 1937 of almost \$3 billion. In other words, at the end of 1937 inventories were \$5 billion greater than they were at the end of 1935.

Secretary Morgenthau - 4

Even allowing for a decrease of inventories during the last three months of \$2 billion, that would still leave us with inventories of \$3 billion greater than at the end of 1935 when industrial activity was 25 percent greater than it is now. (These increases do not include agriculture, mining and other industries which likewise had considerable increases).

Unless there is a substantial upturn in business which would convert what are now regarded as surplus inventories into "normal" inventories there must be a continuation of inventory liquidation. Even though the rate of liquidation slows up it will continue to be a retarding factor in business for some time to come.

9. Prices

Sensitive prices in the past month have resumed their downward trend. Such price behavior cannot help but be a depressing factor. The price structure is becoming steadily more out of line and is probably as bad now as it was during 1921 and 1932, because of the failure of important controlled prices to fall relative to competitive prices.

10. Banking and monetary situation

The banking situation is, on the whole, very good considering the sharpness of the recession and falling security prices. There is little doubt that there are a large number of banks which would become shaky if the recession continues through to the fall. Yet on the whole the banking situation is a bullish factor rather than a bearish one.

The monetary situation is particularly good. Interest rates are low. The gold situation is quiet, the prestige of gold is high, and despite the depreciation of the franc there is no widespread expectancy or fear of a coming period of currency competitive depreciation. Here again as in the banking picture the situation is not bearish.

11. Capital expenditures

The prospect of private expenditure on plant equipment, durable goods, etc., is not good. There has as yet been no significant revival in new capital issues. Railroads certainly do not give promise of unaided improvement. Public utilities are likewise not likely, with demand for their product falling, to increase their expenditure. On the other hand, there are

Secretary Morgenthau - 5

numerous capital construction undertakings involving intricate time absorbing and expensive machinery and equipment which were begun during the upturn and are now being completed. There does not appear to be in any industry any large-scale expansion in capital expenditures contemplated, except the armament industries, which may prove to be an important bullish factor.

12. Government spending

The factor of Government expenditure already allocated is on the up side. (The mere announcement of a forthcoming large recovery program has been enough apparently to give the security and commodities a sharp boost.) The net Federal Government contribution to community expenditure during the first two months of this year was less than \$50 million a month. In March it is computed to have been about \$100 million. The contribution during the coming month will doubtless be greater. The effect will be, of course, to increase purchasing power and help stimulate business activity.

Conclusion

A careful weighing of the foregoing factors of the business situation here and abroad leads us to the definite conclusion that prospects ~~for~~ substantial recovery before next fall are very doubtful.

PARAPHRASE OF TELEGRAM RECEIVED

NO.: 566

FROM: American Embassy, Paris

DATE: April 8, 1938.

FROM COCHRAN.

At 11:30 this morning when I called at the Bank of France, there was considerable fluctuation of the franc but trading was light. The French control, in a private transaction, purchased from a former regent of the bank 200,000 pounds at 161 3/4. 140,000 pounds was needed today by the control to apply on the British coal bill of the Paris-Orleans Railway. This railway's requirements of British coal in 1938 will reach 800,000 pounds, as compared with 200,000 pounds purchased in 1937. This does not result from increased consumption but rather from the present social legislation, and it indicates the strain upon the franc which will result when provision must be made for foreign exchange to purchase materials which were formerly supplied from domestic sources.

The following story regarding Spanish gold was told to me ~~xxxxxxxx~~ in strictest confidence. Some years ago, it will be remembered, the Bank of Spain got an advance of over one billion French francs against gold which was exported from Spain to France and deposited at Mont-de-Marsan

- 2 -

in a branch of the Bank of France. This credit was closed out some months ago. Enough of the gold to cover the repayment of the francs was sold by the Bank of France.

Only part of the gold had to be utilized since from the date of opening of the loan negotiations there had been a franc depreciation of around fifty percent. Approximately 1,400,000,000 current French francs now remains at Mont-de-Marsan in the form of Spanish gold. Efforts have been made by both factions in Spain to secure the release to them of this gold. During the past few weeks - especially since Blum has been in power again - officials of the Spanish Republic have been very persistent in trying to get physical delivery of the gold or the franc equivalent thereof from the Bank of France but on various technical grounds the Bank of France has delayed a decision. At last Premier Blum was directly contacted by the Spanish representatives, and I am informed that Blum gave oral instructions to the Bank of France Governor to release to the Spanish Republican authorities the gold at Mont-de-Marsan.

I have been told that the Bank of France Governor argued the case with Blum, explaining that should a court decision later decide that the Bank had made improper delivery of the gold, the Bank would be itself liable for any loss. Some time ago when this question had come up

the

- 3 -

the opinions of the French Ministries of Justice and of Foreign Affairs had been requested but the opinions had never been received. Blum confirmed his order to the Bank of France Governor for release of the gold a few days ago, and appended two annexes to his letter. One annex was a letter signed by Paul-Boncour, Blum's Minister for Foreign Affairs, in which he advised the Bank of France not to take such a step and insisting that it would be on the responsibility of the Bank itself. The other annex was a letter signed by the Minister of Justice informing the Bank of France that in France there was no official of the Government competent to instruct the Bank of France to release the gold; a judicial decision was the only means of deciding with finality and safety to the Bank of France how the gold could be disposed of.

Fournier was perplexed at receiving Blum's orders to carry out the transaction when his orders were accompanied by letters opposing the move. Therefore he called on Blum who had Vincent Auriol present when he received Fournier. It is said that both Prime Minister Blum and Minister Auriol urged the Bank of France Governor to release the gold, and they gave various arguments, including political ones, for such a move. The Bank of France Governor was adamant and said that the Bank was not concerned with political arguments.

- 4 -

arguments. Finally Blum shook hands with him and said that he was correct, and that they should drop the matter.

The Bank of France statement to which I referred in my telegram No. 551 of April 7, showed that as of the thirty-first of March in the Bank of France there was left to the Treasury's credit only 3,510,000,000 francs of the latest 5,000,000,000 credit which had been authorized. Confidential information has been given to me that as of last night only half of this balance remained, and that it appears that the State will have exhausted all of it by next Thursday, April 14. No matter what Government is in power, therefore, it will be faced by the end of next week with the necessity of raising funds.

Political demonstrations, growing strikes and uncertain governmental prospect have contributed to nervousness and hesitancy of today's Paris exchange market. American "pump priming" plans said to have caused some offering of dollars in London.

I am planning to leave Paris 10:50 pm Saturday for Basel and return Monday night. Could be reached at BIS or Hotel Schweizerhof.

END MESSAGE.

RECEIVED
WILSON.

THOMAS W. WILSON
DIRECTOR OF THE BUREAU OF
ECONOMIC WARFARE

EG

GRAY

London

Dated April 8, 1938

Rec'd 3:55 p.m.

Secretary of State,
Washington.

290, April 8, 6 p.m.

FOR TREASURY FROM BUTTERWORTH

In the course of a conversation at a private dinner given for him Rooth, Governor of the Bank of Sweden, expressed very pessimistic views about the French situation. He was very skeptical as to whether French capital could be induced under present circumstances to return and he thought that either a capital levy or forced conversion of rentes would eventually be found necessary; in such circumstances the problem was to extract concessions from the rentier without penalizing the entrepreneur. Rooth was convinced that exchange control, if instituted would be a complete failure in France. He said from his own experience he felt sure that there was no such thing as limited exchange control except if applied for a very limited period, for merely a few days during a transitional crisis. Therefore, the question came to whether a complete system of exchange control was workable in France. In his
opinion

-2- #290, April 8, 6 p.m. from London

opinion the answer was definitely "no". Rooth said that it now took 15,000 honest and efficient Germans to work the German clearing system but that a similar number of honest Frenchmen were not available for any purpose, much less such a methodical and skillful task.

Rooth inquired about the prospects in the United States and said that thus far Sweden had not been adversely affected in any important degree by the American slump. HOWEVER, the overwhelming majority of its wood pulp exports for 1938 had already been contracted for in the United States and that pressure in some instances was now being exerted by the purchasers to terminate or modify those contracts. He knew that suitable arrangements could be effected through price concessions in return for contract extensions.

It is perhaps interesting that Rooth also asked about the chance of dollar devaluation should American recovery be delayed.

The dollar has been steady and while the franc has fluctuated the volume has in the circumstances been small.

KENNEDY

PEG:SMS

RECEIVED
APR 10 1938
U.S. DEPARTMENT OF COMMERCE
BUREAU OF ECONOMIC RESEARCH

April 10, 1938

The attached was written on the train coming up from Sea Island for the Secretary to use when he saw the President this evening.

Sunday April 10th (1938)

MEMORANDUM FOR THE PRESIDENT

247

The time seems most propitious for presentation to the people of a comprehensive statement of administration policy and of a program of action designed to restore recovery.

I believe it should be presented to the people by you as soon as possible at three broadcasts.

To be most effective, and to give promise that your recovery program aims not only at getting this country out of the recession, but is designed also to keep us out - for many years at least, I believe your program should include:

I. A restatement of your long-run objectives, and of the major measures you propose to seek during the next two years to attain those objectives (railroads, monopolies, wage-hour legislation, tax-exempt bonds, etc.);

II. An outline of specific steps, both administrative and legislative, you propose to take to eliminate the inefficiencies, the wastes, and the failures in parts of the New Deal program already adopted; and

III. A comprehensive government spending and government lending program, coupled with measures to stimulate private reemployment.

The statement to be made to the people is so important, and the material to be presented so varied, that it would seem to require not one, but three radio speeches given as close together as is feasible.

Of the three parts, the most important is, of course,

-2-

your program of immediate action to put 10 million unemployed back to useful and productive work. I am inclined to think that this part of your larger program might well be given in the third speech. The bullish effect of three speeches, culminating in a broad recovery program of immediate action as announced in advance, should be tremendous. It would serve, I believe, to eliminate existing confusion which is working to hold business down; it would give the people much needed reorientation and assurance, and should greatly strengthen the administration's position.

Formulation of the recovery part of the program should include:

- a. Determination of the total expenditure called for by the whole program.
- b. Insistence upon correlating government expenditures with the geographical distribution of unemployment. Wherever possible, government funds should be expended where most unemployment exists.
- c. Careful survey of all proposals for the purpose of eliminating duplication and overlapping of projects and of administration.

Presentation to the public of this part of the program should include an estimate of the total cost of the program, a statement on the amount you propose to ask Congress for and how you propose to finance the expenditures.

Just as soon as you have formulated an outline of your new recovery program I shall be ready to study it and present to you within a reasonable time a plan for financing it.

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KLP

GRAY

Paris

Dated April 10, 1938.

Rec'd. 3:55 p.m.

Secretary of State,
Washington.

578, April 10, 4 p.m.

Reference my 577, April 10, 11 a.m.

Daladier has formed the following Cabinet which
he presented to the Elysee this afternoon:

Premier and Minister of War and National
Defense, Daladier;
Vice Premier and Minister of Interministerial
Coordination, Chautemps;
Foreign Affairs, Bonnet;
Colonies, Mandel;
Navy, Campinchi;
Air, La Chambre;
Justice, Reynaud;
Interior, Sarraut;
Finance, Marchandeau;
Pensions, Champetier de Ribes;
Commerce, Gentin;
Agriculture, Queuille;
Labor, Ramadier;
Public Health, Rucart;
Public Works, Frossard;
Posts, Telephones and Telegraphs, Julien;
Merchant Marine, Chappedelaine;
National Economy, Patenotre.

Of these

- 2 -

#578 from Paris - April 10, 4 p.m.

Of these Ministers there are fifteen Deputies comprising nine Radical-Socialists, one Republican Independent, one Democratic Alliance, three Socialist and Republican Union and one Democratic Left and Independent Radical; and four Senators, comprising three Radical-Socialists and one belonging to no group.

No undersecretarys have been named.

It is reliably reported that there has been formed an Interministerial Committee composed of Daladier, Chautemps, Bonnet, Reynaud, Sarraut and Marchandéau who will meet daily in order to decide upon urgent questions facing the Government.

The Cabinet is scheduled to meet tomorrow and may present itself to the Chamber on April 12.

This is the first time since June 1936 that members of the Center and Right, such as Reynaud and Mandel, appear in the Cabinet and it marks the end for the moment at least of the succession of Popular Front governments. It is reported that when Daladier offered participation to the Socialists on the basis of five Cabinet posts he proposed to seek full powers to govern by decree during six months. With the refusal of the Socialists to participate it is likely that his program may be less ambitious.

This

- 3 -

#578 from Paris - April 10, 4 p.m.

This Government rests on a narrow basis of parliamentary support and assuming that it receives an initial vote of confidence it can hardly aspire to a lengthy term of office.

WILSON

KLP

RECEIVED
APR 11 1918
TREASURY DEPARTMENT
U.S. DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

JR

GRAY

Paris

Dated April 11, 1938

Rec'd 2:15 p.m.

Secretary of State,
Washington.

579, April 11, 4 p.m.

FOR THE TREASURY.

The exchange market today was calm and transactions light. The sterling rate remained close to 160 in unofficial trading this morning and during the official session this afternoon.

On the security market most rentes made substantial gains.

While there is a disposition to wait for the announcement of policy the new government seems to be fairly well regarded in financial circles although some disappointment is apparent that it was not possible to set up immediately a National Union administration.

No official statement has yet been noted regarding a definite financial program but afternoon press predicts that, as conciliating measures, Parliament will be asked tomorrow or Thursday to authorize a further advance of 5,000,000,000 francs from the Bank of France and that a loan issue of 15,000,000,000 francs will be prepared. It

is

-2- #579, April 11, 4 p.m., from Paris.

is said that a comprehensive project will be laid before the Chambers after Parliament reassembles following the Easter holidays.

WILSON

HPD

RECEIVED
APR 12 1934
FEDERAL DEPARTMENT
OF THE TREASURY
WASHINGTON, D. C.

REB

GRAY

London

Dated April 11, 1938

Rec'd 4:14 p. m.

Secretary of State,
Washington.

298, April 11, 7 p. m.

FOR TREASURY FROM BUTTERWORTH:

One. Waley states that as Chairman he has called a meeting of the International Relief Bonds Committee for April 22 to decide about sending a note to the German authorities asking if they accept responsibility for the relief debts and whether they will appoint a representative to discuss methods of settlement with the Committee. Waley referred to our note of April 6 and requested me to inquire whether I might be authorized to attend the meeting here as an observer. When I demurred he talked about the "principle of pari passu" and reiterated his request that his suggestion be forwarded to Washington.

Two. Waley states that the British Embassy in Berlin will present probably today a note, the kernel of which is that the British Government assume that Germany will

REB

2-#298, From London, Apr. 11, 7p.m.

will accept responsibility for the Austrian loans.

THREE. In recent days from separate talks with Waley, Leith-Ross and Lever, Chairman of British Bondholders Committee, I gather (a) that the British have been informally advised by the Germans that they are willing to take care of the Austrian loans for the time being. It was implied, however, that adjustments were expected particularly as regards the seven per cent unguaranteed loan.

(b) that the British although they take the line that they would prefer to deal with the loan position on an international rather than a national basis really expect to be forced to reach a national agreement. A readjustment of the Anglo-German payments agreement will also have to be made.

(c) that they also expect that the whole question of servicing the Reich and non-Reich sterling loans will come up for discussion. (See my 813, December 30, 5 p.m.)

Waley feels that the negotiations will be complicated but he is not unhopeful of the result for the

reason

REB

3-#298, From London, Apr. 11, 7p.m

reason that the amount of free sterling which the Germans obtain under the present Anglo-German payments agreement is large enough to cover present payments on the Reich loans, the guaranteed Austrian loans and the to be agreed upon payments on the non-Reich loans and un-guaranteed Austrian loan and still leave free sterling available to Germany.

Leith-Ross was more pessimistic and called the Germans "mean-minded fellows who had no understanding of the importance of credit". He feared that revising the Anglo-German payment agreement might prove very difficult if a clearing arrangement was to be avoided. He said that the payments agreement had worked unbelievably well; that he was most anxious to avoid a clearing but he could not help remembering how unexpectedly fortunate he had been in 1934 in avoiding one at the final hour.

KENNEDY

HPD

RECEIVED

APR 12 1954

COMMUNICATIONS SECTION

U.S. DEPARTMENT OF STATE

WASHINGTON, D.C.

STR.
REB

PLAIN

London

Dated April 11, 1938

Rec'd 2:59 p. m.

Secretary of State,
Washington.

FOR TREASURY FROM BUTTERWORTH.
299, April 11, 8 p. m. (SECTION ONE)

In commenting on the composition of the Daladier Government the British press continues the policy of studied restraint mentioned in my 281, April 5, 6 p. m. Nevertheless it cannot altogether conceal either its disappointment or anxiety. The appointment of Reynaud is welcomed as a portent. But even the TIMES concludes its article by saying "With the largest party in the Chamber in this ugly mood, tempted to seize the first plausible opportunity to take its revenge by turning out a radical Prime Minister, the government will have to go warily to avoid defeat. Even more disquieting than this unpleasant political atmosphere is the growing disturbance in the metallurgical industries the causes of which are obscure but seem to be as much political as industrial.

M.

REB

2-#299, From London, Apr. 11, 8 p.m.
(Sec. One)

M. Daladier broadcast last night a strong appeal to all Frenchmen to make each his individual contribution to the unity and security of the nation. However, much political and sectional feeling may have been inflamed this is not an appeal which should be allowed to go unheeded."

(END SECTION ONE)

KENNEDY

RR

CSB

KLP

GRAY

London

Dated April 11, 1938.

Rec'd. 3:04 p.m.

Secretary of State,
Washington.

299, April 11, 8 p.m. SECTION TWO.

In the course of a conversation about other matters Waley expressed much the same views as given above.

Two. Waley referred to the posters on the streets "Mexico says no to British note" and said he simply could not understand our patience when from our past experience we knew that Mexico had no intention of paying compensation for expropriated foreign property and in this instance certainly had no means of effecting such compensation payments. He also said that he felt sure that in due course Mexico would begin selling silver abroad and at that time we would be faced with another difficult silver decision.

(END SECTION TWO)

KENNEDY

RR:SIS

REB

PLAIN

London

Dated April 11, 1938

Rec'd 3:05 p. m.

Secretary of State,
Washington.

299, April 11, 8 p. m. (SECTION THREE)

It may be of interest that the City is now receiving considerable sums from Czechoslovakia for hoarding purposes and in many cases the money is being brought to London in cash by the owners themselves. The City is also receiving clumsily worded letters from Vienna financial houses which in effect ask whether accounts held in the name of a deposed principal or partner can drawn^{be}/upon.

Four. The volume of trading in the foreign exchange market was unusually small today. The franc remained steady at around 160 and although, the dollar came on offer toward the close little business was done.

(END MESSAGE)

KENNEDY

HPD

RECEIVED
APR 11 1938
TREASURY DEPARTMENT
WASHINGTON, D. C.

REB

GRAY

London

Dated April 11, 1938

Rec'd 4:14 p. m.

Secretary of State,
Washington.

298, April 11, 7 p. m.

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KENNEDY

HPD

RECEIVED
APR 11 1941
U.S. DEPARTMENT OF THE TREASURY
WASHINGTON, D. C.

GROUP MEETING

April 11, 1938.
9:30 A. M.

Present: Mr. Magill
Mr. Oliphant
Mr. Gaston
Mr. Taylor
Mr. Haas
Mr. Gibbons
Mr. Bell
Mr. Lochhead
Mr. Upham
Mr. McReynolds
Mrs. Klotz

H.M.Jr: Well, you (Magill) and I been talking here, so we are

Magill: Clear.

H.M.Jr: Mr. Oliphant.

Oliphant: I have an invitation from that Princeton-Yale-Harvard banquet to come up there at their next meeting.

H.M.Jr: Why not?

Oliphant: Well, I'll be glad to go.

H.M.Jr: What's the subject?

Oliphant: Monetary.

H.M.Jr: I think you'd better go - don't want them to give you "Law Reform" or something like that.

Oliphant: They wanted me to suggest somebody else here.

Bell: They have also asked me to come.

Oliphant: In case I couldn't come.

H.M.Jr: Let Harry White go.

Oliphant: That's all I have.

- 2 -

- H.M.Jr: I wish you'd get hold of your friend, Bob Allen, the next day or two and have a little talk with him. Will you? And let him know some of the things we have been doing here, like price things, cement, and all that business - some of these things we've been doing.
- Oliphant: (Nods "Yes.")
- H.M.Jr: I really wish you'd get hold of him. Will you?
- Oliphant: (Nods "Yes.")
- H.M.Jr: You know him better than anybody else.
Herbert?
- Gaston: Mr. Bundy, the editor of the Yale Daily News, called up a few days ago and asked if you wouldn't write a letter about the Harvard-Yale-Princeton Conference that they could publish in the Yale News.
- H.M.Jr: (Shrugs) Just right now we'll skip all that stuff.
- Gaston: I should think so, yes.
- H.M.Jr: All right.
- Gaston: That's all I have.
- H.M.Jr: (Nods to Mr. Taylor.)
- Taylor: I have a letter here that just came in from Westervelt.
- H.M.Jr: All right.
- Taylor: Which I'll give to you.
- H.M.Jr: Thanks. I'd like Taylor and Bell to stay after this meeting, please.
(Nods to Mr. Haas.)
- Haas: I'll have that black book in here in a few minutes. Didn't have time to get all the material in it. I'll have a business statement for you around noon.

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- H.M.Jr: I am anxious for you to get hold of that report of Dunn and Bradstreet on business trends.
- Haas: I'm interested to see how they
- H.M.Jr: I really wish you'd get hold of that.
- Haas: I've a note on it.
- H.M.Jr: Harry wrote me that Dunn and Bradstreet - seventeen thousand concerns--and that their inventory position was five million dollars above normal December 31. Well, if that's so, got to work that off before anybody's going to buy anything new. Five million dollars above normal.
- Oliphant: Work it off or raise the value of it.
- H.M.Jr: Yeah.
- Haas: They are working on this cement price - with Blaisdell - making some progress. A very fruitful field, but very difficult.
- H.M.Jr: Well, I think this week that it will be suspended from Mr. Bell's spending program.
- Haas: That's all.
- Bell: First I knew I had one.
- H.M.Jr: (Nods to Mr. Gibbons.)
- Gibbons: Got a telegram on Saturday from Governor Horner - says our Comptroller of Customs out there is trying to intimidate everybody to vote for Mike Igoe out there. I sent him a telegram in reply.
- H.M.Jr: Congratulations.
- Gibbons: I guess this man will come pretty near winning - Horner.
- H.M.Jr: Will he?
- Gibbons: Understand it's about nip and tuck.
- H.M.Jr: Before I do any more bets, you (Mrs. Klotz) are up holding a lot of mine.

