

DIARY

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The majority agreement with respect to the classification of loans is that the three columns in the examination report now known as slow, doubtful, and loss will be continued. Their present form, and that of the instructions to examiners as to the type of loan to be included in each of the three columns, will remain the same as at present. It is proposed to label these three columns by the roman numerals I, II and III. At the top of each page upon which this tabulation occurs, there will appear the roman numeral I and following it a definition of the type of loan which is included in the column; there will also appear roman numeral II followed by the single word "doubtful"; and there will also appear the roman numeral III followed by the single word "loss".

Where there is a recapitulation of the columns now known as slow, doubtful and loss, the same device will be used, i.e., the use of the three roman numerals as symbols with the accompanying explanation of what is included under that. As now, on the recapitulation page only the totals in columns II and III will be included in figuring the net sound capital of banks.

(It should be noted that this agreement would result in the complete elimination of the word "slow" from loan classifications.)

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The minority position with respect to the classification of loans in the examination report is that the column now known as "slow" should be eliminated from the pages upon which it now appears and that provision be made elsewhere in the report, under a heading "Loans Listed for Information or Comment", or other suitable heading, for listing, with appropriate comment, not totaled and not included in any recapitulation, such loans as the examiner feels should be set out for the information of the directors and proper officers of the bank, with the clear understanding that such loans are not being classified as doubtful or loss and are not necessarily to be regarded as criticised assets.

May 2, 1938

April 28, 1938

In 1934 with total loans in 5,275 national banks of \$7,740,596,000, national bank examiners classified 27 per cent in the slow column.

In the last half of 1937 with total loans in 5,267 national banks of \$8,933,216,400, national bank examiners classified only 9.81 per cent in the slow column.

| <u>Year</u>        | <u>Slow</u> | <u>Doubtful</u> | <u>Loss</u> |
|--------------------|-------------|-----------------|-------------|
| 1934               | 27%         | 4%              | 2.9%        |
| 1935               | 16%         | 2%              | .8%         |
| First half of 1937 | 10.68%      | 1.14%           | .65%        |
| Last half of 1937  | 9.81%       | 1.06%           | .49         |

The majority agreement with respect to the appraisal of bonds is

1. That depreciation in stock and defaulted bonds be classified as loss and that securities in these groups (III and IV) be listed and priced in the report of examination. (The minority does not disagree on this point.)
2. That depreciation on securities in group II and in the fourth grade of general market obligations in group I be deducted in the report in computing the net sound capital of the bank, and that securities in these classifications be listed and priced in the report of examination.
3. That depreciation in all group I securities except the fourth grade of general market obligations be disregarded and that these securities not be priced in the report of examination.
4. That unrealized appreciation be not allowed.
5. That a premium on bonds purchased at a premium be amortized.

The minority position with respect to the appraisal of bonds is

1. That only depreciation in stocks and defaulted bonds be classified as estimated loss, and that securities in these groups be listed and priced in the report of examination. (This is in accordance with the views of the majority.)
2. That securities in groups I and II be not priced, and preferably be not listed, in the report of examination. A complete list of all securities, however, should be attached to the report of examination sent to the Supervisory authorities.
3. That depreciation, other than in stocks and defaulted bonds, should not be taken into consideration in computing "net sound capital." On the other hand, it can not be affirmatively stated that depreciation in any securities constitutes sound capital. Therefore, the minority feels that the schedule showing a computation of net sound capital be eliminated from the reports of examination.
4. That unrealized appreciation be not allowed.
5. That a premium on bonds purchased at a premium be amortized.

May 2, 1938

The majority agreement with respect to the treatment of net profits from the sale of securities is that until adequate reserves against the securities account have been built up, all such profits should be impounded and be unavailable for any purpose other than to take care of losses resulting from the sale of securities.

May 2, 1938

The minority position with respect to the treatment of profits from the sale of securities is that

1. Estimated losses should be charged off.
2. Banks should be required to establish and maintain adequate reserves, including reserves against the securities account.
3. Banks should not be required to earmark individual items of profit, regardless of source.
4. Speculation should be severely criticised and penalized.