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- Gaston: Yes, you are.
- Gibbons: What was that bet again?
- H.M.Jr: It was one with Gaston - wouldn't be seven forty-five. I've got one with Irey that the Reorganization Bill wouldn't pass on April 1.
- Klotz: Oh, it wouldn't?
- Taylor: I've a half interest in one of those.
- Klotz: You win a nickel.
- H.M.Jr: We bet him ten cents it wouldn't be seven forty-five. You and I get a nickel, and we'll match for the nickel.
- Dan, have you got your things? I want to talk next year expenditures. I've got your memo.
- Bell: I have a copy of that.
- H.M.Jr: I see.
- (Nods to Mr. Lochhead.)
- Lochhead: Foreign exchange market isn't showing any enthusiasm over the developments over the week-end. They don't think the French setup is very strong yet, and they don't think that it's going to go very far.
- H.M.Jr: I see you slipped my friend, Marchandau, back again.
- Lochhead: I understand once you're a member of the Finance Committee, you're a permanent part of the Cabinet. They've got three former Finance Ministers in the Cabinet - Marchandau, Bonnet, and Reynaud.
- H.M.Jr: Wasn't Marchandau the one just before Blum?
- Lochhead: Yes, he was - just before Blum, under Cheautemps.
- Taylor: He was the boy that was tired.
- H.M.Jr: I wonder if he feels any better after twenty-nine days' vacation.
- All right.

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Upham: ^{Banking Committee,} Pat Boland, of the House / would like to come see you today, to invite you, as near as I can find out, to address some bankers' convention up in Pennsylvania.

H.M.Jr: That's too near. Could he make it California?

(Laughter)

The President, last night, emphatically invited me to be present at eleven this morning, so we'll have to see him. (To Mrs. Klotz:) It's not just to see me?

(Side conversation with Mrs. Klotz)

Did you make any headway with S. E. C. on that particular holding company?

Upham: I've been over there, and they expect something, possibly, to break this week. They are sending us an efficiency letter which goes into the defects in the national set up.

H.M.Jr: It has a report I could take to the Banking Committee?

Upham: No, it has not. It certainly should get here this week. There have been a good many delays that are understandable.

H.M.Jr: Are they?

Upham: Yes.

H.M.Jr: Really?

Upham: Yes.

H.M.Jr: Anything particular on that? Will you keep after Mrs. Klotz on Pat Boland? I'd like to see him if possible. Why not give him a definite appointment tomorrow morning at ten o'clock?

Gibbons: He's a very nice fellow.

H.M.Jr: Of course he is; he's a man that can't just be turned aside. He is efficient in the sense that you can always count on him.

Mac?

McReynolds: I had a letter from the Comptroller of the Currency, dated the sixth day of April, and signed by J. F. T. O'Connor.

H.M.Jr: Well? And so what?

McReynolds: Well, I refused, so far, to grant any official requests of the Comptroller of the Currency in the name of J. F. T. O'Connor.

H.M.Jr: That's what he resigned under.

Gaston: He claims he didn't; that his resignation has never been accepted. I think he has a point there. The wording of the letter is equivocal. It isn't an outright acceptance.

H.M.Jr: Listen, gentlemen, right now, as far as I am concerned, he's out. I've got too many important things. I just don't - I mean, I'm not saying I won't handle it. I'm not going to handle it while we've got all that stuff.

Oliphant: It's in my shop for study.

H.M.Jr: It's proper for you to bring it to me, and explanatory letters go to the President, asking him to clear up with me.

McReynolds: I also asked ~~Jimmy~~ whether the President accepted his resignation. They haven't sent anything back here. He said it was his understanding, and everybody's over there, that he resigned, effective the first of April. I turned it over to Herman. On this Mount Rushmore

H.M.Jr: Well, you better clean it up - that's all. You fellows - I'll appoint a committee of McReynolds, Oliphant, Taylor, and Upham, with power to act. The four of you - the four of you - and handle it promptly, and if it isn't clear, send it over to the President and ask him to clear it up. Will you, please?

Go ahead, Mac.

McReynolds: On this Mount Rushmore. We got this memorandum from the President. I called Peoples, and I also called Interior.

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H.M.Jr: Oh, Mac, let one of the Secretaries - or Assistant Secretaries handle it. Let somebody else sign it. All right - want me to sign it? Is it all right?

McReynolds: It's all right.

H.M.Jr: It seems like a silly way - no, it's a silly letter - I write the Secretary of the Interior, "After the conference of the Secretary of Interior and the Director" "After a conference between you and the Director....." It's such a silly way to address it. But if you want, I'd just leave sign it. "Dear Mr. Morgenthau: After a conference between the Secretary of the Treasury"

Klotz: They'll rewrite it.

McReynolds: But I just wanted you to know that the thing is straightened out so everybody's happy, and the gentlemen out there will get proper service.

(Mr. Kieley hands Secretary note.)

H.M.Jr: I don't like that. She's got..... (Over telephone) Get me. Lieutenant McKay, please.

(Side conversation with Mrs. Klotz)

(Over telephone.) Hello. Hello. Hello. I just got a telegram from Mrs. Morgenthau that she's thinking of flying tonight from Buffalo back to Washington. I wish you'd find out what kind of equipment that they have - that Central Lines - Pennsylvania Central. I'd like to know what kind of equipment and what do our boys think of their pilot from Buffalo here. It's on the seven o'clock plane. I'd like to know what they think of their equipment. I mean, they can find out exactly what kind of plane they are going to fly tonight. Is it a new plane? They've got some awful old Boeings - and what their record is. Will you? Thanks.

Gaston: Are you sure it's Pennsylvania Central?

H.M.Jr: Yes. It's just opened, about a week. They fly Buffalo to Pittsburgh, Pittsburgh to Washington.

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In strictest confidence, so that you people will know what I'm doing, I'll read you two letters - I mean a letter which is going this morning, and a memo which I gave the President last night.

(Reads communication to the President, beginning, "My dear Mr. President: Mr. Magill and I saw you ..."
The letter is attached.)

April 12, 1938

My dear Mr. President:

Mr. Magill and I saw you last in regard to the tax bill on the morning of Saturday, March 19th. At that time we discussed with you what policy the Treasury should follow before the Finance Committee which would be considering the tax bill in executive session during the following week.

You undoubtedly remember that we discussed the possibility of your writing a letter to Senator Harrison expressing your views in regard to your tax principles. After considerable discussion, you decided that you would not write a letter as you felt that your public appearance at Gainesville, Georgia, would be an ideal opportunity to deliver an address covering the tax field. You asked Mr. Magill to send you over material not later than three o'clock, that afternoon, so you could immediately go to work preparing your speech.

You did not, however, find it convenient to discuss tax policy at Gainesville and neither Mr. Magill nor I have had any word from you since on the pending tax legislation other than the general discussion which occurred at Cabinet on April 5th.

As you know, the bill passed the Senate last Saturday and now goes to conference. The bill does not carry out the principles which we have been advocating, earnestly and forcefully, at your request before both Houses.

Prior to the Treasury's appearance before the Conference Committee on the tax bill, we would very much like to know what position you wish us to take in regard to the differences in principle between the

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House bill and the Senate bill.

Mr. Magill and I would appreciate an appointment with you at your earliest convenience.

Yours sincerely,

The President,
The White House.

Bell: So Magill is responsible for the Gainesville speech.

Magill: (Nods "Yes.")

H.M.Jr: I know, so you people will know.

Magill: I sent over the wrong memorandum.

H.M.Jr: Well, it's an interesting fact, for three weeks neither Magill nor I have had any advice from the President.

Gibbons: In this morning's Washington Herald, did you see the editorial on Pat Harrison's tax?

H.M.Jr: I think it's important enough, because no one would believe that for three weeks, the Treasury has had no advice. In three weeks there's been no advice as to what he does or doesn't want. Well, while I was down south - Upham, Haas, and White - I wrote this and gave this to the President last night.

(Reads memorandum to the President, which is attached.)

Sunder P. 277

MEMORANDUM FOR THE PRESIDENT

April 10, 1938.

The time seems most propitious for presentation to the people of a comprehensive statement of administration policy and of a program of action designed to restore recovery.

I believe it should be presented to the people by you as soon as possible at three broadcasts.

To be most effective, and to give promise that your recovery program aims not only at getting this country out of the recession, but is designed also to keep us out - for many years at least, I believe your program should include:

I. A restatement of your long-run objectives, and of the major measures you propose to seek during the next two years to attain those objectives (railroads, monopolies, wage-hour legislation, tax-exempt bonds, etc.);

II. An outline of specific steps, both administrative and legislative, you propose to take to eliminate the inefficiencies, the wastes, and the failures in parts of the New Deal program already adopted; and

III. A comprehensive government spending and government lending program, coupled with measures to stimulate private reemployment.

The statement to be made to the people is so important, and the material to be presented so varied, that it would seem to require not one, but three radio speeches given as close together as is feasible.

Of the three parts, the most important is, of course,

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your program of immediate action to put 10 million unemployed back to useful and productive work. I am inclined to think that this part of your larger program might well be given in the third speech. The bullish effect of three speeches, culminating in a broad recovery program of immediate action as announced in advance, should be tremendous. It would serve, I believe, to eliminate existing confusion which is working to hold business down; it would give the people much needed reorientation and assurance, and should greatly strengthen the administration's position.

Formulation of the recovery part of the program should include:

- a. Determination of the total expenditure called for by the whole program.
- b. Insistence upon correlating government expenditures with the geographical distribution of unemployment. Wherever possible, government funds should be expended where most unemployment exists.
- c. Careful survey of all proposals for the purpose of eliminating duplication and overlapping of projects and of administration.

Presentation to the public of this part of the program should include an estimate of the total cost of the program, a statement on the amount you propose to ask Congress for and how you propose to finance the expenditures.

Just as soon as you have formulated an outline of your new recovery program I shall be ready to study it and present to you within a reasonable time a plan for financing it.

H.M.Jr: That's that. That's that.

Magill: Excellent.

H.M.Jr: What?

Magill: Excellent.

H.M.Jr: So he had that last night. Mr. Hopkins was present, and so was Mr. Jimmy Roosevelt. At eleven o'clock we'll see what they got. But they've been moving awfully fast - moving too fast.

Oliphant: Who's going to be there?

H.M.Jr: Well, Bell and I from the Treasury.

Oliphant: Is Hopkins going to be there?

H.M.Jr: Yes. And the rest are Senators.

Gibbons: Who advises Hopkins?

H.M.Jr: He's got a bigger staff than any other agency. He's got an enormous staff. I have no idea how big, but after all, how much has he got for administrative expenses?

Bell: Five per cent of the total amount he spends.

H.M.Jr: Which is how much?

Bell: He spent a million and a half.

H.M.Jr: He can hire a lot of advice for that.

Bell: And then he has a lot of research projects, which are really in effect, administrative.

McReynolds: Not charges against his administrative expenses.

H.M.Jr: I don't mind telling you gentlemen what I heard last night. The way it was put up to me last night just scared me to death - worse than I've been scared - and the thing hasn't been thought through. And fear begets fear - I mean the thing that - the President's attitude was, in 1933, was, "Let's be calm and do things, and overcome fear," but fear begets fear. Whether I am going to be

stalled, as far as I am concerned, to overcome this thing, so it will be an orderly program which I have formed, but this thing, as far as I can make it, is completely finished and there hasn't been a single person in the Treasury consulted. They had a conference - lasted an hour before I came - in advance of my coming - and I think the whole thing is finished, and there hasn't been a single person in the Treasury that knows a single thing about this.

Gibbons: Not even him? (Bell)

H.M.Jr: No.

Bell: I get my information from the paper.

H.M.Jr: (Over telephone:) Hello. Thank you. Hello. Oh yes. Is that right? Good. Good. But the racket's all right? Uh huh. Well, let our boys keep a line on the weather, will you please. I'll call you. In case any signs of storm, you call me, from here to Buffalo. O. K. Thank you.

So we'll see what we'll see.

McReynolds: Both the Appropriations Committees have called me about the attitude that was developing up there in the Committee about additional authorization for expenditures.

H.M.Jr: What do they say?

McReynolds: They say there is very definite, active block in opposition - to limber appropriations - Wheeler-Byrd in the Senate - that's working very active - to work up

H.M.Jr: I've got a program I'm willing to go on, but I want the thing thought through. I mean, how can I say, when they shoot these things at me, - everything you've read in the paper plus a lot more - how can I say whether you can finance it or not until you total the thing up. I mean, there is such a thing as a limit, and

Oliphant: I think you'll have an opportunity to discuss alternative measures too.

- H.M.Jr: Well, in the financing part, we didn't put down such questions as handling the sterilization of gold. It will all come under - when he gives me the total figure - "I need such and such a thing to be done."
- Oliphant: My point is that you have an alternative.
- H.M.Jr: No.
- Oliphant: You have the same free hands in monetary measures. You can turn the thing around.
- H.M.Jr: Well, they want to do it Thursday night.
- Oliphant: You can act before Thursday night.
- H.M.Jr: Well, not for them. This is - everything that Jimmy Roosevelt's been trying to do - and gets done - he's put across, plus a few things besides. I mean, every single thing they've been advocating over there, they've done, plus a few things we haven't heard.
- Gaston: The things Harry Hopkins wants done he goes to him.
- H.M.Jr: Couple new ones, like building five/^{hundred}million dollars worth of houses for rental.
- Taylor: That isn't branding you.
- H.M.Jr: Trans-continental highway - taking all - anything that bothers Straus, just removing it, and let him start five hundred million dollars, and commit himself to another five hundred million dollars on paper, and get the administration - but he is back of the business, and they let Hopkins put a hundred fifty labor to work for railroads. Have you heard that one?
- Taylor: Yeah.
- H.M.Jr: Well, everything that you've heard, plus a couple more besides.
- Gaston: Would be a good idea to look at that.
- Taylor: It's a program, plus.
- H.M.Jr: Everything that's said

- Gaston: That vote on the Reorganization bill has a bearing on that.
- H.M.Jr: Well, of course
- Oliphant: That's the point.
- Gaston: They are going to get stopped.
- H.M.Jr: That's just the point. What I suggested, I think, is calm and sensible. Get down there at Sea Island, where it is calm - series of three radio speeches, say, over three weeks, and announce you had three and let him state his long-term program; let him put in his wages and hours; let him put in his monopoly message, and price message; and let the public know, and let him admit there are certain things - "and that is why we need reorganization." And then the last thing - this spending - and they think, on account of this thing, they've got to do this thing Thursday.
- Oliphant: On account of what thing?
- H.M.Jr: On account of what happened Friday - Saturday. And, as I say, there is nothing that begets fear like fear. I saw in the paper, I think either today's or yesterday's Tribune - they had a very intelligent article, the point of which - was by the management of the Tribune. Here. (Looking at paper.) He hasn't got it, but yesterday Alfred Warner said, "To offset this defeat in Congress, they are going to have this big spending program." He said it yesterday.
- Haas: You remember, Mr. Secretary, in '33, the five-year plan, the twenty billion dollars in five years. That is having
- H.M.Jr: I am not fearful of any program which you sit down and carefully think through, see?
- (Over telephone.) Tell Miss Chauncey I am waiting for that letter to the President, please.
- I am not afraid of anything, but I'd like - just as though I came back and said to you fellows, "Tomorrow I am going to sterilize gold. I am going to do this, and going to do it tomorrow." What's the sense of having a Treasury staff? Huh? "I'm going to do it tomorrow."

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Oliphant: I think Gaston has a good point.

H.M.Jr: What's that?

Gaston: This reaction is just going to increase the confusion.

Oliphant: He'd better rely on an alternative measure.

Gibbons: Right in this room, the day the Senate passed the Reorganization bill, Farley called him and told him - and said, "That was too close a vote." He said, "If this thing doesn't go through the House you are going to lose control of your party. The thing to do is call in some of these people and sit down with them - not put yourself in a shell and just let lightening strike where it will." I said, "Well, what's the reaction - sitting up and just -" (shrugs) you know. He's lost control now, - there's no question.

(Miss Chauncey brings in letter.)

H.M.Jr: Just a second, Miss Chauncey. I want this to go promptly off.

Chauncey: And want the envelope marked "Confidential"?

H.M.Jr: Ah, I'll phone him it's coming. Tell Dowling to take it special. I'll phone him.

(Over telephone.) Find out what usher is on duty at the White House. I want to talk to him, please.

Well, I want you people to know - as they say, I am calmer today than I was yesterday, now that I know the worse, but I'm awfully afraid that the cards are all stacked against us. I don't think we've got much chance.

Oliphant: Do you think you would have a chance of presenting the alternative program on the monetary thing?

H.M.Jr: I don't think so, Herman. That's worth considering, because while I didn't say so, he classified us into three groups; one group said things are going to get worse; one group said things are going along as they are; and one group said things are going to get better, and he puts me in the group

that says things are going to get better, so I reminded him that

(Telephone.) Hello. All right. Crim, good morning. I've sent my head messenger, Dowling, over with an important letter for the President, and asked him to give it to you. Will you see that it goes up to the President? Will you please? Thank you very much. And congratulations; I wish you success.

Ah, where was I?

Oliphant: That he put you down as one.....

H.M.Jr: Oh, as one saying things are going along, and get better in January, and I said, "If you remember, Mr. President, we came over with two estimates - ninety and ninety-five. I recommended the ninety - you took the ninety-five." I said, "I was off ten per cent, and you were off fifteen.

Incidentally, Herbert, this morning - what I said before, on that particular point, was what I said in December, and what I said when I went up on the Hill. See?

Gaston: Yes.

H.M.Jr: So, ah, uh, going back to what Wallace saw in one day - said the President's raring to go, and they have just stampeded him during the week I was away. He was completely stampeded. They stampeded him like cattle - they trampled the grass under foot.

Gaston: May get in this meeting this morning - may get some surprising words from that group up on the Hill.

H.M.Jr: I'm not

Bell: I don't think so.

Gaston: (To Mr. Bell) You don't think so?

Bell: Well, I've never seen it as yet. They are pretty general when they get to the White House.

- Oliphant: You can say, "Well, let's take the first things first." First it cuts their arguments out and increases the debt. Second, he avoids the danger of going down there and getting defeated again.
- H.M.Jr: But
- Oliphant: And
- H.M.Jr: But I don't know how long Congress is going to stay, but it is (Shakes head negatively.) Well, we'll see. I'll keep you fellows posted, but - and there's no total - I couldn't get a total; I have no idea what the total is.
- Gibbons: Couldn't get totals? I mean, with Harry Hopkins?
- H.M.Jr: The Hopkins thing was - the least thing was that figure for Hopkins - a billion four fifty from the first of July through until next February. That's the least part.
- Magill: That's gone up two hundred million since the Cabinet meeting.
- H.M.Jr: Well, gone up four fifty since he gave his word it would be only a billion. I was there when he gave his word. Woodring said, "I'll go along if you give us your word of honor it's only going to be a billion."
- Gibbons: That's what's got the people on the outside jittery. They say, "Where's the bottom?"
- H.M.Jr: That's what just got Jones' bill. It's through. I made a fight to keep them from wrecking Stewart McDonald's program, and it's going along nicely. Now they are going to wreck R. F. C.'s program - chance to make good before he gets started, not even going to give him a chance. If you are going to have Ickes lending to municipalities, and Jones lending to municipalities, and Hopkins lending to municipalities
- Bell: Hopkins will maintain them.
- H.M.Jr: The city's contribution of trash baskets at twenty-five cents per month.

Oliphant: It's gone so far, the only hope is in an alternative - no?

H.M.Jr: They figured that all in. For some reason or other they overlooked currency and silver certificates; I don't know why, but maybe before Thursday they'll think of those. Give them time.

Well, as I say, what I am saying here is triple confidential, but I'd like you to think about it, but don't discuss it with anybody except in the room. I'm glad I had two weeks of sunshine.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE April 11, 1938

TO Secretary Morgenthau
FROM Mr. Haas
Subject: The Business Situation, week ending April 9, 1938

Summary

Business activity still continues on a generally stable level, despite recent disturbing influences, although some evidence of a tendency toward greater caution appears in a reduction in new steel orders for the second week in succession, a 3-point decline in steel operations, and a drop in carloadings which has reduced the New York Times adjusted business index to slightly below its previous low.

Sentiment in the financial centers, however, which had been severely depressed in recent weeks by acute weakness in security prices and other disturbing developments, has taken a distinct turn for the better.

Also on the favorable side were an increase this week in automobile output in excess of the normal seasonal rise, a continued increase in new orders of reporting companies, outside of the U. S. Steel Corporation, and an improvement in retail sales.

Conditions at the present time appear favorable, in our opinion, for the success of a Government recovery program involving moderate inflationary monetary moves, with spending confined largely to relief appropriations. We base this conclusion on the stability shown by business in recent months, its apparent willingness to respond to a Government recovery program, and our belief that the long decline since last summer has carried industrial production too low in relation to consumer demand.

A marked upturn in security prices has in part been responsible for, and in part has reflected, the improvement in sentiment. Securities had begun to rise earlier in the week on an improved technical position, and made sharp gains at the end of the week after plans for a Government spending program had been reported by the press.

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The steel situation

Steel operations declined 3.1 points this week to 32.6 per cent of capacity, following two weeks of declining orders attributed in some quarters to the decline in security prices. In Chart 1 we show the weekly changes in total steel output during 1937 and 1938, in comparison with new orders reported by the U. S. Steel Corporation.

It will be noted that steel output in recent months has been on a somewhat lower level than new orders. This appears to indicate that orders for certain products are being filled from stocks, a conclusion confirmed by the fact that actual shipments of steel recently have been running higher than steel output. The present level of orders should therefore result eventually in a higher level of steel output.

The fact that steel prices have not yet declined from their 1937 peak levels, despite the downward trend of commodity prices generally, continues to discourage the buying of steel on any but a hand-to-mouth basis. A move is reported this week to correct this situation by having labor take the initiative in a plan whereby wages would be lowered temporarily in return for the promise of steel companies to (1) make an even sharper reduction in steel prices than in wages, and (2) restore the wage cut as soon as buying stimulated by the price reduction had raised the volume of steel output to a higher level.

The automobile situation

In response to a substantial improvement in sales during the latter part of March, automobile production this week rose to 60,975 units, as compared with 57,500 units the previous week. This represents an increase of 2 points in the New York Times seasonally-adjusted index of automobile production. (See Chart 2).

Referring to the improvement in sales, Ward's Reports says that the last third of March more than fulfilled the earlier hopes of manufacturers, and that a continuation of this forward pace appears likely during April. The fact that the plants which are advancing their assembly lines are doing so after having first reduced their field stocks to fairly satisfactory levels, according to Ward's analysis, appears an encouraging feature of the present situation.

A heavy volume of new car buying when the 1939 models appear next fall appears probable. A factor in the small volume

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of sales this year was the lack of any important style change in the 1938 models. Profiting from this experience, the automobile companies are starting early to make plans for radical changes of design in the 1939 models, which on the basis of past experience should result in a marked improvement in demand.

Current developments

The New York Times seasonally-adjusted business index for the week ending April 2 declined 2.0 points to 78.1. This compares with the previous low figure of 78.3 for the last week of December. Largely responsible for the decline was a marked drop in carloadings following the date on which the new freight rates became effective, the Times index for miscellaneous carloadings dropping 12 points, and "all other" loadings 3 points. During the current week a greater than seasonal rise in automobile production will partly offset a contra-seasonal decline in steel production, with the remaining figures for the index not yet available.

New orders reported by 3 important companies, which we tabulate weekly, not including the U. S. Steel Corporation, showed an increase during the week ended April 2 for the fifth successive week. The total of \$9,830,000 compares with \$9,760,000 for the previous week, and with a recent low of \$8,130,000 for the last week of February.

Retail sales continued to improve this week, according to Dun and Bradstreet, despite a wave of unseasonably cold and stormy weather, rising 2 to 5 per cent above the previous week. Wholesale orders were reported as 5 to 10 per cent above the previous week, with a general improvement in the outlook for wholesale business seen in the progressive inventory reduction reported by retailers throughout the country.

The price situation

Commodity prices continued to decline during the early part of the week, but later turned sharply upward in company with security prices on press reports that the Administration was contemplating a program of deficit spending to bring about business recovery. The prospect of such a program has brought inflation talk to the front again, stimulated in part by bulletins on the outlook for inflation published by several market writers.

The action of the markets this week suggests, as did the market action on the President's price statement in February,

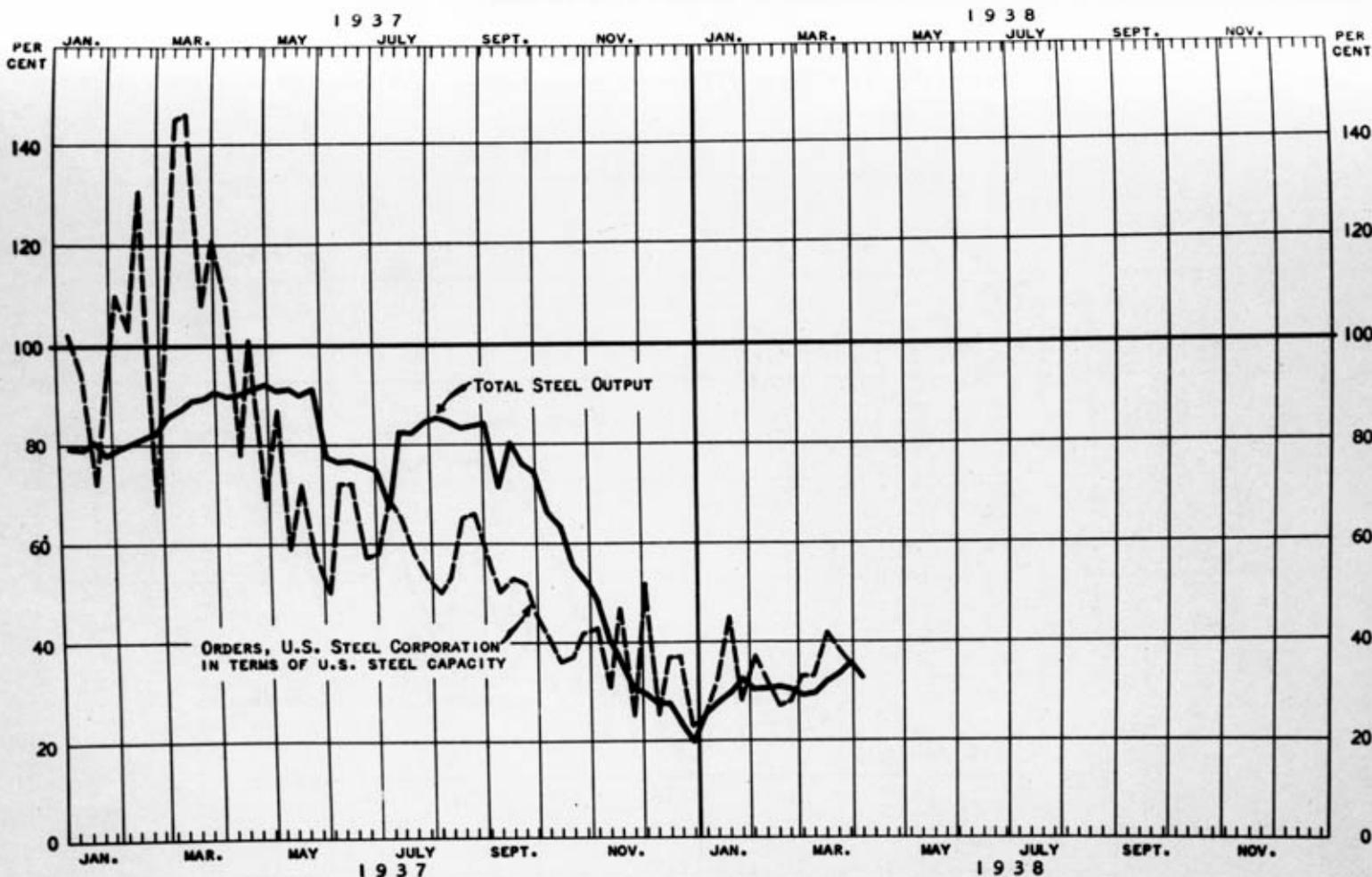
Secretary Morgenthau - 4

that public sentiment is apparently ready to follow the Administration in a definite recovery program. Conditions at this time seem favorable for the success of such a program, barring unfavorable developments abroad that may affect our economy. The severe decline in business since last summer has undoubtedly done much to correct unfavorable features of the inventory situation; the recent stability of business seems to indicate that demand, even at present depressed levels, is sufficient to take care of current production plus inventory withdrawals; brokers' loans are at the lowest levels since May, 1933; and commodity prices, in the absence of a further weakening in foreign currencies, seem well deflated.

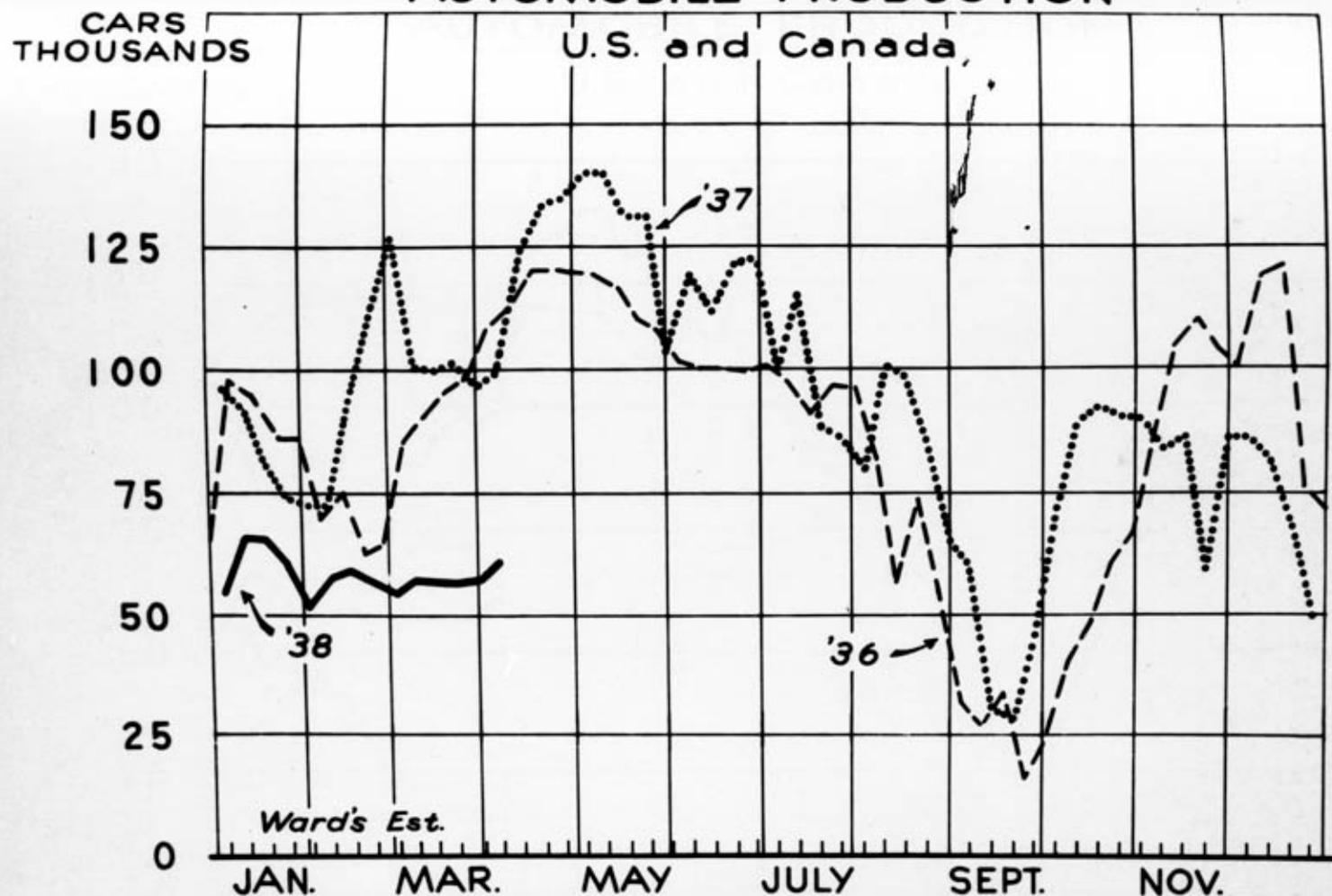
While the prospect of strong Government action directed toward business recovery has favorably influenced business sentiment, the use of funds for pump priming operations has raised misgivings in financial circles over the financial questions involved. The Wall Street Journal mentions that the proposed program has not been so well received in Wall Street as was the program several years ago, owing partly to fear of a possible loss of confidence in municipal bonds if municipalities should be invited to borrow from the Government.

In view of the relatively favorable business outlook, which is markedly different from that in the spring of 1933, and the evident readiness of business to follow any constructive Government recovery program, it is our opinion that an elaborate spending program at this time is unnecessary, and might adversely affect confidence among important sections of the public. To restore public confidence, on the other hand, and permit business to respond fully to whatever recovery measures are adopted, there appears a distinct need for monetary measures which in the minds of the public will remove present brakes on business activity. These actions, coupled with the spending which will be involved in the relief program, should be sufficient as a first move, irrespective of what may later be required if business does not respond.

TOTAL STEEL INGOT PRODUCTION AND U.S. STEEL CORPORATION ORDERS
Expressed in Percent of Capacity



AUTOMOBILE PRODUCTION



April 11, 1938

CONFIDENTIAL: To be held in STRICT CONFIDENCE and no portion, synopsis, or intimation to be published or given out until the READING of the President's Message has begun in the Senate or the House of Representatives. Extreme care must therefore be exercised to avoid premature publication.

STEPHEN EARLY
Secretary to the President

TO THE CONGRESS OF THE UNITED STATES:

During the past month I have consulted with a large number of individuals on the increasingly difficult problem of our railroad transportation. As the Congress is aware, the relationship of the Federal Government to the railroads has been for fifty years through the medium of the Interstate Commerce Commission. This distinguished body was originally set up with the primary purpose of ending serious abuses on the part of the carriers, such as rebating and cut-throat competition.

As the years went by the Congress from time to time has extended the authority of the Interstate Commerce Commission, vesting in it other quasi-legislative and quasi-judicial powers and giving to it also a number of purely executive functions. While the latter powers are, in all probability, unconstitutional in that they create executive authority in a fourth branch of the Government instead of in the President, I do not at this time raise that issue because for the present it is more important for all of us to cooperate in preventing serious bankruptcies among a large number of railroad companies, great and small.

I invited Chairman Splawn of the Interstate Commerce Commission and Commissioners Eastman and Mahaffie to present, somewhat hurriedly and informally, recommendations relating to this serious situation -- and I have kept the Chairmen of the appropriate Committees of the Senate and House of Representatives informed of the report.

Summarized, the three members of the Interstate Commerce Commission recommend as a means of immediate relief the following:

1. That approximately \$300,000,000 be made available from Government funds for the purchase of railroad equipment, the equipment to be the security for the advance.
2. That for twelve months the Reconstruction Finance Corporation be empowered to make loans without certification by the Interstate Commerce Commission that the railroad can meet its fixed charges.
3. That other forms of Government credit be considered from the point of view of public policy.
4. That Government traffic pay the full rate by eliminating land grant reductions.
5. That the Commission does not feel justified in expressing an opinion for or against reduction of railroad wages.
6. That reorganization procedure under section 77 of the Bankruptcy Act receive the attention of the Congress, and they suggest consideration of the establishment of a single court in charge of reorganizations.

The long term program suggested by the Commissioners includes:

1. That a Federal Transportation Authority be created for two years to plan and promote action by railroad companies

to eliminate waste, aid consolidation and coordination.

2. That the Interstate Commerce Act be amended to broaden the powers of the Commission with respect to pooling of earnings or traffic, to eliminate "the consolidation plan" and to approve unifications; that the Authority be permitted to intervene in such proceedings before the Commission, and make recommendations through the Commission to the President and the Congress.

3. That the Authority investigate economy and all types of transportation, encourage special fitness and abate destructive competition.

4. That attention be given to railroad financial abuses now under investigation.

The full report of the three members of the Interstate Commerce Commission is transmitted herewith, and I am transmitting also certain comments which have been made by others with whom I have talked:

(a) Letter to the President from the Secretary of the Treasury, March 25, 1938.

(b) Letter to the President from the Chairman of the Reconstruction Finance Corporation, March 28, 1938.

(c) Letter to the President from the Chairman of the Securities and Exchange Commission, March 28, 1938.

(d) Memorandum to the President from Assistant Secretary of Commerce Ernest G. Draper, March 29, 1938.

(e) Memorandum to the President from the Administrator of Farm Security, March 31, 1938.

(f) Memorandum to the President from Henry Bruere, President of the Bowery Savings Bank, New York City.

(g) Memorandum to the President from J. J. Pelley, President, Association of American Railroads, April 4, 1938.

(h) Letter to the President from George M. Harrison, President, Brotherhood of Railway and Steamship Clerks, April 2, 1938.

(i) Statistical data from the Interstate Commerce Commission relating to revenues and expenses of transportation in the United States in the year 1936, separated between types of transport.

Insofar as information in regard to the railroad problem is concerned, there is probably no other subject to which the Congress, year after year, has devoted more study or obtained more information. The troubles of the railroads are not new, but they have been getting, on the whole, steadily more difficult since before the World War. It is true that a general upturn in business would undoubtedly help to keep many railroads from actual receivership. But it is also true that resumption of traffic at last year's level would not solve their growing difficulties permanently.

Most of us have definite objection to Government subsidies to the railroads to enable them to meet the interest on their outstanding bonds or for any other purpose, and most of us also oppose Government ownership and operation of the railroads. I do.

The suggestions made by the three members of the Interstate Commerce Commission should, of course, be read in the light of the

comments thereon made in the letters appended thereto.

I ask your special consideration of the fact that matters relating to transportation in its wider sense are now dealt with by the following departments or agencies of the Government:

1. The Bureau of Public Roads of the Department of Agriculture.
2. The Bureau of Air Commerce of the Department of Commerce.
3. The United States Maritime Commission.
4. The Division of Transportation of the Bureau of Foreign and Domestic Commerce of the Department of Commerce.
5. The Interstate Commerce Commission.
6. The Lighthouse Service of the Department of Commerce.
7. The Bureau of Navigation and Marine Inspection of the Department of Commerce.

These agencies deal with special phases of transportation rather than the transportation problem in its broader national aspect. Some of the functions are executive, some are legislative, some are judicial.

From the point of view of business efficiency, such as a private corporation would seek, it would seem to be the part of common sense to place all executive functions relating to all transportation in one Federal department -- such as the Department of Commerce, the Department of the Interior or some other old or new Department. At the same time all quasi-judicial and quasi-legislative matters relating to all transportation could properly be placed under an independent commission - a reorganized Interstate Commerce Commission. And such action would be highly constitutional.

I refer to this, not by way of recommendation, but only as one method which should receive Congressional study.

In the meantime, and until it has been possible for the Congress to make any and all studies for permanent solution of the railroad problem, some immediate legislation is, I believe, necessary at this session, in order to prevent serious financial and operating difficulties between now and the convening of the next Congress.

FRANKLIN D. ROOSEVELT

THE WHITE HOUSE,

April 11, 1938.

TREASURY DEPARTMENT

WASHINGTON

April 11, 1938

CONFERENCE AT THE WHITE HOUSE WITH THE PRESIDENT,
MONDAY, APRIL 11, 1938, REGARDING 1939 RELIEF
APPROPRIATION

Those present besides the President were Senators Barkley, Glass, Byrnes and McKellar, Congressmen Rayburn, Taylor, Cannon and Woodrum, Secretary Morgenthau, Mr. Hopkins, Mr. James Roosevelt and Mr. Bell.

The President started the conference by saying that there were three schools of thought in Washington with views on the present business situation. These views are quite divergent and they represent honest differences of opinion. One school of thought feels that conditions will improve over the next few months. Another school of thought feels that the present conditions will remain about the same and that the present business level will drag along for many months to come. The third school feels that conditions are going to get drastically worse unless the Government steps in and takes positive action to put more money in the banks for loaning purposes, to spend money for pump priming purposes in order to increase the purchasing power of the people.

He then went over the W. P. A. rolls saying that in the next few months a great many people will be thrown off of the

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Employment Trust Fund rolls and then it will be necessary for Mr. Hopkins to take them up. It may not be necessary to increase the present W. P. A. rolls which amount to about 2,600,000 people, including about 160,000 employed on relief projects under the supervision of the various governmental departments, but that in all probability it would be necessary to carry this number through the summer and next winter. He says if the billion dollars in the Budget is to last until February 1, it will be necessary for Mr. Hopkins to let 500,000 people go by June 30. By keeping the present force it will require \$1,250,000,000 for W. P. A., approximately \$150,000,000 for Farm Security, and \$50,000,000 for National Youth Administration, the total of which exceeds the present budget estimate by \$450,000,000.

There was a feeling among members of the Appropriation Committee that the bill which is to be sent to Congress should contain these amounts for these purposes in three separate paragraphs in the bill.

The President then discussed at some length the Civilian Conservation Corps' estimates. He said that the budget estimate contemplated a reduction in the number of camps by 300 on July 1, 1938, and that he wanted to let the gentlemen present know that the \$50,000,000, which passed the House and was now pending in the Senate, would not increase employment by one person but all it did

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was to keep on the rolls a number of boys equivalent to those already there now. This had all of the implication of an invitation to the Congressmen present to increase the CCC beyond the present 1,500 camps. It was finally agreed that he would permit an estimate to go to Congress for the CCC although he turned it down when it was pending in the House.

He then discussed at some length the question of loans. He said that this had been given a great deal of study and would have to receive a great deal more before he was prepared to submit anything to Congress. He said he had talked with Jesse Jones and while it was probably too soon to discuss the effect his loans will have on the general situation, Mr. Jones does not feel that more than \$300 or \$400 million will be loaned to industry and he does not think any of it will go for new plants or reopening of old plants. The President said that, in reply to a question by Senator Barkley, he was going to study the loan suggestions further and that he would submit something to Congress on this at a later date.

On the question raised by Congressman Woodrum there was then a discussion whether the new bill should contain the so-called Woodrum Amendment. Some felt that the bill should not contain the Woodrum Amendment but it should be stated on the floor and in the Committee report that the amount appropriated was intended to last

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up to February 1, 1939, and that it would be necessary for the next Congress to appropriate an additional sum to carry relief from February 1 to June 30, 1939. Congressman Woodrum agreed, and several others concurred in his views, that it was important to let the country know in the bill itself just what Congress was doing, namely, the amount of money appropriated which should be apportioned by the President over the seven months beginning July 1, 1938, and that Congress would be asked to appropriate whatever amount was needed for the five months following February 1, 1939.

Just before we adjourned the Secretary of the Treasury said to the conference that he thought it might like to know just what the budget picture looked like for 1939, including some of the money for the full year which had been discussed at this morning's session. He thought that the revenue would fall below the estimate by \$900,000,000; that additional expenditures including those mentioned this morning, but excluding any loaning and pump priming expenditures, would increase the deficit for 1939 to \$3,500,000,000. This seemed to be quite a shock to every one present, even the President.

WWR

April 11, 1938

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MONDAY, APRIL 11, 1938, REGARDING 1939 RELIEF
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April 13, 1938

TO THE SECRETARY:

The President indicated in today's conference that his message would contain recommendations for appropriations as follows:

Works Progress Administration	\$1,250,000,000	to last until February 1, 1939.
Farm Security Administration	175,000,000	full year.
National Youth Administration	75,000,000	full year.
Civilian Conservation Corps	50,000,000	in addition to the amount in the budget.
Roads	100,000,000	in addition to the amount in the budget.
Flood Control	37,000,000	in addition to the amount in the budget.
Federal Buildings	25,000,000	in addition to the amount in the budget.
Public Works	1,000,000,000	for loans and grants.
Total	\$2,712,000,000	

He also stated that he was adding \$300,000,000 for the United States Housing Authority for expenditure in 1939 and that an agreement had been reached between Wagner and Straus to offer an amendment which would permit the United States Housing Authority to pay the entire cost of a housing project but that the title should not pass to the local housing authority until the local housing authority had paid to the United States Housing Authority 10% required under the Act.

As to the billion dollars for public works, loans and grants, the President said that it was his thought that this could be on an optional 45% grant and a 55% loan or on some other percentage basis, and, also, that permission should be granted to loan the whole sum without interest, the borrower to repay the principal

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only over a period of years not to exceed 50. This would result in the Federal Government loaning the principal, paying the interest on the borrowed funds, and using the principal repayments as they come in to retire its outstanding debt obligations. The President stated that it is his thought the total ultimate out-of-pocket cost to the Government should not exceed \$1,000,000,000 and, furthermore, no loans or grants should be made on any state or local project which cannot be started within six months from the date legislation is approved. I asked him if he would care if a provision to that effect were inserted in the proposed legislation. He said he would not care and thought it might be a good thing to insert it.

There is attached hereto statements showing rough budget estimates for the fiscal year 1939 which include expenditures from the above-mentioned appropriations on a full year basis.

ROUGH BUDGET ESTIMATES, FISCAL YEAR 1939

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(In millions of dollars)

	Estimated in 1939 Budget	Revised estimates	Increase
<u>Expenditures-</u>			
Departmental	\$1,324	\$1,324	---
Public Works-			
Highways	\$100	\$200	
Rivers and Harbors	60	60	
Flood Control	63	100	
All other	<u>181</u>	<u>196</u>	\$152
National Defense	989	1,040	51
Agric. Adj. Program	586	636	50
Civilian Cons. Corps	230	280	50
Social Security	338	350	12
Int. on the Public Debt	976	1,000	24
Revolving funds (in- cluding grants)	142	592	<u>1/</u> 450
Transfers to trust accts	667	667	---
Supplemental	75	100	25
Recovery and relief-			
Works Progress Admn.	925	2,200	
Farm Security Admn.	85	200	
All other	<u>128</u>	<u>128</u>	1,390
Total expenditures	6,869	9,073	2,204
Revenues <u>2/</u>	<u>5,919</u>	<u>5,077</u>	<u>(a) 842</u>
<u>Net deficit</u>	950	3,996	3,046

(a) Decrease

1/ The President indicated that he would ask for authority to make grants and loans to local governments optional on a 45% grant and a 55% loan or some other such percentage or advance the whole sum as a loan without interest to be repaid over a term of years, the Government paying interest in the meantime on the outstanding debt obligations, but that the total cost would not exceed \$1,000,000,000. It is estimated in the above statement \$450,000,000 will be spent in the fiscal year 1939.

2/ Above revised revenue estimate is based on Federal Reserve Board business index of 80. If this index declines to 75 the estimate of revenue will be about \$4,881 million, and the net deficit will be \$4,380 million. If this index increases to 85, the revenue estimate will be \$5,238 million, and the net deficit \$4,023 million.