May 2, 1938

## TREASURY DEPARTMENT

Washington

FOR IMMEDIATE RELEASE,  
Monday, May 2, 1938.

Press Service  
No. 13-19

The Secretary of the Treasury today announced the final subscription and allotment figures with respect to the current offering of 3/4 percent notes of Series C of the Commodity Credit Corporation.

Subscriptions and allotments were divided among the several Federal Reserve districts and the Treasury as follows:

| Federal Reserve District | Total Cash Subscriptions Received | Total Cash Subscriptions Allotted | Total Exchange Subscriptions Received<br>(Allotted in full) | Total Subscriptions Allotted |
|--------------------------|-----------------------------------|-----------------------------------|---|------------------------------|
| Boston                   | \$ 135,107,000                    | \$ 10,856,000                     | \$ 2,655,000  | \$ 13,511,000                |
| New York                 | 1,006,296,000                     | 80,584,000                        | 17,770,000  | 98,354,000                   |
| Philadelphia             | 78,770,000                        | 6,327,000                         | 70,000  | 6,397,000                    |
| Cleveland                | 98,577,000                        | 7,943,000                         | 1,730,000   | 9,673,000                    |
| Richmond                 | 61,069,000                        | 4,919,000                         | 1,145,000   | 6,064,000                    |
| Atlanta                  | 47,355,000                        | 3,916,000                         | 1,100,000   | 5,016,000                    |
| Chicago                  | 136,750,000                       | 11,141,000                        | 15,915,000  | 27,056,000                   |
| St. Louis                | 49,292,000                        | 4,046,000                         | 6,930,000   | 10,976,000                   |
| Minneapolis              | 19,429,000                        | 1,631,000                         | 1,010,000   | 2,641,000                    |
| Kansas City              | 28,541,000                        | 2,325,000                         | 2,455,000   | 4,780,000                    |
| Dallas                   | 28,809,000                        | 2,360,000                         | 4,225,000   | 6,585,000                    |
| San Francisco            | 140,641,000                       | 10,994,000                        | 3,425,000   | 14,419,000                   |
| Treasury                 | 8,750,000                         | 700,000                           | -   | 700,000                      |
| <b>TOTAL</b>             | <b>\$1,839,386,000</b>            | <b>\$147,742,000</b>              | <b>\$58,430,000</b>   | <b>\$206,172,000</b>         |

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TREASURY DEPARTMENT

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INTER OFFICE COMMUNICATION

DATE: May 2, 1938

TO Secretary Morgenthau

FROM W. A. Harris

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

Prices of U. S. Treasury bonds generally were steady to slightly easier during the first two days of the past week, but subsequently resumed the upward movement, closing at new highs for the year on Saturday. During most of the week the market was rather quiet, with interest centered in the long maturities, but on Saturday the market was quite active. Reports indicate that a large part of the strength on Saturday was due to an article appearing on Dow-Jones ticker. This article briefly stated that the Treasury had redeemed 3 million special non-market notes for the Postal Savings System to supply the System with cash rather than by selling open market issues of government securities. Thus the Treasury, by this action, was refraining from checking the bond market. A similar article appeared on Dow-Jones today (Monday) when it was learned that the Treasury had redeemed 10 million of these notes for the Federal Deposit Insurance Corporation.

Net gains by intermediate and long issues ranged from 6/32nds to 11/32nds while the three shortest issues were small fractions lower. According to the average price of the 11 issues not due or callable within 8 years, Treasury bonds are more than 2 points above the April 1 low, and the highest since March, 1937.

The Treasury note market was very quiet and neglected. Quotes on any one day did not vary over 1 or 2/32nds and, for the week as a whole, are unchanged to 3/32nds lower with the exception of the 1 3/4s due December, 1942 which are 1/32nd higher.

#### Corporate Bond Market

High grade issues continued in fair demand although volume of turnover remained light. A further increase of about 1/4 point occurred in Moody's combined AAA bond price average, placing the average about 1 5/8 points above the recent low, but 2 3/4 points below the January, 1938 high.