April 11, 1938.

To: The Secretary
From: Mr. Shoup *es*.
Subject: Possibilities of Immediate Action with Respect to
Federal-State Tax Coordination.

1. Possible Plans of Action for the Near Future.

There seem to be two alternative methods that are practicable for getting action in the near future with respect to Federal-State tax coordination.

Under the first method the President would consult with the states and appoint a Commission of about five members to study Federal-State fiscal relations and make a report thereon within a year or eighteen months. The state groups to consult would probably be the Governors' Conference/ and/or the American Legislators' Association. The Commission should have adequate funds to employ the best available talent for research. I understand that the President would probably be able to make such funds available if the proposed program of new spending materializes.

It would be best to select, as members of the Commission, outstanding citizens who do not directly represent either Federal interests or state interests. Presumably the Commission would hold hearings and study sympathetically the special interests involved.

The second method is quite different and much more restricted in scope - but it might have a greater chance of actually improving conditions. Under this plan the Secretary of the Treasury would consult informally with the administrators of a few leading states, notably New York State, to discover whether there is a chance for agreeing on some form of cooperation in administration. If the prospects seemed good a formal conference with one or two or even more states might be held. The result might be, for instance, that one or more of the states would join with the Treasury in setting up a joint Federal-State administrative board to eliminate administrative duplication, particularly in income taxes and estate taxes.

I have considered a third method, which would be the same as the first except that the Secretary of the Treasury, rather than the President, would join with the states in selecting the Commission. Any research staff, however, would have to be Treasury staff, under this plan, and the Treasury could not spend its funds without accepting responsibility for whatever the Commission might do. This method seems, therefore, impracticable.

1/ Last year the Governors' Conference met from September 14 to 16.

2. Data That Should Be Gathered Meanwhile.

While some such plans as those described above are in their preliminary stages it would be helpful to have some basic data on the problem gathered. If a Commission is appointed it will, of course, have to have a substantial research staff of its own, but some of its research needs can be foreseen and to some extent cared for beforehand.

Thus in any case it would be desirable to have the following data assembled during the next few weeks and months:

a. A bibliography describing briefly the contents of each book, report, article, etc., bearing on the problem.

b. A summary of the bibliography by topics.

c. A summary of the chief provisions of each of the state income taxes, death taxes, gift taxes, sales taxes and possibly other taxes. These data would be compiled, not with any particular question in mind, but simply as a storehouse of information that would be useful in many ways. Mr. Zucker's section has already done a large amount of work of this kind and has been planning to continue it, utilizing nearly the full time of two or three members of the section.

d. Data assembled to answer certain questions that reflect specific complaints against the present system.

(i) It might be possible to assemble some information (and perhaps gather new information) on the costs of duplicate administration of certain taxes - costs both to the Government and to the taxpayer.

(ii) Likewise, it might be possible to get some idea concerning the extent to which the lack of uniform rules for the allocation of tax bases among the states has caused evasion and unjust duplicate taxation.

(iii) Again, it might be possible to give some definite impression of just how oppressive are the combined Federal and state tax rates upon a single base in many instances.

e. Data to show how heavy a tax the Federal Government would have to impose if it were to induce all of the states to withdraw from any particular tax. For example, how much would the Federal Government have to add to its cigarette tax in order to get enough money to return to the states to induce all of the states now taxing cigarettes to withdraw from that field?

f. It would probably be necessary to study various plans for Federal aid to the states. Data on existing systems of state aid to localities should therefore be gathered with a view to analyzing various possible mechanisms for Federal aid to states.

April 11, 1938.

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TO: MR. BELL
FRGM: MR. KILEY

Public announcement was made by Secretary Woodin on October 12, 1933, of the call for redemption on April 15, 1934, of approximately three-tenths of the outstanding Fourth Liberty Loan 4-1/4 percent Bonds of 1933-38. At that time, about \$6,268,000,000 Fourths were outstanding, and the first call contemplated the retirement of about \$1,870,000,000. At the same time, he announced an offering of 10-12 year Treasury bonds, for cash at 101-1/2 in the approximate amount of \$500,000,000, and in exchange at par for any Fourth Liberty Loan Bonds, whether called or uncalled. The new bonds bore 4-1/4 percent interest for the first year, and thereafter 3-1/4 percent interest.

The subscription books for the new issue opened on October 16 and were closed at the end of the second day for the receipt of cash subscriptions. At the end of the first week \$573,000,000 Fourths had been exchanged for the new bonds. During the second week \$183,000,000 more were exchanged and during the third week, but \$80,000,000 were exchanged. Although the books were kept open another four weeks, or until the announcement of the December financing, but \$64,000,000 exchanges were received during the last four weeks. When the subscription books finally closed on December 2, a total of \$900,000,000 Fourths had been exchanged, of which all but \$26,000,000 were included in the first call for redemption. It will be noted that although the subscription books were open for six weeks, nearly two-thirds of the total amount exchanged were exchanged during the first week.

Even before the offering was announced, there was much general speculation regarding the future monetary policies of the Administration. On October 22, at the end of the first week of the refunding, in a radio address, the President announced the Government's policy to restore the price level before effecting a permanent valuation of the dollar. In discussing the control of the gold value of our dollar, the President in that address announced the establishment of a Government market for gold in the United States and the authorization to the Reconstruction Finance Corporation to buy gold newly mined in the United States at prices to be determined from time to time after consultation with the Secretary of the Treasury and the President. He also stated that whenever necessary to the end in view, we would buy or sell gold in the open market. The President's executive order relating to gold recovered from natural deposits, and the Treasury's new gold regulations, were issued under date of October 25. On the following day, the Reconstruction Finance Corporation announced that it would issue short-term notes which could be paid for only in newly mined gold. The gold price was announced daily at the Treasury, \$31.36 an ounce being the first price set under the new arrangement. The price rose steadily during the period the books on this offering were open, \$34.01 an ounce being the price on the closing day, December 2, 1933.

Daily exchanges of Fourth Loan bonds during the first, second and third weeks of the offering were as follows:

(In millions of dollars)

<u>First Week</u>	<u>Second Week</u>	<u>Third Week</u>
Oct. 16 - 118	Oct. 23 - 40	Oct. 30 - 12
" 17 - 162	" 24 - 32	" 31 - 18
" 18 - 120	" 25 - 29	Nov. 1 - 22
" 19 - 78	" 26 - 25	" 2 - 9
" 20 - 51	" 27 - 38	" 3 - 12
" 21 - <u>44</u>	" 28 - <u>19</u>	" 4 - <u>7</u>
<u>573</u>	<u>183</u>	<u>80</u>

Immediately following the closing of the subscription books on this exchange offering, the December financing was announced. This consisted of \$950,000,000 of 1-year 2-1/4 percent certificates of indebtedness. The December 15th maturity was \$728,000,000 and such maturing certificates to the amount of \$607,000,000 were tendered and accepted in payment for the new issue.

The following month, on January 24, 1934, the Treasury announced an offering of 14-month 2-1/2 percent Treasury notes and an offering of 8-month 1-1/2 percent certificates of indebtedness, each for \$500,000,000, or thereabouts, for cash only.

On February 13, 1934, an offering of two series of Treasury notes for cash to the amount of about \$400,000,000 each was announced. This offering consisted of a 22-month 2-1/2 percent note and a 3-year 3 percent note.

EWB
EWB

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE April 11, 1938

TO Secretary Morgenthau

FROM M. A. Harris

A short review of the U. S. Government
security market during the past two weeks

In the first week under review, the market was firm on Monday but during the next four days was under considerable pressure. Sizeable liquidation took place and along with the selling was a lack of buying interest as investors chose to stay out of the market. The factor largely responsible for the liquidation appeared to be the general weakness in other security markets, which resulted in sharp declines for both corporate bonds and stocks. Due to purchases by the Federal Reserve System, an orderly market was maintained and declines on each of the four days were confined to rather small fractions. The average loss by all Treasury bonds during the period of weakness was about $1/2$ of a point, with individual losses ranging from 10 to $22/32$ nds. The intermediate issues suffered the larger losses. Short notes declined 6 and $7/32$ nds and those issues maturing after 1939 10 to $13/32$ nds. However, turnover in notes was considerably lighter than that for bonds.

Beginning on Saturday and continuing through Tuesday of the past week, prices tended higher, were steady on Wednesday and Thursday, but turned somewhat easier on Friday when the System again entered the market. Nevertheless, for the past week as a whole, Treasury bonds were generally 1 to $4/32$ nds higher and notes 1 and $2/32$ nds higher. The somewhat hesitant

manner in which government securities performed the latter part of last week was contributed in part to the news of a Government spending program.

Dealers' Portfolio

Holdings of U. S. Government securities and guaranteed issues by dealers remained small throughout the past week, with the larger part of their holding in short notes. Figures given below indicate that dealers sold about 18 million bonds and about 14 million notes maturing after 1 year during the four days of weakness from March 29 to April 1. Subsequently, they increased their holdings but were again sellers the latter part of the past week. For four days during the past two weeks dealers were short bonds.

Below is given total holding on March 26 and April 9 and the change for this period. Also, total holding of Treasury bonds and Treasury notes (those maturing after 1 year) for each day during the past two weeks.

(In millions of dollars)

	<u>Holding</u> <u>Mar. 26</u>	<u>Holding</u> <u>Apr. 9</u>	<u>Change</u>
Treasury bonds	7.6	- 1.3	- 8.9
Treasury notes (maturing within 1 yr.)	50.0	36.8	- 13.2
" " (" " 1-5 yrs.)	28.4	20.6	- 7.8
Treasury bills	3.2	16.9	+ 13.7
H.O.L.C. bonds	2.7	-0.8	- 3.5
F.F.M.C. bonds	0.1	1.5	+ 1.4
	<u>92.0</u>	<u>73.7</u>	<u>- 18.3</u>

	<u>Bonds</u>	<u>Notes</u>		<u>Bonds</u>	<u>Notes</u>
March 28-	9.0	28.6	April 4-	0.0	22.6
" 29-	10.3	30.1	" 5-	3.6	20.0
" 30-	6.4	25.5	" 6-	.9	18.5
" 31-	-1.1	23.4	" 7-	2.3	20.1
April 1-	-7.7	16.7	" 8-	-1.4	19.8
" 2-	0.1	20.4	" 9-	-1.3	20.6

Corporate Bond Market

during the past two weeks

From March 28 through April 1 prices declined sharply. Best grade issues, according to Moody's AAA average, declined $1\frac{3}{8}$ points during this period and on April 1st the average was $4\frac{3}{8}$ points below the January 1938 high and only 2 points above the April 1937 low. Medium and low grade corporates, rated BAA, declined $2\frac{1}{2}$ points during the period and were at a new low since January 1934.

Since April 1, medium and lower grade issues, rated BAA, have recovered sharply, rising to a level 4 points above the March 31 low. The largest gains during the past week occurred in second grade rails, Moody's average of which was about $4\frac{1}{2}$ points above the recent low. Utilities showed somewhat larger gains than industrials. The average of highest grade corporate issues, those rated AAA, showed little net change, as price declines in the industrial and railroad group were about offset by advances in the utilities.

Treasury Accounts

The only transactions in the market for the various investment accounts were the following purchases, none of which were in support of the market:

\$ 930,750	- 2 7/8%	Treas. bonds	1955/60-	a/c Housing Loan Fund
300,000	- 2 7/8%	"	"	1955/60- a/c Comptroller of Currency (Retirement System)
230,000	- 2 3/4%	"	"	1956/59- a/c " " "
<u>1,000,000</u>	- 2 7/8%	"	"	1955/60- a/c Govt. Life Ins. Fund
\$2,460,700				

Federal Reserve System

During the past two weeks the System added a total of \$52,268,000 various Treasury bonds to their holdings. These purchases were offset by permitting maturing bills to run off and by sales of bills and the 2 7/8% Treasury notes due June 15, 1938 in the market. The total holding of bonds now amounts to \$785,588,000, or about 30% of the total holdings of the System account. Details of these transactions follow:

On March 30th, 31st, April 1st and 2nd, a total of \$54,619,000 bonds were purchased to aid in maintaining an orderly market for government securities. As offsets to these purchases, \$29,000,000 Treasury bills were sold and \$25,619,000 Treasury bills maturing April 6th were allowed to run off without replacement. But on April 5th, due to higher prices, it was possible for the System to reverse a part of the purchases of bonds and \$8,400,000 bonds were sold and replaced with Treasury bills, so that the total bond portfolio showed only an increase of \$46,219,000 for the statement week ended last Wednesday, April 6th.

However, the market turned soft last Friday and the System again entered the market and purchased \$6,049,000 Treasury bonds for delivery April 11. Against these purchases the System sold for delivery April 11, \$5,000,000 of 2 7/8% Treasury notes maturing June 15, 1938. It is expected that the excess of purchases over sales (\$1,049,000) will be offset before the end of the statement week ending April 13.

Treasury Notes due in 1938

All Treasury notes maturing in 1938 are selling at prices above a "no yield" basis, with the June maturity showing quite a substantial

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premium. Below is given their current bid price, the premium above a "no yield" basis that the current price indicates and the amount of these obligations that the various investment accounts of the Treasury hold:

	<u>Issue</u>	<u>Current Bid Price</u>	<u>Premium</u>	<u>Amount Owned</u>
2	7/8% TN 6/15/38	101.12	28/32	\$11,905,000
2	1/2% TN 9/15/38	101.23	20/32	10,971,000
1	1/4% TN 12/15/38	101.	5/32	1,650,000
				<u>\$24,526,000</u>

If it becomes necessary for the Treasury to make purchases in the market any time in the near future, the above notes seem to present a means of doing so. They could be sold at substantial profits and the funds invested in bonds. Such a method not only provides a means without the requirement of additional money but would aid in temporarily keeping the premiums from becoming larger. Premiums tend to grow as the date of financing draws closer and in view of the fact that at this time such large premiums do not seem justified, it would be much better to keep the premium relatively small than to offer an issue that would sell in the market at a premium substantially under that anticipated by the market. The latter step would certainly have a depressing effect on the market, thus hampering the success of the operation. High premiums lead to speculation and speculation leads to an unhealthy market, particularly if news is uncertain and the market is nervous.

The Federal Reserve System has the following holding of the notes maturing in 1938:

	<u>Amount held by System</u>	<u>Amount Outstanding</u>
2 7/8% TN 6/15/38	\$ 82,921,000	\$ 618,000,000
2 1/2% TN 9/15/38	90,784,000	596,000,000
1 1/4% TN 12/15/38	42,785,000	434,000,000

April 11, 1938

(Dictated April 12, 1938)

Wallace came to see me at my house last night at a quarter of seven.

He said in addition to the \$1,250,000,000 that he had just come from Jimmie Roosevelt and that they raised it \$300,000,000 on top of that for relief, making it \$1,550,000,000 instead of \$1,450,000,000. I said the way we are talking, \$100,000,000 does not make any difference.

At lunch yesterday, the President said, "Nothing is agreed upon. I have not told Steve Early that I will talk on the radio." He said, "What are you so excited about? I have not committed myself that I would do anything."

oOo-oOo

Monday
April 11, 1938
2:25 p.m.

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HMJr: ... says if you can give him a letter that the man on the street can understand, giving the history of capital gains and the history of the surplus tax and why we're for it, see? Hello.

Roswell Magill: Hello.

HMJr: Hello.

M: Yes.

HMJr: And if you and I will come over there at 9:15 tomorrow morning he'll go over a letter addressed to the two chairmen.

M: Well, that's something, isn't it?

HMJr: Yes. It's plenty, ---isn't it?

M: Yes. I don't know - I guess I'd better get back down there and see what I can do.

HMJr: That's what I think.

M: Yeah.

HMJr: You'd better get it to me tonight and let me go over it with you.

M: Yeah.

HMJr:

M: Yeah.

HMJr: It's got to be - I'd like you to - if you don't mind - if you could get it straight and then I'd like to go over it with you personally and make it so that I can understand it.

M: Yeah.

HMJr: And if Mrs. Klotz and I can understand it maybe the fellow on the street corner can understand it.

M: (Laughs) Well, I'm not so sure. Ah ...

HMJr: (Laughs) About Mrs. Klotz and myself or the street corner?

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M: The man on the street. (Laughs)

HMJr: Well ...

M: But I'd better shoot right back there I guess and see what I can do.

HMJr: Well, the letter did the trick.

M: Well, that's something. You sound better.

HMJr: What?

M: You sound better.

Monday
April 11, 1938
3:29 p. m.

Harold
Ickes:

Hello, Henry.

HMJr:

Hello.

I: I noticed that you weren't at that bum show
Saturday night.

HMJr:

No, I was on the train.

I: Good. I didn't want to go either.

HMJr:

Did you go?

I: Yes. And I don't think I'm going to many more of
them; I'm fed up on them.

HMJr:

I don't know whether it was good, bad or indiffer-
ent. How ...

I: That one was even worse than usual and they're pretty
bad.

HMJr:

How did they treat you and me?

I: They didn't say anything about you; they didn't say
anything about me that mattered. But they're always
jibing the President..

HMJr:

Yes.

I: They're always running on him.

HMJr:

Yes.

I: Say, what I called you up about, Henry...

HMJr:

Yes.

I: The President wants us to draft some legislation
for a P.W.A. program.

HMJr:

Yes.

I: And he wants it by Wednesday. And I was wondering
whether you would lend me Foley for a couple of
days.

-2-

HMJr: Ah - sure - sure. When do you want him?

I: Right away.

HMJr: I'll call him up and tell him.

I: Thanks a lot, Henry.

HMJr: Can you spend a billion in a week?

I: Oh, that's what they want me to do. No, I'm not going to waste it any more than I ever did, Henry.

HMJr: I know, but can't you do it within a week?

I: Well, I'm going to try to.

HMJr: I see.

I: I'll give you half and I'll take half.

HMJr: All right, Harold.

I: (Laughing) All right, Henry.

HMJr: I'll see that Foley

I: All right. Goodbye.

April 12, 1938

In connection with the attached draft and carbon copy of letter sent to the President on the tax bill, see diary entry of April 13, 1938.

April 12, 1938

My dear Mr. President:

Mr. Magill and I saw you last in regard to the tax bill on the morning of Saturday, March 19th. At that time we discussed with you what policy the Treasury should follow before the Finance Committee which would be considering the tax bill in executive session during the following week.

You undoubtedly remember that we discussed the possibility of your writing a letter to Senator Harrison expressing your views in regard to your tax principles. After considerable discussion, you decided that you would not write a letter as you felt that your public appearance at Gainesville, Georgia, would be an ideal opportunity to deliver an address covering the tax field. You asked Mr. Magill to send you over material not later than three o'clock, that afternoon, so you could immediately go to work preparing your speech.

You did not, however, find it convenient to discuss tax policy at Gainesville and neither Mr. Magill nor I have had any word from you since on the pending tax legislation other than the general discussion which occurred at Cabinet on April 5th.

As you know, the bill passed the Senate last Saturday and now goes to conference. The bill does not carry out the principles which we have been advocating, earnestly and forcefully, at your request before both Houses.

Prior to the Treasury's appearance before the Conference Committee on the tax bill, we would very much like to know what position you wish us to take in regard to the differences in principle between the

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House bill and the Senate bill.

Mr. Magill and I would appreciate an appointment with you at your earliest convenience.

Yours sincerely,

The President,

The White House.

(DRAFT)

April 11, 1938

My dear Mr. President: .

Mr. Magill and I saw you last in regard to the tax bill on the morning of Saturday, March 19th. At that time we discussed with you what policy the Treasury should follow before the Finance Committee which would be considering the tax bill in executive session during the following week.

You undoubtedly remember that we discussed the possibility of your writing a letter to Senator Harrison expressing your views in regard to your tax principles. After considerable discussion, you decided that you would not write a letter as you felt that your public appearance at Gainesville, Georgia, would be an ideal opportunity to deliver an address covering the tax field. You asked Mr. Magill to send you over material not later than three o'clock, that afternoon, so you could immediately go to work preparing your speech.

From that date to this, neither Mr. Magill nor I have received any communication from you, orally or otherwise, in regard to the pending tax legislation other than the general discussion which occurred at Cabinet on April 5th.

As you know, the bill passed the Senate last Saturday and now goes to conference. The bill does not carry out

-2-

the principles which we have been advocating, earnestly and forcefully, at your request before both Houses.

Prior to ^{the Treasurer's} our appearance before the Conference Committee on the tax bill, we would very much like to know what position you wish us to take in regard to the differences in principle between the House bill and the Senate bill.

Mr. Magill and I would appreciate an appointment with you at your earliest convenience.

Yours sincerely,

The President,
The White House.

April 12, 1938

When we were working on the President's recovery message, this is what Oliphant gave me.

PROGRAM FOR IMMEDIATE ACTION

(1) The present crisis should be met first with powers that do not need to be got from Congress, and later if necessary with further Congressional authorizations and appropriations for the various spending and lending projects now being discussed.

(2) The broadcast Thursday night should begin with the statement that you propose to take, one after another, whatever steps (whether monetary, credit, lending or spending steps) are necessary to reverse the recession and that you begin by announcing two tonight. These two are lowering reserve requirements and desterilizing a billion of gold.

(3) For immediate action and without consent of Congress, you will then still have the following trumps:

- (a) Additional free gold of about a half billion.
- (b) Silver seigniorage already realized but held sterile, about \$425 millions.
- (c) Additional unrealized silver seigniorage of about \$500 millions.
- (d) Leeway in working balance - about half a billion.
- (e) Deposit of Stabilization Fund - \$1,800,000,000.
- (f) A further ten point devaluation, which would yield $2\frac{1}{2}$ billions "profit."
- (g) Thomas amendment currency - \$3,000,000,000

Total of monetary aces in hole - \$9,225,000,000.

(4) Loans by Jones should be stressed in the broadcast and these two immediate measures allowed to operate for a reasonable time, to be followed if necessary by the various lending and spending measures now under discussion.

To repeat, the broadcast should make it abundantly clear that you

- 2 -

propose to take, one after another, whatever measures, of whatever character, are necessary to reverse the trend.

Olyphant &
Gaston gave
this to the
Secretary

329
April 12,
1938

PROGRAM FOR IMMEDIATE ACTION

(1) The present crisis should be met first with powers that do not need to be got from Congress, and later if necessary with further Congressional authorizations and appropriations.

(2) The broadcast Thursday night should begin with the statement that you propose to take, one after another, whatever steps are necessary to reverse the recession and that you begin by announcing two tonight. These two are lowering reserve requirements and desterilizing a billion of gold.

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- (g) Thomas amendment currency - \$3,000,000,000

Total of monetary aces in hole - \$9,225,000,000.

(4) Loans by Jones should be stressed in the broadcast and these immediate measures allowed to operate for a reasonable time, to be followed if necessary by the various lending and spending measures now under discussion.

To repeat, the broadcast should make it abundantly clear that you propose to take, one after another, whatever measures are necessary to reverse the trend.

(Draft)

Apr. 12, 1938

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PROGRAM FOR IMMEDIATE ACTION

(1) The present crisis should be met first with powers that do not need to be got from Congress, and later if necessary ^{with} further Congressional authorizations and appropriations.

(2) The broadcast Thursday night should begin with the statement that you propose to take, one after another, whatever steps are necessary to reverse the recession and that you begin by announcing two tonight. These two are lowering reserve requirements and desterilizing a billion of gold.

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- (a) Additional free gold of about a half billion
 - (b) Silver seigniorage already realized but held sterile, about \$425 millions.
 - (c) Additional unrealized silver seigniorage of about \$500 millions.
 - (d) Leeway in working balance - about half a billion.
 - (e) Deposit of Stabilization Fund - \$1,800,000,000.
 - (f) A further ten point devaluation, which would yield $2\frac{1}{2}$ billions "profit,"
 - (g) Thomas amendment currency \$3,000,000,000
- Total of monetary aces in hole - \$9,264,000,000.

(4) Loans by Jones should be stressed in the broadcast and these immediate measures allowed to operate for a reasonable time, to be followed if necessary by the various lending and spending measures now under discussion.

To repeat, the broadcast should make it abundantly clear that you propose to take, one after another, whatever measures are necessary to reverse the trend.

About April 12, 1938

This is Wallace's recovery plan for the President, prepared before the President's message to Congress.

SALIENT POINTS OF THE PROPOSED PROGRAM

The Program, exclusive of W. P. A., is designed:

(1) to provide for more than \$2 of expenditures for every \$1 charge on the budget.

(2) to keep the total charge on the budget for the next fiscal year below \$1 billion, which can be financed through gold deesterilization.

(3) to provide for the initiation of institutions and developments which will have important implications for greater stability in the future.

Examples: R. R. Equipment Authority, Toll Authority, Housing Corporations, social expenditures such as old-age insurance and health.

(4) to meet the needs that are generally regarded as most pressing both in rehabilitating and improving material and human resources.

Examples: Housing, railroads, utilities, hospitals, health and economic security.

(5) to be not merely another hastily improvised spending program but, rather, a program designed to implement the longer-term objectives of the New Deal.

(6) to carry popular appeal and mean something concrete for the man in the street.

Examples: Old age insurance and health.

(7) to lay stress on self-liquidating projects and in this way give some assurance to those fearful of the consequences of "non-productive" expenditures.

Material Presented.

Tables Outlining Program:

1. Draft of Message to Congress.
2. Details of program to accompany message.
3. Draft of new legislation.
4. Draft of Presidential letters.
5. Comments and explanations.

PROPOSED PROGRAM (IN ADDITION TO ORIGINAL BILLION DOLLARS FOR RELIEF IN 1938-39)

	Authority needed	From federal budget Non-re- coverable	Federal Recover- able	Federal under writing	State & Local sources	Private investment	Resulting total ex- penditure	Resulting private investment in successive fiscal years		
								1938-39	1939-40	1940-41
Housing:	Letters to RFC & FHA)									
Rental projects	Legislation	(1)	25			225	250	225	350	500
Tax exemption	Letter to RFC		5			35	40	35	125	300
Housing corporation	Legislation		50	(450)		450	500	450	600	700
R.R. Equip. Corp.	Letter to RFC	100	200				300	-	-	-
R.R. roadbed, etc.	Legislation		20	(30)		30	50	30	100	100
Roll authority	Legislation			(90)		100	100	100	-	-
Business Loan Guarantee	Letter to RFC		300				300	-	-	-
Utility loans	Letter to RFC				10	490	600	490	600	400
P. W. A.	Legislation	(1)								
Health & human conservation:							50	-	-	-
Old age	Legislation	(2)					165	-	-	-
Health	Legislation		<u>165</u>		<u>10</u>	<u>1,320</u>	<u>2,355</u>	<u>1,320</u>	<u>1,775</u>	<u>2,000</u>
Total, excluding WPA			<u>265</u>	<u>600</u>	<u>(570)</u>	<u>10</u>	<u>1,320</u>	<u>2,355</u>	<u>1,320</u>	<u>1,775</u>
WPA (incl. NYA & FSA)	Legislation(3)	<u>1,850</u>	<u>(3)150</u>	<u>(570)</u>	<u>300</u>	<u>(3)1,320</u>	<u>2,300</u>	<u>1,320</u>	<u>1,775</u>	<u>2,000</u>
TOTAL		<u>2,115</u>	<u>750</u>	<u>(570)</u>	<u>310</u>	<u>1,320</u>	<u>4,635</u>	<u>1,320</u>	<u>1,775</u>	<u>2,000</u>

(1) Negligible cost in 1938-39

(2) Paid from old-age reserve account

(3) Estimated WPA expenditures for 12 months, in addition to one billion originally proposed, based on proposed 7-month appropriation.

Statement of Sources of Federal Funds Called for in the Program.

<u>Activity</u>	<u>New Appropriations</u>	<u>R.F.C. Existing Authority</u>	<u>Old Age Reserve Fund</u>
Rental projects.....		25	
Housing corporation.....		5	
R.R. equipment corporation....	50		
R.R. roadbed loans.....		300	
Toll authority.....		20	
Utility loans.....		300	
Health.....	<u>275</u>		<u>75</u> 50
Total, excl. W.P.A.....	325	650	<u>75</u> 50
New W.P.A. (incl. NYA and FSA)	<u>2,000</u>	-	-
Grand Total.....	2,325	650	75 50

Suggestions for Message

Last fall I urged certain lines of action to check the recession then under way and to encourage a resumption of private activity. We wanted then and want now as much of private and as little of government spending as is consistent with our national well-being. I stated then in all sincerity, "Our immediate task is to try to increase the use of private capital to create employment. Private enterprise, with cooperation on the part of government can advance to higher levels of industrial activity than those reached earlier this year. Such advance will assure balanced budgets. But obviously also, government can not let nature take its course without regard to consequences. If private enterprise does not respond, government must take up the slack."

Since the opening of the Congress you have enacted new housing legislation and new farm legislation. The farm bill has helped shield farmers' income from the full effect of the drop in business. There has already been a gratifying increase in mortgage insurance under the F.H.A. You have also undertaken revisions in certain tax provisions which many business men believe will stimulate the flow of private investment. Despite these measures, there is a practically complete cessation of private investment and capital formation in many lines.

Many business men advise me that they alone can not increase employment and production and that it is again the duty of government to help start the process of recovery. The Chamber of Commerce announced last Sunday that business alone could not cope with the present difficulties. More than the measures so far adopted or reasonably certain of adoption is needed to check and reverse the ebbing tide of business activity.

Present conditions do not permit a longer wait. The need of the people for the assurance of jobs and homes; the need for a stable American democracy which can only come from a people at work and prosperous, are both so great that action is imperative. Again I say, "A government of the people must not let the people down." I am therefore proposing to the Congress a broad program of immediate action.

The last five years have demonstrated that the one sure method of starting economic activity is for the government to put men to work. The funds disbursed to them in turn stimulate activity through the whole economic structure. This is not a matter of theory or conjecture. It is a matter of fact. ^{In 1935 and 1936} The follow-up of private investment expansion was all that could have been expected. ¹ The trouble in late 1936 and early 1937, the repetition of which we must strive to avoid in the future, was the emergence of a highly speculative period of advancing prices and costs which lead on the one hand to one of the biggest inventory booms we ever experienced, and on the other, to the killing off of a promising building revival. When the course of recovery is again resumed through the stimulus of government we must bend every effort to keep it orderly so that the transition to a balanced budget and the retirement of public debt can be made smoothly and without shock to the economy.

The proposed program will create an immediate increase in purchasing power through public spending, and will also provide new channels through which private investment may flow, so that soon only a minimum of ~~government~~ ^{deficit} spending will be required. The program is so drawn as to add as little as possible under the circumstances to the federal debt. It provides:

- (a) for such stimulation of private investment in a variety of industries, especially in housing and railroad equipment, as will provide a continually expanding field for private investment.
- (b) for the initiation of supplementary self-liquidating public projects in such fields as public works, toll roads, and bridges, as will provide funds in public activities of a productive and self-liquidating character.

(c) for a broad program of public health and medical care for those unable to provide care for themselves, which will aid in physical rehabilitation of the workers of this country and fit them to participate in a high level of industry and business activity in the future. This will center on hospitals in areas where equipment is inadequate, an expanded program of public health, an expanded program of care for mothers, infants, and children, and the essentials of medical care for people unable to obtain such care through their own resources.

(d) The above activities will take varying periods of time to get under way. An immediate and large expansion of employment on relief projects and of other relief expenditures is therefore also required.

I want to emphasize that this program has the double purpose of starting recovery immediately and ^{of securing such cooperation between} of maintaining it continuously thereafter. ^{business and government as well}

The legislative authority which is needed for these undertakings is indicated in the program outlined in the attached statement which I hereby submit to Congress for its consideration.

In addition, there are certain supplementary activities for which there is authority under existing legislation which could be reasonably undertaken if backed by this general program. These measures include:

1. Use of R.F.C. funds up to 10% ^{rental} of each project to encourage large-scale limited-dividend housing developments, where the sponsors can provide 10% of the cost of suitable projects, so as to enable such projects to qualify for Federal Housing Administration loans.
2. Use of W.P.A. labor to install facilities, streets and other needed improvements on public property, adjoining or in connection with new housing developments.
3. Use of R.F.C. funds for loans to utilities to stimulate capital developments.
4. Use of R.F.C. funds for the underwriting of bank loans to small concerns to enable immediate replenishment of inventory.

I am directing the Department of Commerce to start action on a program of Economic information for business men comparable to the economic information hitherto provided to farmers. This will include the collection of data on

various industries which will furnish industrial concerns more adequate information on inventories of all concerns in the industry and on the investment and expansion program of industry as a whole. This will enable business men to develop more stable business policies with reference to inventories and capital formation. I am prepared to put these additional measures into action as soon as the Congress approves the general program outlined above.

This program of new legislation and of action under existing legislation represents the considered judgment of ^{many} all branches of the Executive Department, as to the methods which will be most helpful in dealing effectively with the current economic problem.

The combined program, exclusive of relief expenditures, will entail a total net outlay by the Federal Government of ^{\$750} ~~between \$600 and \$900~~ million in the fiscal year 1939. ^{A large part} ~~The bulk~~ of such expenditures will be in the recoverable category. At the same time ^{much more than} ~~upward of~~ a billion dollars of private capital will be attracted into housing, railroad equipment, and other new forms of investment opened up by these measures. ^{in addition to the investment already} It is believed therefore that total expenditures arising directly from the program, ^{including} ~~exclusive of~~ relief, will total ^{at least} ~~well over \$2 billion~~. In addition, of course, there will be an indeterminable amount of indirect private expenditures stimulated by the program.

It is not contemplated that this program will entail any net increase in the public debt, ^{except what is involved in the new appropriation} since it is intended to utilize the funds in the inactive gold account to meet a part of the Government's increased financial requirements. The ^{rapidly} ~~desterilization~~ of gold will not only serve to finance increased expenditures without a corresponding increase in the public debt but will also supply increased funds to banks and thus contribute to continued monetary ease.

I request that the Congress give this program its immediate consideration so that if it approves it may be put into action as promptly as possible.

Under the program outlined we can move forward within a short space of time to a restoration of industrial production, an increase in the number of employed, and an expansion of private investment, which will correct many of the difficulties of the present situation. Railroads that appear bankrupt when industry is operating at half of capacity and when building is ^{low} ~~almost at a standstill~~ will show reasonable earnings when full production is restored. Industrial corporations with heavy overhead that now show large losses when sales are low, will show satisfactory profits as markets for their products are restored.

I am confident we can soon restore activity and production to the levels of 1937 or higher. I am confident we can carry activity forward to continually higher levels of production until our present deficits of houses and other goods have been made good. Restoration of activity will reduce the relief load, so that in subsequent years more funds can be used for self-liquidating projects, both private and public, and less ^{for} carrying the relief load.

The work we will set the unemployed doing in the months immediately ahead, the building of adequate hospitals for communities that do not have them, the installation of streets and other public utilities, the building of flood prevention and soil conservation structures, and similar activities, will be increasing the wealth of the country and adding to our standard of living for the future.

In addition the program will contribute to our national defense in several different ways:

1. In the immediate provision of new rolling stock for our railroads, through the proposed railroad equipment corporation.
2. In the rapid rehabilitation of the roadbeds and other physical operating structure of our railroads, through the special authority for this purpose.
3. In bringing our vital electrical generating and distribution equipment up to the level needed to sustain a high level of output, through the special loans to utilities.
4. In strengthening our road traffic facilities in those areas where congestion is most serious, through the Toll Authority Act.
5. In increasing the health and physical effectiveness of that portion of our population which is unable to provide medical and health care for itself.

Although we Americans are a peaceful nation, we have already recognized the international dangers that threaten in the troubled world of today. The Congress is already considering measures to strengthen our naval and military power to ward off any danger that might threaten. To be fully prepared, however, it is essential not only that our defense forces be strong, but that our industrial power be adequate to supply and support those forces. Under these measures, we will bring our rail and road transportation facilities, our electrical energy equipment, and, most important of all, the physical conditions of our manpower, up to a high level of capacity and efficiency. The precautions we take in these fields will be as serviceable in times of peace as they would be essential in time of war. While we are arming to be strong to avoid war, it would be senseless to fail to strengthen these other sectors which are equally vital to our national defense.

The program I am laying before you is essential to meet the needs of our citizens in distress. It is essential to provide avenues back to full recovery. It is essential to strengthen our national defense.

The original See

One of the distinguishing features of this new program is its provision to get capital circulating. Along with increasing unemployment great pools of unemployed capital have developed. We must get that capital to work. The program provides syphons through which the capital can be drawn out and put to work in useful projects. It will help prevent similar pools of idle capital developing in the future. It will help prevent the reoccurrence of the masses of idle men which are associated with idle capital.

During the past 12 months we have waited to see how far the business community could take on the load of providing work for our people. We have wanted the government to do, in the field of providing direct relief for the unemployed and in the development of self-liquidating public works, only as much as it is necessary for the government to do. During the past fall and winter the business community felt that there was a reasonable prospect for recovery in the spring. That expectation has not been fulfilled. Now not only those unemployed, but business concerns themselves need help from the government. The heavy unemployment and the increasing decline of morale in our industrial system shows that such help is needed to safeguard our whole social order. Government must act. If we act fearlessly and vigorously, we can restore and maintain the economic prosperity of this country. That is what I propose we now proceed to do.

April 12, 1938.

Luncheon Meeting in the Secretary's Office,
Tuesday, April 12, 1938.

Those present: Secretary Morgenthau ✓
James Roosevelt
Marriner Eccles ✓
Ronald Ransom ✓
Secretary Wallace ✓
Harry Hopkins ✓
Jesse Jones ✓
Paul Appleby
Wayne Taylor
Herman Oliphant
Dan Bell
Herbert Gaston

Secretary Morgenthau said that the meeting was more or less accidental. He took advantage of the presence of several of the gentlemen present in his office and called in others to discuss the immediate situation. The President had asked him to report today his own views and those of the Federal Reserve Board on the two questions of release of sterilized gold and the reversal of the action taken last May by the Federal Reserve Board in increasing reserve requirements. The President contemplated going on the air Thursday evening and the Secretary thought it desirable to consider what action the President should be prepared to announce at that time. He then read a memorandum, which he said represented his views and those of others in the Treasury Department, as to statements the President should make. The memorandum suggested that the President should say in his Thursday evening broadcast that he proposed to take immediate action in the monetary field, by the two steps mentioned above, and would follow these up by taking later successive appropriate steps to overcome the recession. Other action which was suggested would

be held in abeyance. The Secretary added that the monetary action would, of course, be coupled with the lending activities to be carried on by R.F.C. under new powers granted to them.

James Roosevelt questioned the sufficiency of these powers to meet the needs of the situation and asked Jesse Jones what he expected to be able to do. Mr. Jones said he had very broad powers under the Act to renew widespread lending to banks, railroads, insurance companies and municipalities. James objected that loans to rescue banks or others from financial difficulties would not put men to work, but Jones replied that saving people from being thrown out of work was the same as putting them to work. He mentioned the large number of applications for loans and grants in the files of FWA and said that he expected to begin by going over these.

There then arose a discussion between James Roosevelt, Jesse Jones, Harry Hopkins, Eccles and others, as to whether Jones could make loans, coupled with grants by WPA or FWA and whether he could make loans without interest to municipalities. As to the latter point Jones said he would prefer to ask Congress for additional authority even though he might have the legal right to make loans without interest. Harry Hopkins said that this discussion seemed to be turning to the question of machinery for administering the program and what he would like to discuss was the program itself. The Secretary invited him to do that.

Hopkins then outlined a program involving "heavy" public works to combine loans and grants and to involve grants of about \$450,000,000; a doubling of the power of the U. S. Housing Authority to incur obligations; increases in appropriations for highways and flood control and enlarged appropriations for Works Progress, National Youth Administration and C.C.C.

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James Roosevelt, under correction by Hopkins and Bell, then enumerated the proposed increases in appropriations for the fiscal year 1939. These were:

Works Progress and National Youth	\$1,175,000,000
Farm Security	115,000,000
Other recovery and relief	72,000,000
Highways	190,000,000
Flood control	150,000,000

This makes a total of additional appropriations for recovery and relief of \$1,702,000,000. Mr. Bell pointed out that there were to be added to this, in order to measure the proposed increases over the President's budget, the following additional authorized expenditures:

National defense	\$ 51,000,000
Agricultural Adjustment	50,000,000
C.C.C.	45,000,000
Social Security	12,000,000
Interest on the Public Debt	24,000,000
Miscellaneous	25,000,000

The total of outright expenditures thus authorized and proposed to be authorized under the enlarged program would be \$1,909,000,000 above the budget figures of January.

This tabulation, however, makes no allowance for grants to localities for the "heavy works" program about which Hopkins had previously spoken. The omission, it developed, was due to uncertainty whether the Government's contributions would be made through the grant method. If the precedent of making combined loans and grants was followed, Hopkins estimated that grants might be made in the fiscal year in the amount of about \$450 millions, which would increase the total of outright expenditures in the fiscal year to about \$2,359 millions. Hopkins insisted, however, that the whole program should be regarded as one for an additional billion only, since, he said, his own

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increase and the various items listed by Bell were already accomplished facts.

In response to questions Jesse Jones estimated that he might be able to put out as much as a billion dollars in loans during the fiscal year. Hopkins estimated that the additional authority sought for Strauss would cause him to market securities above his present estimates to the amount of about \$200 millions. Mr. Bell, on the basis of the program as above outlined, including the grants, estimated total expenditures for the fiscal year 1939 as \$9,350 millions and revenue, on the basis of a Federal Reserve Index of eighty-five was estimated at \$5,238 millions, resulting in a prospective deficit of approximately \$4,100 millions. Chairman Eccles stressed the point that not all of this would have to be raised by market borrowing.

It was agreed that Social Security receipts would reduce the public borrowings by one billion and if a billion and a half of gold were released from sterilization, the amount to be raised by Treasury borrowing would not be much over a billion and a half. It was pointed out, however, that the borrowings by Jesse Jones, Strauss and others in guaranteed obligations, which would also be drawn from the money market, would make a total of at least three billions, even if all the available gold were turned loose. Eccles expressed the opinion that this would not be a difficult problem.

Secretary Morgenthau dissented vigorously. He also warned against the danger of a program which would stimulate a quick up-turn and then fall flat.

Harry Hopkins previously in outlining the spending program had stressed its political advantages. He said the President had twice engaged in battles

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which did not mean a thing to the average man and on which therefore he could make no effective fight, but the issue of whether hungry people ought to be fed was one which everybody would understand and it would have its effect in the fall elections. Referring to this Secretary Morgenthau said a burst of activity in the summer and a slump in the fall would have far from a good political effect.

Secretary Morgenthau reminded Chairman Eccles that he had promised a decision from the Federal Reserve Board today as to whether they would be willing to go along on a reduction of reserve requirements. He said he was quite willing to call a meeting of the Board for this afternoon and Ransom went to the phone to arrange it. Eccles discussed at great length the reasons for the original increase in reserve requirements and the advisability of making a change. The substance was that he did not think it would have any effect "unless it would be psychological", but finally agreed that he was willing to go along, after a good deal of prodding by Jesse Jones and others. Eccles thought bank examiners' requirements were too stringent and ought to be relaxed and Jones agreed with him.

The meeting, which had assembled at one, broke up at three and Eccles and Ransom went with the Secretary to his office to continue discussion.

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April 12, 1938.

The last thing I said to Jimmy Roosevelt at luncheon in my office to-day was, "Now, Jimmy, at last I have heard the program" and Jimmy, much to my surprise, said, "There has always been a program". So I said, "Well this is the first time I have heard it and I wish you would take the following message to your father." 'After giving the matter further consideration, I will let him know whether I can or cannot finance it'. So he said, "Well, of course, you can finance it" and I said, "I don't know, Jimmy" so he said, "Will you not consider the possibility of alternative programs" and I said, "I will be glad to consider anything".

PUBLIC STATEMENTS BY SECRETARY MORGENTHAU ON THE RECESSION

Before the Academy of Political Science, Wednesday evening, November 10, 1937:

"I am fully aware that many of our problems remain unsolved. I am aware that there still remains a considerable volume of unemployment; that the speculative markets have recently been under severe pressure; and that our business indexes have recently shown a declining tendency. I am further aware that some persons contend that another great spending program is desirable to ward off the risk of another business depression.

"I claim no prophetic insight into the future. But, after giving serious and careful consideration to all of these and other factors, I have reached the firm conviction that the domestic problems which face us today are essentially different from those which faced us four years ago. Many measures are required for their solution. One of these measures, but only one, in the present juncture is a determined movement toward a balanced budget."

"**** The present situation is not characterized by the existence of huge inventories, high interest rates, over-extended credit positions, or great surpluses of housing and capital equipment. We have not reached the stage of full employment of our productive resources. On the contrary, from all these standpoints, conditions are favorable for a continued increase in the level of business activity."

"**** The basic need today is to foster the full application of the driving force of private capital. We want to see capital go into the productive channels of private industry. We want to see private business expand. We believe that much of the remaining unemployment will disappear as private capital funds are increasingly employed in productive enterprises. We believe that one of the most important ways of achieving these ends at this time is to continue progress toward a balance of the Federal budget."

Before the Sum-Committee of the House Appropriations Committee, Wednesday, December 8, 1937, considering the Treasury Department Appropriation Bill.

"Mr. Ludlow: We have heard a great deal about the recession in business, and I wonder if you would give us your view of the business picture, and a statement of what you and the experts of your Department think about this so-called business recession -- whether or not you think it is temporary, or a little depression, and generally what your thought on that situation is.

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"Secretary Morgenthau. That question is not easy to answer. The slowing down of business did not really begin until November. October was a good month, and certainly the first 9 months of this year have been the best of any business year we have had since 1929. Business in general has made handsome profits. We have been going up since March 1933, and I am told by economists who study business cycles that this was the longest rise in business that this country has ever experienced.

"This slowing down of business hit us in November of this year, and over in the Treasury we are studying the thing as carefully and intelligently as we know how. We have called in a great many people to advise with us so that we could make up our estimates for the coming year on the basis of what our business may or may not be. I want to say that -- this slowing down of business having come so recently, I think it is impossible for anybody to say whether it is a temporary matter or whether it is something that will last for several months or several years. Frankly, it is too early to say -- we do not know.

"Mr. O'Neal. Quite a bit of that recession is seasonal, is it not?