In the second grade market further ground was lost, particularly in the rail group where most of the selling was centered. Losses in the industrials and utilities were confined to small fractions while the losses by rails ranged to several points. Moody's combined BAA average decreased about 1/2 point.

#### Dealers' Portfolio

Total holding of direct government securities and guaranteed issues by dealers declined \$11,400,000 during the past week. Changes in the individual groups, as shown below, were small.

(in millions of dollars)

|                   | <u>Holdings</u><br><u>Apr. 23</u> | <u>Holdings</u><br><u>Apr. 30</u> | <u>Change</u> |
|-------------------|-----------------------------------|-----------------------------------|---------------|
| Treasury bonds    | 49.3                              | 51.6                              | + 2.3         |
| "  notes (1 year) | 36.3                              | 33.7                              | - 2.6         |
| "  "  (1-5 years) | 60.8                              | 64.1                              | + 3.3         |
| "  bills          | 3.9                               | 0.1                               | - 3.8         |
| H. O. L. C. bonds | 14.5                              | 6.8                               | - 7.7         |
| F. F. M. C. bonds | <u>6.1</u>                        | <u>3.2</u>                        | <u>- 2.9</u>  |
|                   | 170.9                             | 159.5                             | -11.4         |

Treasury Accounts

There were no sales made in the New York market for investment accounts during the past week. However, the following purchases were made:

\$ 188,000 2 7/8% Treas. bonds of 1955/60 a/c District of Columbia -  
Teachers Retirement Fund

1,000,000 2 7/8% Treas. bonds of 1955/60 a/c Government Life Insurance  
Fund

System Account

The only transaction in the market by the Federal Reserve System during the past calendar week was the replacement of \$39,656,000 Treasury bills maturing last Wednesday by purchase of a similar total amount of 13 other issues of bills.

## TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE May 2, 1938

TO Secretary Morgenthau  
 FROM Mr. Haas *HA*  
 Subject: The Business Situation

Conclusions

While the current trend of business activity as shown by published indexes continues to decline, various basic trends which give advance indication of a turn in the business situation show definite improvement: (1) new orders have increased substantially during March and April; (2) the production in certain consumers' goods industries has turned upward; (3) a general rise in bond prices initiated by recent monetary moves has brought greater confidence to the security markets, and paved the way for an increased volume of new capital flotations.

The time which will elapse before these trends, if continued, will bring an upturn in the published business indexes will depend upon certain influences which are tending to retard recovery: (1) the continued liquidation of inventories is tending to prevent an immediate translation of new orders into production; (2) the memory of recent losses from anticipatory buying is making businessmen unusually cautious in their current buying policies; (3) an increased threat of labor difficulties, uncertainty over commodity price trends, and the prospect of reduced agricultural incomes later in the year, tend to cloud the business picture and hold back business initiative.

The conflicting trends between general business indexes like that published by the New York Times, and indications of underlying business movements such as our recently-constructed new orders index, arise largely from the fact that the general index reflects business which originated perhaps a month or more previously. At the top of a business cycle, unfilled orders may keep activity at a high level for several months after actual business has turned downward. Similarly, at the bottom of a cycle the continued liquidation of inventories may keep industrial activity depressed for some time after the actual turn in the underlying trend, the time depending somewhat upon public sentiment regarding price trends.

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The general outlook

An upturn in business activity next fall is widely expected, based on the belief that Government spending will at that time be getting under way, that the change to new models in the automobile industry will be followed by a revived new-car demand, that inventories will have been reduced to normal or below normal, leading to a stepping up of industrial production, and that the cumulative effects of recent monetary moves will have strengthened commodity and security prices. Such an upturn would not be likely to occur suddenly, however, but preliminary evidence of a reversal of trend should be apparent several months in advance. Following the initiation of the Government's recovery program, one should be able to determine from sub-surface indications whether the program is taking hold, regardless of the immediate trend in general business indexes.

Is business making such a turn? Evidence has appeared in at least three important directions indicating an underlying improvement, which should later be reflected in the published indexes of business activity.