"Secretary Morgenthau. Some of it is seasonal, and some of it is not. As you understand, the country was so convinced that we would have inflation, and that this administration would not be able to control runaway inflation, that business generally stocked up pretty heavily. Then, when they felt that this administration would not stand for inflation, and would not let prices run away, they found themselves with more than normal inventories.

"They were also convinced that we would make a serious effort to balance the Budget, and we will balance it if we spend \$1,500,000,000 less than we spent last year. Also, the people were pretty well convinced that we would have real trouble in Europe, and things like copper, nickel, and commodities of that sort went up on a war basis. Then, as somebody put it, 'Peace reared its ugly head.' As a result of those things, we find businessmen making an adjustment all over the country, getting themselves in a better inventory position. That is due to a combination of those factors, and I do not think we will have to look much beyond that. How long it will take business to sell off their inventories and get in a position where they must buy is something that we all want to know, but I do not believe anybody can give you the answer. The combination of those things would have been enough to slow up any situation.

"Mr. Ludlow. Is it not the history of these movements that there is generally a rise over a considerable period, followed by a temporary recession?

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"Secretary Morgenthau. It has always been so. This rise has been one of the longest we have ever had in the business history of this country. It has lasted more than 4 years.

"Mr. Johnson. You spoke about the great rise in business from, I believe, 1933 up to last October.

"Secretary Morgenthau. From March 1933.

"Mr. Johnson. From March 1933?

"Secretary Morgenthau. Yes; from March 1933 to last October.

"Mr. Johnson. Was that the longest period with the greatest rise in business that history records?

"Secretary Morgenthau. Yes; so far as I know. I do not think we have had anything else like it in this country.

"Mr. Johnson. Also you state, I believe, that this was the longest period that business had increased -- during which there had not been a decline.

"Secretary Morgenthau. Yes.

"Mr. Johnson. In your investigation of this matter do you recall any instance where there was such a rapid decline in so short a time, as upon this occasion -- the last of October?

"Secretary Morgenthau. I do not know of any.

"Mr. Johnson. It is an unusual situation and one that is quite difficult to tell the cause of.

"Secretary Morgenthau. That is right."

Before the Sub-Committee of the House Committee on Appropriations considering supplemental relief appropriation, Saturday, February 12, 1938.

"The Chairman. I think it would be a good idea, Mr. Secretary, to give us your reaction to the fiscal condition of the country. What is the trend?

"Secretary Morgenthau. When I was up here the last time, I think on December 10, I told you gentlemen at that time that business

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conditions only began to get bad in November, and since then they have gotten increasingly worse, with the result that a great many people have been thrown out of work.

"As the President pointed out in his letter, there are some 3,000,000 people more out of work than there were before, and at present business conditions seem to have reached a level, and the movement is what I would call sidewise; but whether we have reached the bottom of this down-turn or not, I do not know, and I do not think anybody else knows.

"But as a result of one of the most rapid declines in business that has ever been experienced in the history of this country, we have a situation where we have a great many people who have been thrown out of work, and I do not mind saying that ~~the~~ situation is most acute."

"**** Mr. Bacon. In other words, will there be such a pick-up in business that you will not need all of this \$250,000,000?"

"Secretary Morgenthau. We do not want to make the same mistake that President Hoover made when he made the statement that prosperity was just around the corner.

"Mr. Taber. We have already made that mistake, and there is no use in our going into that. We have already made the same kind of mistakes.

"Secretary Morgenthau. He made that mistake, taking figures from the Department of Commerce for the first week of the new year and comparing them with the last week of the year. In every year practically, if you take the first week, you get a pick-up over the last week. I think you have got to take into account that seasonal situation. The reason I made that statement was because you were quoting figures of the Department of Commerce for the first week of the year."

"****Mr. Bacon. My general impression, Mr. Secretary, is that there is some expectation that this condition will become better within the next 6 months.

"Secretary Morgenthau. I do not believe that anybody can come up here and tell you that it will or will not."

"Mr. Bacon. In other words, we are spending money on the theory that conditions will not get better.

"Secretary Morgenthau. Or will not get any worse."

April 12, 1938

To: The Secretary
From: Mr. Magill

Re: Conference with the President on a proposed letter to the Chairmen of the Ways and Means Committee and the Senate Finance Committee, regarding the pending tax bill, 9:15 to 10:35 a.m., April 12, 1938.

I handed the President a draft letter, copy of which is attached. The President made a number of suggestions which I took down and which are embodied in the second draft, a copy of which is also attached hereto. Toward the close of his consideration of the letter, the President asked that we think about a possible addition to it along these lines: "The bill as passed by the House gives a flat exemption from the undistributed profits to the smaller corporations which make earnings up to \$25,000 per year. Out of the total of 200,000 taxpaying corporations this gives exemption from undistributed profits taxation to _____ corporations. Furthermore, out of this smaller number there are _____ corporations which earned in 1936 between \$25,000 and \$75,000 net incomes and the House bill gives them a preference by graduating their tax from 16 to 20 percent. This means that any young and growing corporation earning up to \$25,000 per year can in the discretion of its stockholders set aside the whole amount to surplus without penalty and can continue to do so with additional taxation from 1 to 4 percent until it gets to \$75,000 per year size.

The Senate Bill on the other hand gives the same right of growth or building up of surplus without penalty to the largest corporation.

The Senate Bill seeks to strengthen Section 102 of the Revenue Act of 1913, which in theory let the Treasury Department determine the validity of sums added to surplus; or in other words determine whether they exceed the surplus amount called for by prudent business management. Long practice and many decisions of the courts prove that this is as a matter of practical fact in the great majority of cases impossible to enforce. The Secretary of the Treasury advises me that the Senate amendment places the burden of proof on corporations, will not in all probability change the situation much, if any.

The net result in the opinion of the Treasury is that surpluses could be piled up."

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The President asked me what I thought of this addition. I said I thought he might be playing into the hands of his opponents by referring to the undistributed profits tax as a penalty; and also by referring to the fact that the Senate Bill permits large corporations to build up reserves, since that is precisely the argument which is made for the Senate Bill.

I said further that I was afraid the reference to Section 102 would not be understood.

I have embodied part of the suggestions in the second draft but not all.

The President then inquired whether it would be possible to work out in conference provisions whereby an accumulated surplus is treated as a trust fund which may be expended for the maintenance of wages or dividend payments during recessions or for replacing obsolete plants, but which may not be used for the purchase of the corporation's own stock or other similar activities. I told the President that we had worked at length on this subject but had found it almost impossible to define all the various legitimate and illegitimate uses of corporate surpluses. I asked him whether the Securities and Exchange Commission had done anything on the subject and the President said he did not know. The President said that some Congressmen would like to see such provisions as he had outlined. I told him that I did not believe they could be worked out in the comparatively short time the bill would be in Congress.

The President asked that the revised letter be sent over as soon as we could complete it. I told him we would get it over this afternoon.

The President then went on to discuss the spending program with Secretary Morgenthau. This part of the conference is covered in a separate memorandum.

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Letter Mr. Magill handed to the
President at 9:15 A.M. conference- April 12, 1938

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THE WHITE HOUSE
WASHINGTON

April 12, 1938

Dear Mr. Chairman:

The Revenue Bill as it passed the House and the Revenue Bill just adopted by the Senate differ in many particulars. Differences in detail can be ironed out in conference committee without sacrifice of fundamental principles. On the other hand, in two major respects I believe that important principles of fairness in taxation are an issue. I wish to bring these two matters briefly to your attention at this time.

1. Capital Gains and Losses - If the income tax is to be imposed in accordance with ability to pay, then capital gains must be taxed; and taxed at rates fairly comparable to those imposed on earned income. There is no fairness in taxing the salaried man and the merchant upon his income, and exempting the profits of the speculator or the investor. Nor is it fair to subject the salaried man and the merchant to graduated surtaxes upon their earnings, and at the same time to tax capital gains, large or small, merely at a flat rate, to the particular advantage of the taxpayer who otherwise would pay much higher surtax rates. The tax on the capital gain, like the tax on other income, should increase with the size of the gain, and with the size of the taxpayer's income from other sources.

The present law treats capital gains very favorably - more favorably than dividends, interest, or salaries earned over similar periods of time. The discount in favor of capital gains under the present law in many cases runs to 50 percent or more, as compared to the taxes applicable

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to ordinary income. In my opinion, there is no sound basis for further increasing this discount. Desirable as it is to foster business recovery, we should not do so by creating injustices in the tax system, particularly injustices at the expense of the man who earns his income.

2. Corporation taxes - For many years the Congress has sought to devise a fair system for taxing incomes from business, whether received by individual proprietors, by partnerships, or by corporations. Legally the corporation is a separate entity from the individuals who own it. Hence, while individual proprietors and partners are taxable at the usual normal tax and surtax rates upon the entire incomes of their businesses, whether distributed or reinvested, the corporate charter sets up a Chinese wall which prevents the corporation earnings from being taxed to the shareholders who really own them, unless those earnings are distributed to the shareholders in dividends. Thus a wide and basically unfair disparity between the taxation of individual proprietors and partnerships on the one hand, and of corporations on the other is created, unless some provision for taxing undistributed corporation earnings appears in the law.

At present, corporations are taxable on their earnings at a normal rate of from 8 to 15 percent, whether the earnings are paid out in dividends or not. If dividends are declared, the individual stockholders pay an additional normal tax and the applicable surtaxes on what they receive. Consequently, if there is no tax on undistributed earnings, the Treasury collects considerably more taxes from distributed corporate earnings than from corporation earnings that are retained. Moreover, with no undistributed profits tax, the partnership or individual proprietor is discriminated against as compared to the corporation.

Finally, with no undistributed profits tax, the avoidance of surtaxes through the use of the corporation becomes a readily available device.

For these reasons and others, I recommended the undistributed profits tax in 1936, and the Congress adopted it. Modifications shown by experience to be desirable, in particular the exemption of small corporations, should be made, but the principle of the tax is sound, and it should be retained in our tax system. It would be particularly undesirable to eliminate the undistributed profits tax at this time, in favor of a flat rate of tax, representing an increase in the tax burden on many small corporations, and on all corporations which follow established American practices of dividend distribution; and a decrease in the tax burden of large corporations which hoard their earnings.

There are many other provisions in the two bills which will improve the equity of the tax system, and the efficiency of its administration. Some pending amendments grant unjustifiable exemptions from a fair general rule, complicate the law and should be eliminated. It is most important, however, to hold fast to that which is good in the tax system. Equal taxation of incomes of similar size, and of corporation and individual taxpayers are axiomatic. The repeal of the undistributed profits tax and the reduction of the tax on capital gains to a fraction of the tax on earned income strike at the root of fundamental principles of taxation.

Faithfully,

The Honorable Pat Harrison,

United States Senate.

Copy of second draft of
letter, including the President's
suggested changes.

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April 12, 1938

Dear Mr. Chairman:

The Revenue Bill as it passed the House and the Revenue Bill just adopted by the Senate differ in many particulars. While differences in detail can, I am confident, be ironed out in conference committee without sacrifice of fundamental principles, in two major respects important principles of fairness in taxation are in issue. I wish to bring these two matters briefly to your attention at this time.

1. Capital Gains - For many years the country has accepted without question the principle of taxation in accordance with ability to pay. This principle applies to all forms of additional wealth accruing to individuals. There is no fairness in taxing the salaried man and the merchant upon their incomes and exempting the profits of the speculator or of the investor. Nor is it fair to subject the salaried man and the merchant to progressive surtaxes upon their earnings and at the same time to tax capital gains, large or small, merely at a flat rate, to the particular advantage of the taxpayer who otherwise would pay such higher surtax rates. In other words, as a matter of principle, if additional wealth in the form of earnings from business, such as dividends, interest, or wages, is taxed at progressive rates then capital gains should also be taxed at progressive rates.

The present law treats capital gains very favorably - more favorably than dividends, interest, or salaries earned over similar periods of time. The advantage given to capital gains under the present law, as compared to ordinary income, in many cases runs as high as 50 percent. Under the Senate Bill this preferential advantage is further increased by reducing the tax to a flat rate, no matter how large are the taxpayer's capital gains or how large his other income. For example, a man who makes a capital gain in a given year amounting to \$5000 would have to pay a tax of not more than 15 percent; while at the same time the man who makes capital gains of \$500,000 in a given year will also pay a tax of not more than 15 percent. Desirable as it is to foster business recovery, we should not do so by creating injustices in the tax system, particularly injustices at the expense of the man who earns his income - injustices to the advantage of the man who does not.

2. Corporation taxes - For many years the Congress has sought to devise a fair system for taxing incomes from business, whether received by individual proprietors, by partnerships, or by corporations. Legally the corporation is a separate entity from the individuals who own it. Hence, while individual proprietors and partners are taxable at the usual normal tax and surtax rates upon the entire incomes of their businesses, whether taken out of the business or left in it, the corporate charter sets up a Chinese wall which prevents the earnings from being taxed to the shareholders who really own them, unless these earnings are actually distributed to the shareholders in the form of dividends. Thus a wide and basically unfair disparity between the

taxation of individual proprietors and partnerships on the one hand, and of corporations on the other is created, unless some provision for taxing undistributed corporation earnings appears in the law.

At present, corporations are taxable on their earnings at a normal rate of from 5 to 15 percent, whether the earnings are paid out in dividends or not. If dividends are declared, the individual stockholders who get the earnings pay an additional normal personal income tax. If their incomes are large enough, they pay progressive surtaxes also. Consequently, the Treasury stands to lose where the corporation does not distribute earnings, whereas if earnings were distributed, the Treasury would collect additional taxes on the personal income tax returns of the stockholders. Moreover, with no undistributed profits tax, the partnership or individual proprietor is discriminated against as compared to the corporation. Finally, with no undistributed profits tax, the avoidance of surtaxes through the use of the corporation becomes a readily available device, for those persons in the higher surtax brackets, who seek legally to keep their net personal incomes down for taxpaying purposes, and to hide their actual profits by leaving them in the corporations they own.

For these reasons and others, I recommended the undistributed profits tax in 1936, and the Congress adopted it. Modifications shown by experience to be desirable, in particular the exemption of small corporations, should be made, but the principle of the tax is sound, and it should be retained in our tax system; otherwise we grant a definite incentive to the avoidance of personal income tax payments

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through methods which are legal, but which are contrary to the spirit of the principle that every citizen should pay taxes in accordance with his means. It would be particularly undesirable to eliminate the undistributed profits tax at this time, in favor of a flat rate of tax, representing an increase in the tax burden on many small corporations, and on all corporations which follow established American practices of dividend distribution; and a decrease in the tax burden of many large corporations, which have hoarded their earnings in the past, and would be encouraged to resume the practice in the future.

The Bill as passed by the House gives a flat exemption from the undistributed profits tax to those smaller corporations which make net earnings up to \$25,000 per year. Out of the total of 200,000 taxpaying corporations, approximately 176,000 are exempted from the undistributed profits tax under this provision. This means that any young and growing corporation earning up to \$25,000 per year can in the discretion of its directors set aside all its earnings for growth and expansion. Moreover, under the House Bill, corporations with incomes in excess of \$25,000 can also accumulate reserves for legitimate purposes by paying an additional tax of only 4 percent on undistributed earnings.

There are many other provisions in the two bills which will improve the equity of the tax system, and the efficiency of its administration. Some pending amendments grant unjustifiable exemptions from a fair general rule, complicate the law, and should be eliminated.

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It is most important, however, to hold fast to that which is good in the tax system. Equal taxation of incomes of similar size, and ^{equal taxation of} of corporations and individual taxpayers are axiomatic. The repeal of the undistributed profits tax and the reduction of the tax on capital gains to a fraction of the tax on other forms of income strike at the root of fundamental principles of taxation.

Faithfully,

The Honorable Robert L. Doughton,
House of Representatives.

RM's 2nd draft (WHITE HOUSE PAPER)

but first draft seen by Secy.M.-
and the draft taken to White House
for first conference.

April 12, 1938

Dear Mr. Chairman:

The Revenue Bill as it passed the House and the Revenue Bill just adopted by the Senate differ in many particulars. Differences in detail can be ironed out in conference committee without sacrifice of fundamental principles. On the other hand, in two major respects I believe that important principles of fairness in taxation are an issue. I wish to bring these two matters briefly to your attention at this time.

1. Capital Gains and Losses - If the income tax is to be imposed in accordance with ability to pay, then capital gains must be taxed; and taxed at rates fairly comparable to those imposed on earned income. There is no fairness in taxing the salaried man and the merchant upon his income, and exempting the profits of the speculator or the investor. Nor is it fair to subject the salaried man and the merchant to graduated surtaxes upon their earnings, and at the same time to tax capital gains, large or small, merely at a flat rate, to the particular advantage of the taxpayer who otherwise would pay much higher surtax rates. The tax on the capital gain, like the tax on other income, should increase with the size of the gain, and with the size of the taxpayer's income from other sources.

The present law treats capital gains very favorably - more favorably than dividends, interest, or salaries earned over similar periods of time. The discount in favor of capital gains under the present law in many cases runs to 50 percent or more, as compared to the taxes applicable

Original-R.M. took to White House for conference with
the President & Secy.M.-4/12/38-9:15 A.M. See 2nd page showing President's notes

to ordinary income. In my opinion, there is no sound basis for further increasing this discount. Desirable as it is to foster business recovery, we should not do so by creating injustices in the tax system, particularly injustices at the expense of the man who earns his income.

2. Corporation taxes - For many years the Congress has sought to devise a fair system for taxing incomes from business, whether received by individual proprietors, by partnerships, or by corporations. Legally the corporation is a separate entity from the individuals who own it. Hence, while individual proprietors and partners are taxable at the usual normal tax and surtax rates upon the entire incomes of their businesses, whether distributed or reinvested, the corporate charter sets up a Chinese wall which prevents the corporation earnings from being taxed to the shareholders who really own them, unless those earnings are distributed to the shareholders in dividends. Thus a wide and basically unfair disparity between the taxation of individual proprietors and partnerships on the one hand, and of corporations on the other is created, unless some provision for taxing undistributed corporation earnings appears in the law.

At present, corporations are taxable on their earnings at a normal rate of from 8 to 15 percent, whether the earnings are paid out in dividends or not. If dividends are declared, the individual stockholders pay an additional normal tax, ^{general income tax} and the applicable surtaxes on what they receive. Consequently, if there is no tax on undistributed earnings, the Treasury collects considerably more taxes from distributed corporate earnings than from corporation earnings that are retained. Moreover, with no undistributed profits tax, the partnership or individual proprietor is discriminated against as compared to the corporation.

- 3 -

Our error in copying - not a correction

~~or individual proprietor is discriminated against as compared to the~~
 corporation. Finally, with no undistributed profits tax, the avoidance of surtaxes through the use of the corporation becomes a readily available device.

For these reasons and others, I recommended the undistributed profits tax in 1936, and the Congress adopted it. Modifications shown by experience to be desirable, in particular the exemption of small corporations, should be made, but the principle of the tax is sound, and it should be retained in our tax system. It would be particularly undesirable to eliminate the undistributed profits tax at this time, in favor of a flat rate of tax, representing an increase in the tax burden on many small corporations, and on all corporations which follow established American practices of dividend distribution; and a decrease in the tax burden of large corporations which hoard their earnings.

There are many other provisions in the two bills which will improve the equity of the tax system, and the efficiency of its administration. Some pending amendments grant unjustifiable exemptions from a fair general rule, complicate the law, and should be eliminated. It is most important, however, to hold fast to that which is good in the tax system. Equal taxation of incomes of similar size, and of corporation and individual taxpayers are axiomatic. The repeal of the undistributed profits tax and the reduction of the tax on capital gains to a fraction of the tax on earned income strike at the root of fundamental principles of taxation.

Faithfully,

(for President's signature)

The Honorable Robert L. Doughton,

House of Representatives.
 (same letter written to Senator Harrison)

First draft 365
discussed at WH 9:15 am
4/12

Mr Magill's 2d draft, but the
first seen by Secy. Ho.
and taken to White House
conference 4/12 - 9:15 am

April 12, 1938

Dear Mr. Chairman:

The Revenue Bill as it passed the House and the Revenue Bill just adopted by the Senate differ in many particulars. Differences in detail can be ironed out in conference committee without sacrifice of fundamental principles. On the other hand, in two major respects I believe that important principles of fairness in taxation are an issue. I wish to bring these two matters briefly to your attention at this time.

1. Capital Gains and Losses - If the income tax is to be imposed in accordance with ability to pay, then capital gains must be taxed; and taxed at rates fairly comparable to those imposed on earned income. There is no fairness in taxing the salaried man and the merchant upon his income, and exempting the profits of the speculator or the investor. Nor is it fair to subject the salaried man and the merchant to graduated surtaxes upon their earnings, and at the same time to tax capital gains, large or small, merely at a flat rate, to the particular advantage of the tax-

Note: This is the draft discussed at the White House conference on 4/12/38- 9:15 A.M. -- The President, Secy. Morgenthau and Mr. Magill present. --typed by Miss Chauncey- let. to Sen. Harrison was exactly like it and typed in Mr. Magill's office

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payer who otherwise would pay much higher surtax rates. The tax on the capital gains like the tax on other income, should increase with the size of the gain, and with the size of the taxpayer's income from other sources.

The present law treats capital gains very favorably - more favorably than dividends, interest, or salaries earned over similar periods of time. The discount in favor of capital gains under the present law in many cases runs to 50 percent or more, as compared to the taxes applicable to ordinary income. In my opinion, there is no sound basis for further increasing this discount. Desirable as it is to foster business recovery, we should not do so by creating injustices in the tax system, particularly injustices at the expense of the man who earns his income.

2. Corporation taxes - For many years, the Congress has sought to devise a fair system for taxing incomes from business, whether received by individual proprietors, by partnerships, or by corporations. Legally the corporation is a separate entity from the individuals who own it. Hence, while individual proprietors and partners are taxable at the usual normal

-3-

tax and surtax rates upon the entire incomes of their businesses, whether distributed or reinvested, the corporate charter sets up a Chinese wall which prevents the corporation earnings from being taxed to the shareholders who really own them, unless those earnings are distributed to the shareholders in dividends. Thus a wide and basically unfair disparity between the taxation of individual proprietors and partnerships on the one hand, and of corporations on their other is created, unless some provision for taxing undistributed corporation earnings appears in the law.

At present, corporations are taxable on their earnings at a normal rate of from 8 to 15 percent, whether the earnings are paid out in dividends or not. If dividends are declared, the individual stockholders pay an additional normal tax and the applicable surtaxes on what they receive. Consequently, if there is no tax on undistributed earnings, the Treasury collects considerably more taxes from distributed corporate earnings. Moreover, with no undistributed profits tax, the partnership or individual proprietor is discriminated against as compared to the corporation. Finally, with no un-

74

distributed profits tax, the avoidance of surtaxes through the use of the corporation becomes a readily available device.

For these reasons and others, I recommended the undistributed profits tax in 1936, and the Congress adopted it. Modifications shown by experience to be desirable, in particular the exemption of small corporations, should be made, but the principle of the tax is sound, and it should be retained in our tax system. It would be particularly undesirable to eliminate the undistributed profits tax at this time, in favor of a flat rate of tax, representing an increase in the tax burden on many small corporations, and on all corporations which follow established American practices of dividend distribution; and a decrease in the tax burden of large corporations which hoard their earnings.

There are many other provisions in the two bills which will improve the equity of the tax system, and the efficiency of its administration. Some pending amendments grant unjustifiable exemptions from a fair general rule, complicate the law, and should be eliminated. It is most important, however, to hold fast to that which is good in the tax system. Equal taxation of income of

-5-

similar size, and of corporations and individual taxpayers are axiomatic. The repeal of the undistributed profits tax and the reduction of the tax on capital gains to a fraction of the tax on earned income strike at the root of fundamental principles of taxation.

Faithfully,

Honorable Robert L. Doughton,
House of Representatives.

Corrections in red are those made by
the President after the copy left
the Treasury.

April 12, 1938

Dear Mr. Chairman:

The Revenue Bill as it passed the House and the Revenue Bill just adopted by the Senate differ in many particulars. While differences in detail can, I am confident, be ironed out in conference committee without sacrifice of fundamental principles, in two major respects important principles of fairness in taxation are in issue. I wish to bring these two matters briefly to your attention at this time.

1. Capital Gains - For many years the country has accepted without question the principle of taxation in accordance with ability to pay. This principle applies to all forms of additional wealth accruing to individuals. There is no fairness in taxing the salaried man and the merchant upon their incomes and ^{levying at far lower rates than on the profits} ~~and exempting the profits of~~ the speculator, ~~or of the investor~~. Nor is it fair to subject the salaried man and the merchant to progressive surtaxes upon their earnings and at the same time to tax capital gains, large or small, ^{at a flat rate} ~~at a flat rate~~, to the particular advantage of the taxpayer who otherwise would pay much higher surtax rates. In other words, as a matter of principle, if additional wealth in the form of earnings from business, such as dividends, interest, or wages, is taxed at progressive rates then capital gains should also be taxed at progressive rates.

Final copy as sent to the White House (after 4/12/38 conference there); the written corrections on this copy are the changes made by the President before he sent the letter to the two Chairmen. (White House sent us a final copy - dated 4/13/38 -- which we compared with our final draft.)

The present law treats capital gains very favorably - more favorably than dividends, interest, or salaries earned over similar periods of time. The advantage given to capital gains under the present law, as compared to ordinary income, in many cases runs as high as 50 percent. Under the Senate Bill this preferential advantage is further increased by reducing the tax to a flat rate, no matter how large are the taxpayer's capital gains or how large his other income. For example, a man who makes a capital gain in a given year amounting to \$5000 would have to pay a tax of not more than 15 percent; while at the same time the man who makes capital gains of \$500,000 in a given year will also pay a tax of not more than 15 percent. Desirable as it is to foster business recovery, we should not do so by creating injustices in the tax system, particularly injustices at the expense of the man who earns his income - injustices to the advantage of the man who does not.

2. Corporation taxes - For many years the Congress has sought to devise a fair system for taxing incomes from business, whether received by individual proprietors, by partnerships, or by corporations. Legally the corporation is a separate entity from the individuals who own it. Hence, while individual proprietors and partners are taxable at the usual normal tax and surtax rates upon the entire income of their businesses, whether taken out of the business or left in it, the corporate charter sets up a Chinese wall which prevents the earnings from being taxed to the shareholders who really own them, unless these earnings are actually distributed to the shareholders in the form of dividends. Thus a wide and basically unfair disparity between the

tion of individual proprietors and partnerships on the one hand, and of corporations on the other is created, unless some provision for taxing undistributed corporation earnings appears in the law.

At present, corporations are taxable on their earnings at a normal rate of from 6 to 15 percent, whether the earnings are paid out in dividends or not. If dividends are declared, the individual stockholders who get the earnings pay an additional normal personal income tax. If their incomes are large enough, they pay progressive surtaxes also. Consequently, the Treasury stands to lose where the corporation does not distribute earnings, whereas if earnings were distributed, the Treasury would collect additional taxes on the personal income tax returns of the stockholders. Moreover, with no undistributed profits tax, the partnership or individual proprietor is discriminated against as compared to the corporation. Finally, with no undistributed profits tax, the avoidance of surtaxes through the use of the corporation becomes a readily available device, for those persons in the higher surtax brackets, who seek legally to keep their net personal incomes down for taxpaying purposes, and to hide their actual profits by leaving them in the corporations they own.

For these reasons and others, I recommended the undistributed profits tax in 1936, and the Congress adopted it. Modifications shown by experience to be desirable, in particular the exemption of small corporations, should be made, but the principle of the tax is sound, and it should be retained in our tax system; otherwise we grant a definite incentive to the avoidance of personal income tax payments

through methods which are legal, but which are contrary to the spirit of the principle that every citizen should pay taxes in accordance with his means. It would be particularly undesirable to eliminate the undistributed profits tax at this time, in favor of a flat rate of tax, representing an increase in the tax burden on many small corporations, and on all corporations which follow established American practices of dividend distribution; and a decrease in the tax burden of many large corporations, which have hoarded their earnings in the past, and would be encouraged to resume the practice in the future.

The Bill as passed by the House gives a flat exemption from the undistributed profits tax to those smaller corporations which make net earnings up to \$25,000 per year. Out of the total of 200,000 taxpaying corporations, approximately 176,000 are exempted from the undistributed profits tax under this provision. This means that any young and growing corporation earning up to \$25,000 per year can in the discretion of its directors set aside all its earnings for growth and expansion. Moreover, under the House Bill, corporations with incomes in excess of \$25,000 can also accumulate reserves for legitimate purposes by paying an additional tax of ^{from 1 to} only 4 percent on undistributed earnings.

There are many other provisions in the two bills which will improve the equity of the tax system, and the efficiency of its administration. Some pending amendments grant unjustifiable

... than a fair general rate, complicate the law, and
 ... be allowed. It is most important, however, to hold
 ... that which is good in the tax system. Equal taxation
 ... of similar rates, and equal taxation of corporations,
 ... individual taxpayers are essential. The repeal of the un-
 ... justified tax and the reduction of the tax on capital
 ... to a fraction of the tax on other forms of income would
 ... the best of fundamental principles of taxation.

*Business will be helped, not hurt, by these
 suggestions*

*Sincerely,
 J. D. Roosevelt*

Mr. Hamilton W. Thurston,
United States Senate

*Mr. Pat Harrison,
 Chairman, Finance Committee,
 United States Senate,
 Washington, D. C.*

Delivered to Sec'y by Majiel
4-12
(Final etc) H.Y. 376

FINAL DRAFT

April 12, 1936

Dear Mr. Chairman:

The Revenue Bill as it passed the House and the Revenue Bill just adopted by the Senate differ in many particulars. While differences in detail can, I am confident, be ironed out in conference committee without sacrifice of fundamental principles, in two major respects important principles of fairness in taxation are in issue. I wish to bring these two matters briefly to your attention at this time.

1. Capital Gains - For many years the country has accepted without question the principle of taxation in accordance with ability to pay. This principle applies to all forms of additional wealth accruing to individuals. There is no fairness in taxing the salaried man and the merchant upon their incomes and exempting the profits of the speculator or of the investor. Nor is it fair to subject the salaried man and the merchant to progressive surtaxes upon their earnings and at the same time to tax capital gains, large or small, merely at a flat rate, to the particular advantage of the taxpayer who otherwise would pay much higher surtax rates. In other words, as a matter of principle, if additional wealth in the form of earnings from business, such as dividends, interest, or wages, is taxed at progressive rates then capital gains should also be taxed at progressive rates.

Original of this letter to Doughton, and orig. of same let. to Sen. Harrison, was handed to the Secretary 4/12 late afternoon, for the President's signature-- and is the Treasury's final draft reply for the President's signature. (Note: the same letter to President made certain changes before sending the letters out -)

Doughton and Harrison

The present law treats capital gains very favorably - more favorably than dividends, interest, or salaries earned over similar periods of time. The advantage given to capital gains under the present law, as compared to ordinary income, in many cases runs as high as 50 percent. Under the Senate Bill this preferential advantage is further increased by reducing the tax to a flat rate, no matter how large are the taxpayer's capital gains or how large his other income. For example, a man who makes a capital gain in a given year amounting to \$5000 would have to pay a tax of not more than 15 percent; while at the same time the man who makes capital gains of \$500,000 in a given year will also pay a tax of not more than 15 percent. Desirable as it is to foster business recovery, we should not do so by creating injustices in the tax system, particularly injustices at the expense of the man who earns his income - injustices to the advantage of the man who does not.

2. Corporation taxes - For many years the Congress has sought to devise a fair system for taxing incomes from business, whether received by individual proprietors, by partnerships, or by corporations. Legally the corporation is a separate entity from the individuals who own it. Hence, while individual proprietors and partners are taxable at the usual normal tax and surtax rates upon the entire incomes of their businesses, whether taken out of the business or left in it, the corporate charter sets up a Chinese wall which prevents the earnings from being taxed to the shareholders who really own them, unless those earnings are actually distributed to the shareholders in the form of dividends. Thus a wide and basically unfair disparity between the

taxation of individual proprietors and partnerships on the one hand, and of corporations on the other is created, unless some provision for taxing undistributed corporation earnings appears in the law.

At present, corporations are taxable on their earnings at a normal rate of from 8 to 15 percent, whether the earnings are paid out in dividends or not. If dividends are declared, the individual stockholders who get the earnings pay an additional normal personal income tax. If their incomes are large enough, they pay progressive surtaxes also. Consequently, the Treasury stands to lose where the corporation does not distribute earnings, whereas if earnings were distributed, the Treasury would collect additional taxes on the personal income tax returns of the stockholders. Moreover, with no undistributed profits tax, the partnership or individual proprietor is discriminated against as compared to the corporation. Finally, with no undistributed profits tax, the avoidance of surtaxes through the use of the corporation becomes a readily available device, for these persons in the higher surtax brackets, who seek legally to keep their net personal incomes down for taxpaying purposes, and to hide their actual profits by leaving them in the corporations they own.

For these reasons and others, I recommended the undistributed profits tax in 1936, and the Congress adopted it. Modifications shown by experience to be desirable, in particular the exemption of small corporations, should be made, but the principle of the tax is sound, and it should be retained in our tax system; otherwise we grant a definite incentive to the avoidance of personal income tax payments

- 4 -

through methods which are legal, but which are contrary to the spirit of the principle that every citizen should pay taxes in accordance with his means. It would be particularly undesirable to eliminate the undistributed profits tax at this time, in favor of a flat rate of tax, representing an increase in the tax burden on many small corporations, and on all corporations which follow established American practices of dividend distribution; and a decrease in the tax burden of many large corporations, which have hoarded their earnings in the past, and would be encouraged to resume the practice in the future.

The Bill as passed by the House gives a flat exemption from the undistributed profits tax to those smaller corporations which make net earnings up to \$25,000 per year. Out of the total of 200,000 taxpaying corporations, approximately 176,000 are exempted from the undistributed profits tax under this provision. This means that any young and growing corporation earning up to \$25,000 per year can in the discretion of its directors set aside all its earnings for growth and expansion. Moreover, under the House Bill, corporations with incomes in excess of \$25,000 can also accumulate reserves for legitimate purposes by paying an additional tax of only 4 percent on undistributed earnings.

There are many other provisions in the two bills which will improve the equity of the tax system, and the efficiency of its administration. Some pending amendments grant unjustifiable exemptions from a fair general rule, complicate the law, and should be eliminated.

through methods which are legal, but which are contrary to the spirit of the principle that every citizen should pay taxes in accordance with his means. It would be particularly undesirable to eliminate the undistributed profits tax at this time, in favor of a flat rate of tax, representing an increase in the tax burden on many small corporations, and on all corporations which follow established American practices of dividend distribution; and a decrease in the tax burden of large corporations, many of which have hoarded their earnings in the past, and would be encouraged to resume the practice in the future.

The Bill as passed by the House gives a flat exemption from the undistributed profits tax to those smaller corporations which make net earnings up to \$25,000 per year. Out of the total 200,000 taxpaying corporations, approximately 178,000 are exempted from the undistributed profits tax under this provision. This means that any young and growing corporation earning up from \$25,000 per year can in the discretion of its directors set aside all its earnings for growth and expansion. Moreover, under the House Bill, corporations with incomes in excess of \$25,000 can also accumulate reserves for legitimate purposes by paying an additional tax of only 4 percent on undistributed earnings.

The undistributed profits tax in the form in which it passed the House in 1936 protected the small corporation and if it had become law in that form much of the present criticism of our tax system could not have been made. With this recent experience before us we should not make the same mistake again.

This is an alternate page 4 - the Secretary and Mr. Magill eliminated it before the final draft went to the White House.

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It is most important, however, to hold fast to that which is good in the tax system. Equal taxation of incomes of similar size, and equal taxation of corporations and individual taxpayers are axiomatic. The repeal of the undistributed profits tax and the reduction of the tax on capital gains to a fraction of the tax on other forms of income strike at the root of fundamental principles of taxation.

Faithfully,

The Honorable Robert L. Doughton,
House of Representatives.

April 12, 1938

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8:15 p.m.

While the Secretary was attending the meeting at the White House, he received a telephone call from Eccles and attached are the notes the Secretary made of Eccles' suggestions.

Eccles 3 conditions 8:15

1. Gold decontrol of ^{the} to pay for expenditures
 2. Consider modification of BK. examination and investment
 3. F. E. C.
Considers some relaxation in some of their rules
-
- Federal Reserve will lower reserve requirements as part of program.

gov. Bond market
got to be prepared
will agree to
support gov.
market. Federal
Reserve unanimous
in favor of it.

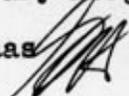
TREASURY DEPARTMENT

383

INTER OFFICE COMMUNICATION

DATE April 12, 1938

TO Secretary Morgenthau

FROM Mr. Haas 

In accordance with your request of yesterday, we have made a rough and tentative estimate of the revenues and receipts for the fiscal year 1939 which might be expected if the Federal Reserve Board index of industrial production for the calendar year 1938 were to average 85, 80 and 75, respectively. At these levels of the index, the total receipts from the general and special accounts are estimated at \$5,238.8 millions, \$5,077.0 millions, and \$4,881.1 millions, respectively.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE April 12, 1938

TO Secretary Morgenthau

FROM A. Lochhead

U. S. GOVERNMENT SECURITIESMATURING BEFORE July 1, 1938

(In millions of dollars)

<u>Maturity Date</u>	<u>Treasury Bills</u>	<u>Treasury Notes</u>
4/20/38	\$ 100	-
4/27/38	100	-
5/ 4/38	100	-
5/11/38	100	-
5/18/38	100	-
5/25/38	100	-
6/ 1/38	100	-
6/ 8/38	100	-
6/15/38	100	\$ 618
6/16/38	100 *	-
6/17/38	100 *	-
6/18/38	50 *	-
6/22/38	150	-
6/29/38	150	-
	<hr/>	<hr/>
	\$1,450	\$ 618
		<u>TOTAL \$ 2,068</u>

* Tax-dated bills.

U. S. GOVERNMENT SECURITIES MATURING BETWEENJuly 1, 1938 and July 1, 1939

(In millions of dollars)

<u>Maturity Date</u>	<u>Bills</u>	<u>Notes</u>	
7/ 6/38	\$ 150	-	
7/13/38	150	-	
7/20/38	50	-	
9/15/38	-	\$ 596	
12/15/38	-	434	
3/15/39	-	942	
6/15/39	-	1294	
	<hr/>	<hr/>	
TOTAL	\$ 350	\$3,266	\$ 3,616
<u>GRAND TOTAL</u>			
(Maturing before July 1, 1939)	\$ 1,800	\$ 3,884	\$ 5,684

Besides the above direct obligations, the following guaranteed issues mature before July 1, 1939.

	<u>Amount</u>
2% H. O. L. C. bonds due 8/15/38	\$ 49
1 1/2% H. O. L. C. bonds due 6/1/39	325
	<hr/>
TOTAL	\$ 374

(12914)

EMPLOYMENT ON WPA PROJECTS, BY STATE

386 38

UNITED STATES AND TERRITORIES

Weeks Ending April 9 and April 2, 1938

(Partly Estimated - Subject to Revision)

State	Number of Persons Employed		Increase (+) or Decrease (-)
	Week Ending April 9	Week Ending April 2	
GRAND TOTAL	2,504,479	2,445,316 A/	+ 59,163
CONTINENTAL UNITED STATES	2,502,177	2,442,816 A/	+ 59,361
Alabama	37,541	36,928	+ 613
Arizona	9,075	8,708	+ 367
Arkansas	35,612	35,326	+ 286
California - Total	94,735	94,321	+ 414
Northern	50,991	51,463	- 472
Southern	43,744	42,858	+ 886
Colorado	27,519	27,530	- 11
Connecticut	21,833	21,807	+ 26
Delaware	3,250	3,094	+ 156
District of Columbia	8,150	8,032	+ 118
Florida	32,138	31,578	+ 560
Georgia	42,533	41,511	+ 1,022
Idaho	11,511	11,579	- 68
Illinois	199,205	197,335	+ 1,870
Indiana	88,644	84,931	+ 3,713
Iowa	30,854	30,444	+ 410
Kansas	35,727	35,728	- 1
Kentucky	51,384	50,215	+ 1,169
Louisiana	31,353	31,501	- 148
Maine	7,573	7,632 A/	- 59
Maryland	11,971	11,946	+ 25
Massachusetts	106,184	105,659	+ 525
Michigan	129,901	125,723	+ 4,178
Minnesota	57,388	57,864	- 476
Mississippi	31,376	30,819	+ 557
Missouri	90,349	86,279	+ 4,070
Montana	18,311	18,126	+ 185
Nebraska	28,255	28,246	+ 9
Nevada	2,601	2,674	- 73
New Hampshire	8,775	8,638	+ 137
New Jersey	89,948	82,209	+ 7,739
New Mexico	10,041	9,977	+ 64
New York City	156,595	153,960	+ 2,635
New York (Excl. N.Y.C.)	53,514	53,048 A/	+ 466
North Carolina	31,977	31,575 A/	+ 402
Ohio	218,904	196,089	+ 22,815
North Dakota	14,368	14,849	- 481
Oklahoma	61,281	60,952	+ 329
Oregon	16,883	16,725	+ 158
Pennsylvania	226,744	223,052	+ 3,692
Rhode Island	13,112	13,050	+ 62
South Carolina	31,058	30,699	+ 359
South Dakota	16,153	17,170	- 1,017
Tennessee	31,346	31,278	+ 68
Texas	78,086	77,876 A/	+ 210
Texas	10,364	10,667	- 303
Utah	5,038	5,096	- 58
Vermont	22,889	22,748	+ 141
Virginia	46,431	46,131	+ 300
Washington	42,108	40,931	+ 1,177
West Virginia	66,835	65,940 A/	+ 895
Wisconsin	4,714	4,620	+ 94
Wyoming	2,302	2,500	- 198
Hawaii			

A/ Revised.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE April 12, 1938

TO Secretary Morgenthau
FROM Mr. Taylor

Frankly I do not think that the program which we heard described at lunch today shows originality or holds sufficient appeal to guarantee its success. It is merely doing over again on a big scale what we have tried before. While the country recognizes its responsibility to the unemployed and is prepared to meet it, I seriously question whether it wants or would understand a new program of extensive public works of the character described. While the immediate political appeal to mayors of great cities and the heads of local organizations is no doubt great, I doubt the effectiveness of the utilization of this type of government expenditures at this time. It is slow in taking effect and cannot be cut off when, as and if private expenditures have been resumed. Above all it lacks originality at a time when the country is expecting a great deal in the form of a new approach to pressing problems. Even assuming that it serves as a satisfactory stop-gap and that it gives the Administration a chance to reform its lines, it must of necessity be followed by a new program which will face the added handicap on financing which will have been imposed by the proposed public works program.

I agree with the position which you stated this morning, namely, that Thursday's Message and radio talk should be confined to the W.P.A. appropriations and supplemental items amounting to say \$1,500,000,000, the R.F.C. Program, the change in reserve requirements, the desterilization and spending as required of the inactive gold and vigorous statements to the effect that

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if these measures prove insufficient additional measures will be taken even if the enactment of such measures may require the calling of a Special Session of Congress.

I believe that a new, carefully worked out program should be prepared and held in readiness for use if necessary, and I think that this program should meet the requirements which I outlined to you in my memorandum of April 6, 1938, namely:

"1. That the program ~~is~~ intended to help and encourage private initiative, and that expenditures will be made and credits extended in those fields where private initiative and credit are unavailable or in those fields where private initiative and credit will participate in the endeavor.

"2. That each element composing the program shall meet the requirement that it represents something that the country really needs and which has an individual appeal on its merits. For example, the establishment of a human resources board with its necessary research activities, flood control, farm security and rehabilitation, the C.C.C., housing, both private and slum clearance, the improvement of our regular and emergency airports, adequate credit facilities for small business enterprises, the modernization of railroad equipment, the maintenance of essential rights of way, the elimination of grade crossings on essential rights of way and adequate hospital and public health facilities, all have real appeal and should be undertaken whenever the condition of our economy permits or demands action."

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While certain of the components of the program discussed today meet these requirements the largest individual item and the one on which the most stress will be laid by Congress and the public, namely, the grants and loans to municipalities and other public bodies for miscellaneous public works, in my opinion fails to meet either of the requirements which I believe to be essential.

I believe that the minimum program which you outlined may well prove to be adequate if it is given a chance and if it is properly sold to the country. I think that the additional program which was described at luncheon would interfere with the program which you outlined and would have to be followed by a new program which in turn would have to be financed under conditions which we cannot attempt to forecast.

I believe that the Treasury, with the cooperation of the Federal Reserve Board, could finance your minimum program plus a carefully prepared additional program which must show originality and universal appeal, if it were found that such an additional program were necessary. It might be possible to finance the program described at lunch if the scenery and presentation were handled perfectly, but I seriously doubt if the Treasury and the Federal Reserve Board would be able to finance this program plus the additional new program which would inevitably follow.

Wage Taylor

April 12, 1938
(Dictated April 13, 1938)

The Secretary left a copy of this with the President
at the White House last night (April 12).

- 2 -

will amount to \$5,077,000,000, and that the total expenditures, including the extraordinary expenditures set out above and not included in the budget, will amount to \$9,261,000,000, leaving a net deficit of \$4,184,000,000, an increase over the budget estimate of \$3,234,000,000;

6. That the latest estimated deposits in the Unemployment Trust Fund for the fiscal year 1939 will amount to \$791,000,000 and that the estimated withdrawals will amount to \$391,000,000, leaving \$400,000,000 available with which to help finance the above-mentioned deficit. To this should be added the other special investments such as Old Age Reserve, etc., aggregating \$600,000,000;

7. That our working balances during this period will range between 700 and 900 million dollars;

8. That there will be no further sale of public debt obligations for the purpose of purchasing gold for deposit in the inactive gold fund, and that inactive and free gold amounting to \$1,392,000,000 will be used to finance the deficit; and

9. That the financial requirements of the Commodity Credit Corporation estimated at \$250,000,000, the Reconstruction Finance Corporation estimated at \$1,000,000,000, and U. S. Housing Authority estimated at \$200,000,000, will be met through the sale of their own obligations in the market and the Treasury relieved of supplying these three organizations with cash.