(1) Probably the most fundamental indication of actual business is that provided by new industrial orders. These improved sharply during March, and have shown a further improvement in April, after announcement of the recovery program. We have constructed a composite monthly index of new orders from data received from companies reporting confidentially to the Treasury and from various published data, weighted by the relative importance of each industry. This index, which is the only composite index of new orders available, is presented in Chart 1, in comparison with the F.R.B. adjusted index of industrial production. It will be noted that the trend of new orders which turned downward last spring, initiating the fall business decline, stopped its decline in January and February and turned sharply upward during March.

The unadjusted F.R.B. index of manufactures, which excludes mining, provides a somewhat better measure of the actual trend of business activity, since seasonal adjustments frequently obscure underlying tendencies. In Chart 2 we show this index in comparison with our index of new orders. It will be seen that the peak in the unadjusted index of manufactures was reached in April, 1937, shortly after the peak in new orders, and that an upward movement accompanying the increase in orders has already begun.

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In Chart 3 we show a breakdown of the new orders index as between different industries, arranged to indicate the relative contribution of each industry to the total. At the top of the chart a comparison is made between the trend of new orders and the New York Times adjusted index. The tendency of the latter index to be misleading at a time when business is reversing its direction is clearly indicated by its making a new high last August, when the basic trend of business as shown both by our new orders index and by the F.R.B. index of manufactures had several months previously turned downward.

(2) Consumers' goods industries are recognized as normally being first to revive after a business recession. Certain industries in the consumers' goods group have already started a recovery, after reaching their lows several months ago. In the following table we show recent index figures for these industries, seasonally adjusted, together with the low point and date:

|                  | : Low | : Month of low | : February | : March |
|------------------|-------|----------------|------------|---------|
| Wool goods       | 51    | November       | 61         | 54      |
| Boots and shoes  | 84    | November       | 116        | 120     |
| Tobacco products | 155   | November       | 157        | 160     |
| Silk goods       | 69    | December       | 88         | 100     |
| Cotton goods     | 82    | January        | 85         | 89      |
| Rubber tires     | 56    | February       | 56         | 61      |

(3) An upturn in bond prices has begun, following the increase in excess bank reserves by recent monetary moves. Commenting on the initial rise in Government bonds, the Wall Street Journal stated that the real problem at that time was "to improve materially the more speculative bonds and stocks, to induce a better market for 'venture' money. This money will build the houses and industrial plants that will relieve the Government of the necessity for deficit financing." The rise has since spread to municipal and corporate bonds and to the speculative issues. It is thus tending to restore confidence in the security markets, and to pave the way for an increased volume of new capital flotations. (See Chart 4).

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The fact that industrial production has for some time been running at a lower level than apparent consumption suggests that inventories are being steadily reduced, and that eventually an upturn in production will be required to satisfy even present requirements.

#### The steel situation

An illustration of the current low level of production in relation to actual orders is seen in a comparison of steel orders with steel production. New orders received by the U. S. Steel Corporation have increased for three successive weeks, the latest figure representing an order volume equivalent to about 45 percent of capacity. The operating rate during April has remained practically unchanged around 32.5 percent, suggesting either that shipments are being made from inventories or that unfilled orders are accumulating.

During the past three weeks the orders received by the U. S. Steel Corporation have been about 40 percent in excess of production. Since it appears entirely unlikely that the Corporation is shipping 40 percent more than its production, the excess orders must represent some accumulation of unfilled orders that may later be reflected in increased activity. During the current week, although operations decreased in certain steel districts, the important Chicago district showed a gain of 4 points to 54 percent of capacity, largely because of increased railroad and automobile demand, and operations in the Wheeling region were up 11 points to 68 percent of capacity.

Although some improvement in steel demand from the automobile industry is reported recently, this industry continues to operate largely on inventories built up a year ago. It appears that the inventories accumulated last summer were large enough to carry the companies through practically an entire season with scarcely any additional buying. A general shutdown by the automobile companies for extensive model changes, expected to begin about July 1, should have no unfavorable effect on steel activity, since they have been buying practically no steel. On the contrary, it is believed in the steel industry that the automobile companies will begin stocking steel products for their new models around that time.