- 3 -

Based on these assumptions there is set out below a statement showing the total estimated Government financing which will be required for the fiscal year 1939 and also the proposed methods of meeting these financial requirements.

Total Treasury Financing:

Net deficit	\$4,184,000,000	
Maturing Treasury notes . . .	3,265,000,000	
Maturing special Treasury bills (4 times \$250M) . . .	1,000,000,000	
Maturing regular Treasury bills (4 times \$1,550M) . . .	<u>6,200,000,000</u>	
Total		\$14,649,000,000

Method of Financing:

Refunding -

Treasury notes (exchanges) . . .	\$3,100,000,000	
Treasury bills (replacements) . . .	<u>7,200,000,000</u>	<u>10,300,000,000</u>

Cash requirements		4,349,000,000
Unemployment Trust Fund (net) \$	400,000,000	
Old Age Reserve, etc. (net) . . .	600,000,000	
U. S. Savings bonds	400,000,000	
Gold deposits	<u>1,392,000,000</u>	<u>2,792,000,000</u>
Market cash operations		\$ 1,557,000,000

Additional estimated guaranteed obligations to be sold:

Reconstruction Finance Corp. . .	\$1,000,000,000	
Commodity Credit Corporation . . .	250,000,000	
U. S. Housing Authority	<u>200,000,000</u>	<u>1,450,000,000</u>

Total market operations (direct and guaranteed)		\$ 3,007,000,000
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Note: In addition to the foregoing financing, there are outstanding guaranteed obligations which mature during the fiscal year 1939 and which will have to be refunded, in the aggregate amount of about \$730,000,000.

s/s D. W. B.

Gross public debt March 31, 1938		\$ 37,556 M
Estimated increase to June 30, 1938 . . .	\$ 150 M	
Estimated increase fiscal year 1939 to finance deficit (less gold deposits)	<u>2,792</u>	<u>2,942</u>
Estimated gross public debt June 30, 1939		\$ 40,498 M
<hr/>		
Guaranteed debt January 31, 1938		\$ 4,706 M
Estimated increase by June 30, 1939:		
Reconstruction Finance Corp.	\$1,000 M	
Commodity Credit Corporation	250	
U. S. Housing Authority	<u>200</u>	<u>1,450</u>
Estimated guaranteed debt June 30, 1939		\$ 6,156 M
<hr/>		

April 12, 1938



FEDERAL DEPOSIT INSURANCE CORPORATION
WASHINGTON

OFFICE OF THE CHAIRMAN

April
12th
1938

My dear Mr. Morgenthau:

This Corporation is taking certain steps with respect to bank supervision which we believe are of such importance that they should be called to your attention.

1. We are instructing our examiners no longer to classify any loan as "slow." They shall classify a loan as "substandard" if it involves a substantial degree of risk to the bank, but no loan shall be criticized by a bank examiner of this Corporation simply because it has run a long time or because it will not be paid off in the near future. We have long urged this step and intend it to be a permanent policy.
2. We are instructing our examiners to value the securities held by banks on a reasonable basis rather than blindly to follow the market quotations. Securities of high investment quality are to be valued at cost and market price is to be ignored. Securities not of a high investment grade but also not involving great risk of default are to be valued at cost, but the market price is to be noted as a memorandum figure in the examinations. Defaulted bonds, bonds having a high risk of default, and stocks held by the banks are to be valued at market price.

- 2 -

On the other hand, neither unrealized nor realized security profits are to be taken into consideration in bank examinations. As a permanent policy with respect to the banks which we supervise, and insofar as we have power to enforce sound banking standards, we intend to change the practices of banks in rising security markets. Profits from security sales are to be used as a reserve for future losses. Banks will thus no longer be able to profit from security speculation. They must invest simply for interest return. We anticipate that this policy will discourage speculation on the part of the banks and promote stability in the bond market.

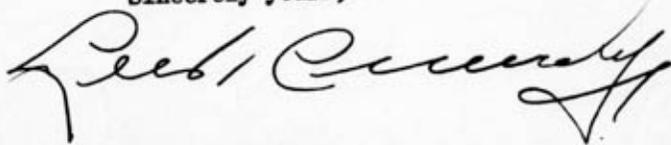
The officials of the State Bank Supervisors association have agreed that the members of their organization will go along with us in this program of loan classification and security valuation.

I am very glad to report, incidentally, that the banking system appears to me to be in a very strong position. Its present liquid condition, with more than 50 percent of its assets consisting of cash, interbank deposits and U. S. Government securities, not only makes possible meeting all deposit withdrawals but also permits the banks to meet all demands for loans of a reasonable character. We hope that our change in loan classification will encourage the banks to make all reasonable loans. Loans at present in the portfolios of the banks appear, on the

whole, to be sound. In 1934, 7 percent of the loans in national banks and banks not members of the Federal Reserve System were classified as doubtful and loss, and 28 percent as slow. In 1937, the corresponding percentages were 2 percent and 12 percent.

As you can well appreciate, there are, however, certain banks, largely banks which have never regained their strength since 1933, which are in a weakened condition. In the near future it may be necessary and desirable for us to make substantial payments in connection with these situations. However, our present record indicates that where we make such payments there is no substantial loss to depositors. It is my opinion that the banking situation is fundamentally sound and need be no subject of concern.

Sincerely yours,



Leo T. Crowley
Chairman

The Honorable Henry Morgenthau
Secretary of the Treasury
Washington, D. C.

April 12, 1938

(Dictated April 13, 1938)

I stayed last night after the group left the White House and then the President went over the tax letter which is to go to the two Chairmen and Jimmy and Steve Early did everything possible to stop the President from signing it. Steve Early suggested that I sign it. They said, "It will make the Senate furious" and I said, "What about the 130 million people who were under the impression that the President wants certain principles in the tax bill and he keeps quiet and lets the thing pass without saying anything?" The President's attitude was fine and he made a few changes after going over the letter very carefully and swept both Steve Early and Jimmy aside.

PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Paris, France

DATE: April 12, 1938, 10 a.m.

NO.: 583

FROM COCHRAN.

This morning I got back from Basel where on Monday the regular meeting of the Board of Directors of the BIS was held. The members decided to recommend to the annual general meeting on the ninth of May a distribution of the usual 6 percent gold dividend for the year ended March 31, the eighth business year of the BIS. Bachmann, the President of the Swiss National Bank, was reelected as BIS director for another term of two years.

On Sunday afternoon at Badenweiler, Germany, those BIS directors who are central bank governors held their usual informal meeting. Schacht and his German colleagues entertained the BIS group there at an annual luncheon. At this confidential meeting the chief topic of discussion was the question of the four thousand BIS shares which the National Bank of Austria had originally subscribed. Schacht said that since he is President of the Reichsbank, and the Reichsbank has taken over the business of the National Bank of Austria which has now been liquidated, he has the right to vote the shares. Some of the other governors protested against this. The point was brought

- 2 -

brought up by Norman of the Bank of England that when the BIS had been set up it had been envisaged and arranged that in the bank the seven founding countries should be on an equal footing; if Schacht could now vote the Austrian share in addition to those which the Reichsbank had previously held, that arrangement would be upset. Schacht said that it was a pleasure to him that someone was now approaching him asking for equality of treatment after all these many years of his being in an opposite position. In addition he intimated to the Bank of England Governor that he had no objection to the Bank of England increasing its BIS shares through some merger. The governors did not reach a decision on this question, but a small committee is to study the matter before the annual meeting of the shareholders.

Schacht has completely recovered his well-known self-assurance, as is indicated by the above remarks. Schacht's term of office was recently renewed for four years; coupled with this is the extent to which he has participated in activities of the past few weeks, all indicating that Hitler has placed even greater confidence in Schacht. His friend Funk, who succeeded him as Minister of Economics, and Schacht are getting on well together.

Some concern was evidenced by Schacht over the increasing

creasing budget burden arising from heavy borrowing for the Government, which the Austrian undertaking has increased. There is no danger that this situation will have early consequences, but it must nevertheless cause constant worry to a man like Dr. Schacht who has such a comprehension of financial and monetary matters.

I was told by Hechler, Schacht's Basel resident director, that the great struggle for Schacht was trying to keep Goering from his constant demands for resources to carry out his four year plan in Germany.

The subject of Austrian bonds was brought up by Hechler. Before the taking over of Austria by Germany, he said, the BIS as trustee had been active in negotiations for converting the 7 percent 1930 Austrian loan into a 4 1/2 percent issue, and that it had been hoped by the first of July this transaction would be consummated. Hechler said that so far as the BIS is aware, nothing has been done on this since the Austrian affair; however, he said he believes it entirely inconceivable that the German Reich should undertake to continue full service on this loan at the original rate of interest, 7 percent. Hechler said it was much more likely that the Central Government should look on this loan as a continuing Austrian obligation which that part of greater Germany should take care of just
as

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as Bavaria should take care of a Bavarian loan.

The central bankers who were at Basel did not expect that Germany would make an early move against Czechoslovakia. They believe that possibly a year may elapse before Germany takes any really aggressive action to follow up the annexation of Austria. In their opinion, during that time the present Czechoslovakia will tend to disintegrate, which would prepare the way for the three parts of the country to be amalgamated with Germany, Poland and Hungary respectively. This would leave a central part which has a very uncertain future. Basel observers believed that increasing degeneration in France would be the one factor which might tempt Germany to hasten moving on Czechoslovakia.

Because of the governmental and financial crisis in France the Bank of France Governor, Fournier, could not attend the April BIS meeting. People in the BIS have become greatly discouraged by and tired of crises in France. In their opinion, France has already become a second-rate power in monetary and economic importance, and that in the international political sphere the country is rapidly moving in that direction. Basel observers feel that the attempted social reforms in France, and labor's consequent unrest and cost of production increase have so crippled

France

- 5 -

France economically that the country would not be a dangerous competitor in the world markets no matter what depreciation may take place in the franc. For a really wealthy country such as France which does not put its own house in order there is not much sympathy. At the time of the meeting of the BIS in March the Austrian crisis had just developed, and then it was hoped that this shock would be sufficient to bring a National Union Government in France which could patriotically lead the country out of the difficulties it is in. A National Union Government was not set up and political fight and labor disorders have in the meantime developed more bitterly; thus many of the even sympathetic observers at Basel do not show much interest any more in who is directing the French Government, but their interest is rather in the question as to whether the situation can ever be made right without shedding blood.

General satisfaction was expressed that the Popular Front party had broken up, and especially that Blum was no longer in office. It was thought that great damage to France had been done by Blum through disturbing the economic and social position. There has been a decline in the respect for him as a patriot since his recent

tenacious

- 6 -

tenacious holding on to office when failure was inevitable. The strike situation was only being aggravated by his remaining in office, and involved elements over which he is supposed to have had real control. The opinion of most of my friends is that if the Senate had accepted Blum's program, France would within a week have had full exchange control. They think that even this would have been ineffective in France, and that none of the flight capital already out of the country would have come back to France. Perhaps you have had from Germany a report of the article in the FRANKFURTER ZEITUNG in which reference is made to Blum's plan as appearing to be "made in Germany". Some observers admitted that Blum may have done some good for the country in revealing the wide field over which reforms must take place and in proposing such a variety of measures, even though several were contradictory and some of them were by no means feasible.

END SECTIONS TWO TO FIVE, INCLUSIVE.

WILSON.

The Daladier set-up became known at Basel over the weekend. This set-up made a better impression on BIS observers than any recent Government. However, these observers are still skeptical as to whether sufficient confidence to float a fifteen billion franc loan will be inspired by this Government, especially in view of the strike situation which it inherited, and whether it will live long enough to effect the drastic measures which are necessary in France in order to bring about repatriation of capital and economic recovery.

When the first reports of the Sunday plebiscite in Germany and Austria came to Basel I was with the Italians; their remarks to me at that time, as well as certain indications given to some of my friends, led us to believe that the Austrian affair has ~~markedly~~ considerably weakened the Berlin-Rome axis; a contributing factor to this weakening is the willingness of Great Britain to negotiate a treaty with Italy and to take the lead vis-à-vis the League of Nations in seeking a normalization of relations with the Italian Government. There was a general belief that very shortly the Anglo-Italian treaty would be completed and that this constitutes the most hopeful development for a long time in European political affairs. An early European war was not expected by anyone. The situa-

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- 2 -

tion in France and possible repercussions therefrom caused most concern. There was general regret that the French had not speedily followed the British initiative in improving their relations with the Italians. Hope was still held that a step in this direction might be taken soon, since Bonnet is Minister for Foreign Affairs.

I talked with President Trip of the Netherlands Bank. Trip believes that German ~~autarchy~~ is having a detrimental influence on other lands, giving the impression of activity and prosperity while in reality an artificially stimulated regime is being carried on which in the end will cost the Reich heavily. In the Netherlands, he told me, those who have been impressed by the German example, are making increasing demands for public works. President Trip is in favor of a certain amount of public works, but not such a program as would involve early completion of all the projects that would be done over a period of years under normal conditions; i.e., he does not think that for the sake of immediate amelioration all possibilities for public works should be used up and leave the future with the bill to pay and no opportunities for public works.

Naturally Trip wants the unemployment situation taken care of; however he is of the opinion that in most countries

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we are too susceptible to propaganda in behalf of our allegedly suffering brethren. The result of this he said is perpetuation of loafing, politicians are aided in their moves to get votes through uneconomic spending, and there is evasion of courageous steps toward sound recovery and saving.

I had a private talk with Professor Beneduce of Italy. During the conversation it was recalled that he had remarked to me in 1933 or 1934 that most of the measures which the United States was undertaking then were not new in history, and that American history would reveal the new failure thereof and that ^{one of} the last countries to emerge from the world-wide depression would be the United States. Professor Beneduce is particularly concerned over the various national experiments seeking to raise standards of living; in his opinion the world is not wealthy enough to give to every people the standards of living which national legislators might want to give to them; varying scales of living must continue, he believes. The natural wealth and resources of the respective countries, as well as their own initiative and willingness and capacity to work, will determine the height to which they may move up their standards. For his own poor country he benevolently desires that there be improvement in the standard
of

- 4 -

of living, but he realizes that in spite of enthusiastic effort of regimented labor, a level cannot be achieved similar to that which should normally be expected in a new and wealthier area such as in the United States; however, he would rather see a gradual move toward the higher standards than a rush to them through legislation which tries to give labor so much that the load is too heavy for capital and there is an increase in unemployment.

END SECTIONS SIX, SEVEN AND EIGHT.

WILSON.

RECEIVED
APR 13 1930
TREASURY DEPARTMENT
OFFICE OF THE ASSISTANT
SECRETARY FOR THE BUREAU

EA: LWW

PARAPHRASE OF SECTIONS NINE TO THIRTEEN, INCLUSIVE
Telegram No. 583 of April 12, 1938, from Paris.

I was told by Galopin of Belgium that in his country industry has continued to decline with the steel trade suffering most severely. He does not see a turn for the better as yet, saying that so much depended upon the United States. I made reference to the recent report in the London Press that very shortly Paul Van Zeeland might be made Prime Minister of Belgium again; this was emphatically denied by Galopin, who said that in Belgium there was no thought in this direction or any possibility that it could happen. It is too early, he said, for Van Zeeland to reenter politics even though the charges against him and the late Governor Franck will be cleared up next month. Neither is there a likelihood that ex-Finance Minister Deman will return soon, since there was so much unhappiness over the budget as he left it and the people are not meeting cheerfully the present need for increased taxes.

The Swiss National Bank officials, Bachmann and Pfenniger, said that the Austrian situation had caused enough capital to leave Switzerland to obviate the necessity for any further efforts by them to check the influx of hot money, but that the banking structure had not been hurt by the affair. The Swiss hotel industry and railways anticipate an important profit from the annexation of Austria by
Germany

- 2 -

Germany, as tourists are not so likely to go to Austria because of the change in government and because of the exchange situation. The Austrian resorts, particularly for winter sports, have in recent years cut seriously into the Swiss trade because prices in Austria were lower.

I had a talk with Governor Rooth of the Swedish Central Bank. He said that in his country there is practically no unemployment, but that there is a decline in future orders for exports. American cancellation of orders for Swedish wood pulp is largely the cause of this. I was told by Rooth that most of the cancellations had been abrupt without even any negotiations toward receiving more favorable prices than those agreed upon when the contracts were drawn up. The European situation still worries him; he hopes to keep an increasingly large part of his reserves in gold crowns. The Scandinavian countries, he said, have now started on a program of armament expenditures and outlay for reserves that would be useful in wartime that will cost in the neighborhood of four hundred million Swedish crowns. In his opinion the raw material market should sooner or later feel a real impetus with Scandinavia spending to this extent and with more important areas going much further.

I had a talk with Sir Otto Niemeyer about protection

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of bondholders and he emphasized the desirability and urgency of cooperation between the United States and Great Britain in Brazil lest one be played against the other.

The Bank of England Governor, Norman, was decidedly pessimistic and he thinks that so long as a cheap money policy is maintained in the leading business countries of the world there will be no lasting economic and financial recovery.

The continuing slump in affairs in the United States, ~~and~~ caused general unhappiness, and the reported decision of the Government to resort to "pump priming" to achieve recovery caused deep disappointment. There was general recognition that the unemployed should not be permitted to starve and that there would of course be some pickup in certain lines as a result of distribution of Government funds. However, no one believed that such spending would go far toward reviving confidence or lasting prosperity, as few if any permanent benefits had resulted from previous spending. In the opinion of most of the BIS observers, the soundest approach to the problem would be made if only the most necessitous spending for relief of actual need were resorted to with concentrated effort on bringing about normal business activity. In the opinion of some of them such a recovery would start itself if in the near future business only had a little more en-

- 4 -

couragement such as may be extended to some degree through revision of tax measures. These observers want to see business insured of an opportunity to make substantial profits over a substantial period; they would like to see the home construction program carried along. They do not think that for the Government to guarantee railway bonds is a good policy. Should large amounts be voted now, they think that there should be a safeguarding clause to relieve the Government from spending should there be a recovery in business in the meantime. Private initiative should be encouraged to take the place of outlay by the Government. A real beginning had been made, it was believed, when the Secretary of the Treasury spoke before the Academy of Political Science at New York and when conferences of businessmen were held in Washington. Government officials making successive attacks against business, revelations of improper practices on the New York markets and other factors have not only stopped the progress which was hoped for but a real depression has grown out of a slump. If the domestic economic situation does not permit purchases it is evident that a lowering of our trade barriers will not increase imports. Should there be spending of important sums, it is recommended that simultaneous private spending

be

- 5 -

be encouraged. As an example, should the Government advance 20 percent to home builders, the balance should be financed by the builder. There should be similar handling of outlay by railways for capital construction. Leaders in business should make known their genuine desire to cooperate with the Government and business should be met halfway by the Government.

Yanagita and Kano, the Japanese directors, as well as others, spoke of the American silver program with particular reference to suspension of purchases of silver from Mexico. They said they realized that the decision of the Treasury Department to stop purchases of Mexican silver was difficult to avoid in consideration of the general trade and business relations between the two countries. It was appreciated that this step had brought up a problem for the Treasury in carrying out its legislative mandate with regard to silver. The BIS representatives for the most part do not come from countries directly interested in silver, although the British, China, India, the Dutch, their Eastern Colonies and Japan, following Chinese problems, are naturally anxious to see what happens on the world silver market now. In previous telegrams I have reported that European central bankers have never looked upon the American silver program as a monetary measure which would

be

- 6 -

be helpful. Some observers might welcome the United States taking advantage of the present difficulty with Mexico to begin a liquidation of the entire silver purchasing program. Others, on the other hand, ~~might~~ feel that now when the world has suffered a degree of decline in raw material prices, the list should not suddenly be augmented by silver.

I had a conversation with Golay, the leading Swiss private banker who last autumn was in the United States. Golay told me that the BIS observers had no more reason being pessimistic with respect to the American outlook in April than they had in December in being optimistic. Golay said that observers over here are foolish to try to estimate a situation which depends entirely upon the psychology of a people influenced almost entirely by their Executive.

On May 9 the next monthly and annual meeting of the BIS directors will be held at Basel.

END MESSAGE.

WILSON.

EA:LWW

REB

GRAY

London

Dated April 12, 1938

Rec'd 2:23 p. m.

Secretary of State,
Washington.

301, April 12, 6 p. m.

FOR TREASURY FROM BUTTERWORTH.

Mixed sentiments both as regards the dollar and the franc have made the exchanges unsteady today but the volume of trading have not been large. The movement in francs has been affected by whether or to what extent financial powers will be granted the Daladier Government and the dollar, by whether or to what extent Congress will limit the Administration's spending program.

There is as yet no tangible evidence that Mexico has begun to sell silver in this market. The fixings continue small in both spot and futures. But the market anticipates Mexico will attempt to place some silver soon and probably through a continental bank. It is therefore on the lookout for any evidence of such a move.

KENNEDY

CSB

EG

GRAY

Paris

Dated April 12, 1938

Rec'd 3:40 p.m.

Secretary of State,
Washington.

587, April 12, 5 p.m. (SECTION ONE)

FROM COCHRAN

The bill submitted this afternoon by Daladier to French Parliament consists of a ~~set~~ article seeking authority for the Government to take, up to July 31, 1938, by decrees reached in the Council of Ministers those measures judged necessary to meet requirements for national defense and to restoring the finances and economy of the nation. These decrees would be submitted for ratification during the extraordinary session of Parliament and at latest by December 31, 1938.

The explanatory note which accompanied the bill indicated that the Government would still have to raise approximately 35 billion francs to meet its requirements during the balance of the present calendar year, this borrowing made necessary largely by constantly increasing national defense expenditures.

The

-2- #587, April 12, 5 p.m. SECTION ONE from Paris

The Government plans: to reestablish budgetary unity, improve the commercial balance and augment the resources of the state through a moderate tax increase which would not harm production, resuscitation of special duties, increase of special taxes touching industries which work for national defense, revision of the customs tariff, suppression of frauds, increasing taxes applicable to industries benefitting from a de facto or de jure monopoly.

WILSON

CSB

REB

GRAY

Paris

Dated April 12, 1938

Rec'd 4 p.m.

Secretary of State,
Washington.

587, April 12, 5 p. m. (SECTION TWO)

To assist in economic recovery and particularly to alleviate the credit situation, the plan envisages concerns working for the national defense being given the privilege of drawing, in a limited measure and in accordance with strictly controlled provisions, drafts on the state eligible for discount, presumably with the Bank of France.

In view of the heavy charges facing the Government, resort to borrowing will be necessary and appeal will be made to the public largely on the grounds of national defense. Until such borrowing can be effected the Government must be given certainty of meeting its requirements and seeks a new increase of credit facilities with the Bank of France, up to a limit of 10 billion francs, it being understood that this privilege would be availed of only to the extent that normal borrowing arrangements may not provide the necessary funds.

The

REB

2-#587, From Paris, Apr. 12, 5p.m.
(Sec. Two)

The urgent program indicated above would be supplemented by group of bills to be submitted to Parliament in normal course which would be aimed at effecting economic and financial recovery of the country.

Paris exchange market has been dull all day with every one awaiting parliamentary action on the new Government's program, the announcement of which had little effect. Rentes had earlier declined and discount on forward franc widened principally because of increased strikes. Indo-Chinese Bank yesterday sold dollars importantly here on word of American spending program but sales on this side today are said to have come from New York.

(END MESSAGE)

WILSON

CSB