#### Time of upturn not definite

While an upturn in business has usually followed rather promptly after a marked upturn in new orders, certain influences at present are tending to postpone the beginning of recovery. Of major importance is an apparent tendency to

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continue the liquidation of inventories, and to continue a hand-to-mouth buying policy, on the fear of still lower prices. One may well question whether business is not making the same mistake in following a policy of extreme liquidation as it made last year in following a policy of inventory accumulation on the belief in inflation. Nevertheless, so long as this continues it will prevent new buying from being reflected immediately in increased industrial production.

Businessmen are doubtless unusually cautious in their present buying policies because many were severely "burnt" last year in buying too much, and are taking care not to repeat the experience. Furthermore, they are letting inventories run down because small inventories seem normal at the present low level of sales, and seem "good business" when prices are declining.

The clouding of the business outlook by the recent outbreak of labor troubles, by uncertainty over the outlook for agricultural buying in view of declines in agricultural prices, and by general uncertainty over the price outlook, are further factors tending to keep the underlying improvement from being immediately reflected in increased business activity.

#### The price situation

The failure of commodity prices to show more improvement after announcement of the recovery program, and their declining tendency during the past week, appear to indicate that the inflationary aspects of the program have for the time being been overshadowed by other influences. Apprehension over the ultimate effect of the spending program in raising taxes appears in particular to have had some dampening effect on public sentiment, judging from the stress placed on this section of the program in editorial comment and financial reviews.

The attitude of buyers now appears to be that of awaiting definite evidence of price and business improvement before revising their present cautious buying policies. The New York Cotton Exchange Service expresses the general feeling in saying that "while sentiment in the cotton trade has improved as a result of the recovery program, neither the fear of inflation nor the confidence of business in profit possibilities is sufficiently widespread to start heavy anticipatory buying."

The current reaction of the public to the recovery program, however, has no necessary relationship to their later reaction. While the prospect of further deficit spending may unfavorably

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affect sentiment temporarily, before the spending has had time to affect industrial demand, its eventual effect should undoubtedly be to increase prices. In the meantime, the two monetary measures will continue to work mechanically toward this end, despite the fact that their immediate psychological effect has been relatively small.

In the stock market, the drying up of activity on the decline this week provides some encouragement to those who believe that the more important trend at the moment is upward. Surprisingly good earnings statements of the two leading steel companies, indicating that their "break-even" point in the first quarter was around 36 per cent of capacity, tended to improve sentiment. General upturns in the stock market are often anticipated by individual groups which turn up against the general trend. The aircraft group recently has shown independent strength because of its current high rate of operations and the possibility of an increased export business, and stocks in this group are now selling at close to their highs for the year.

#### The longer term trend

Although the evidence cited appears to indicate a turn in the underlying business trend, and provides the basis for our optimism over the business outlook, it does not suggest how extensive the upturn may be when it occurs. If new factors should arise to prevent private enterprise from taking over the reins after an initial period of Government pump priming, it is possible that a short recovery may be followed by a further recession. To make sure that no failure occurs in the critical period of transition from Government spending to private spending, such as occurred in 1937, all possible avenues for private spending should be opened as rapidly as possible. The transition may then be made gradually, under a carefully planned program, while business is in a strong forward movement.

# COMPARISON OF NEW ORDERS WITH INDUSTRIAL PRODUCTION

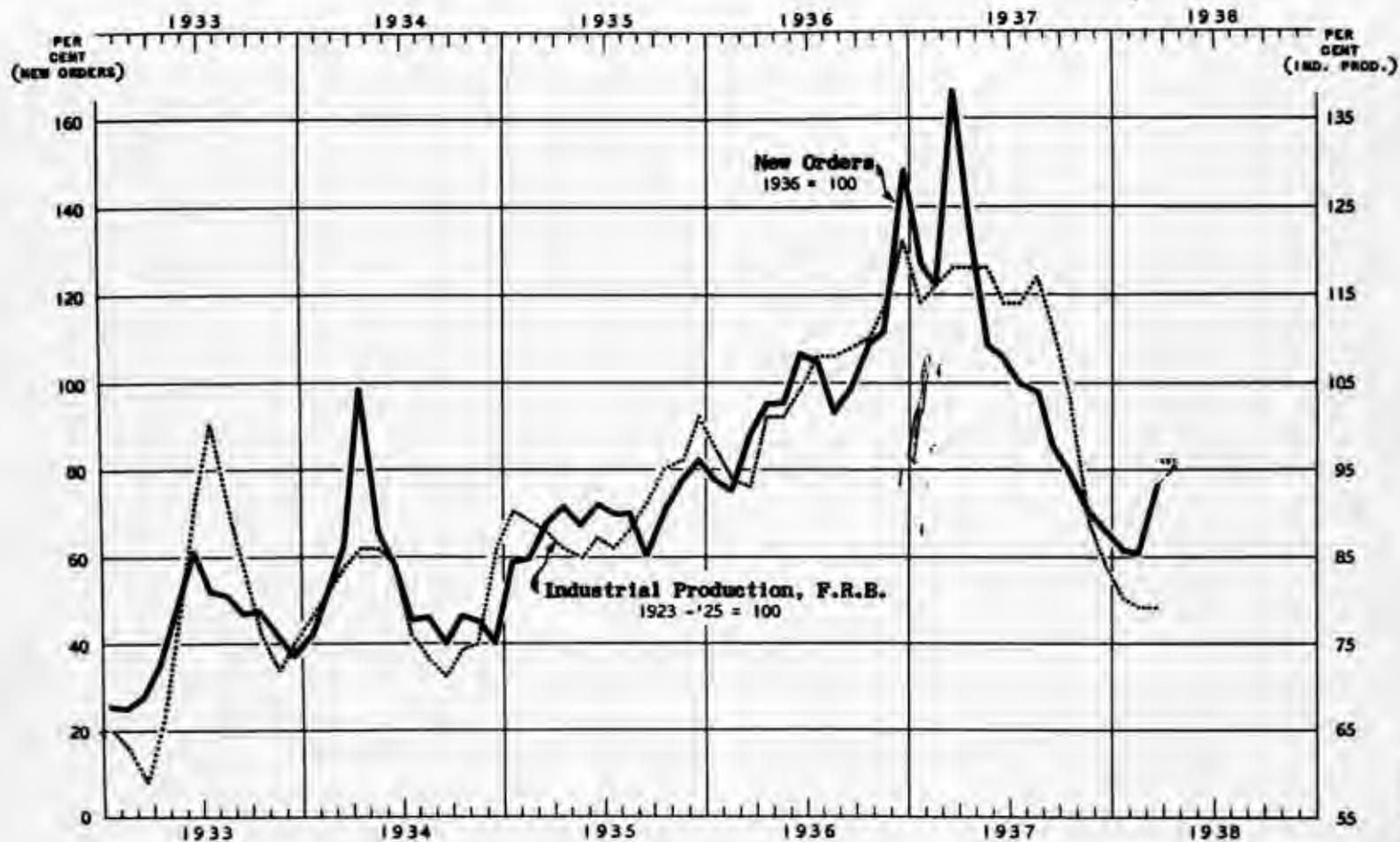


Chart 1

# COMPARISON OF NEW ORDERS WITH FACTORY OUTPUT

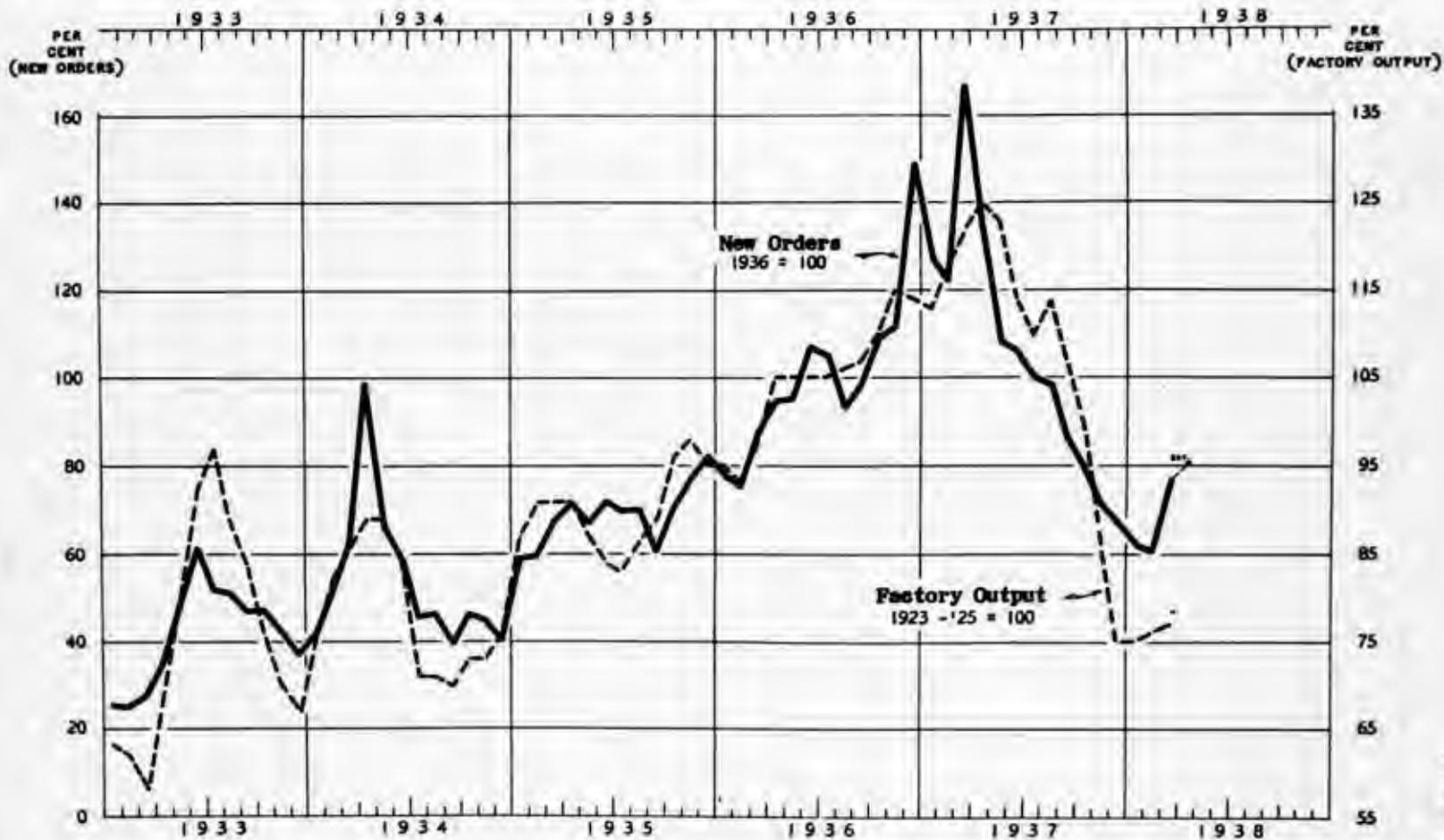
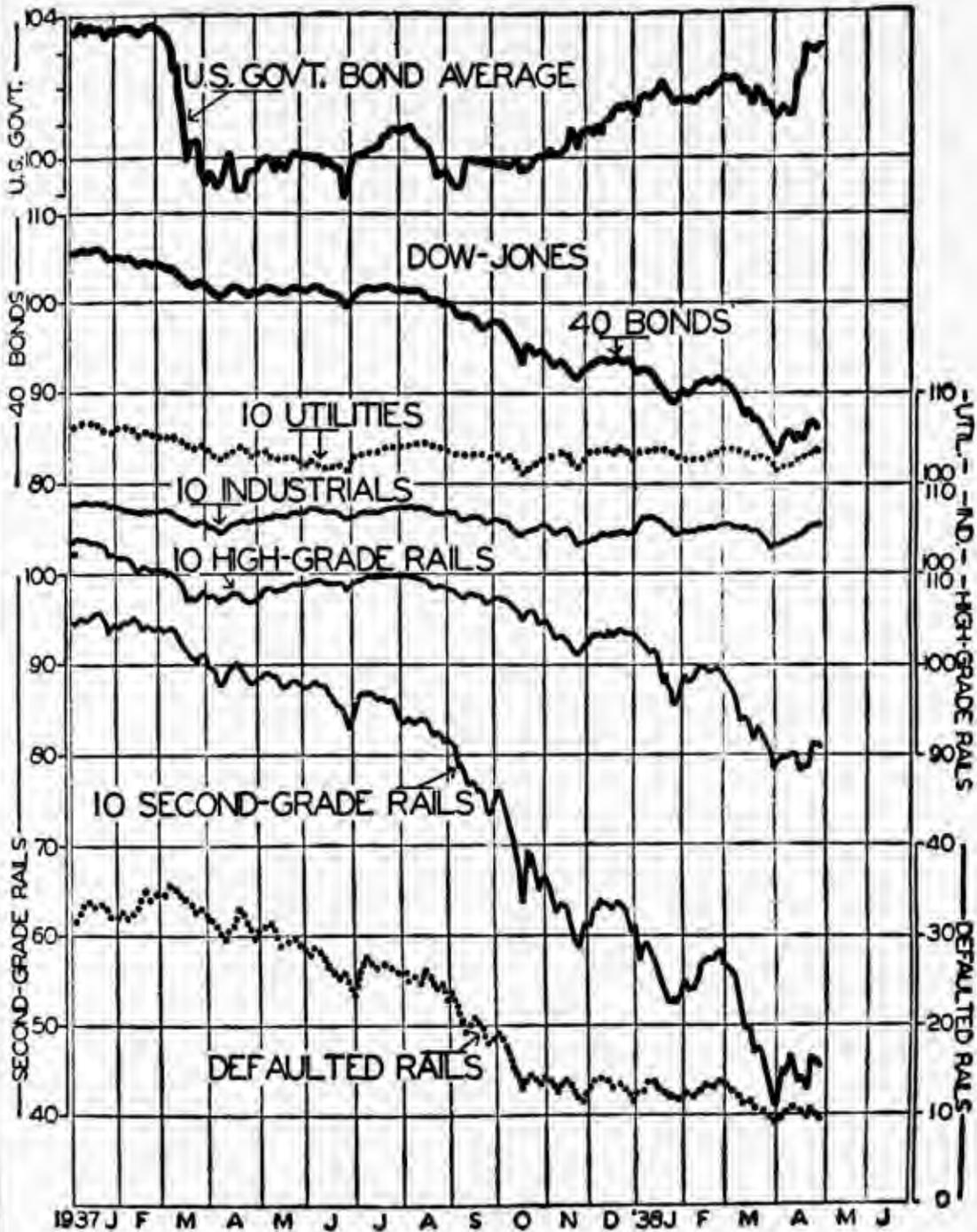


Chart 2



# BOND PRICE COMPARISONS



FROM BARRON'S WEEKLY, MAY 2, 1938



MAY 2 1938  
PAGE 409

# MOODY'S STOCK SURVEY

Copyright, 1938, by MOODY'S INVESTORS SERVICE, 65 Broadway, New York

VOLUME 30, No. 18

MAY 2, 1938

ESTABLISHED 1909

Published Mondays. Subscription rate \$100.00 per annum. With Moody's Bond Survey \$150.00 per annum. Entered as second-class matter January 6, 1906, at the post office at New York, N. Y., under the Act of March 3, 1879.

## Stock Review and Outlook

Lack of tangible evidence of business improvement and a succession of unstimulating earnings reports discouraged sentiment and depressed prices most of last week.

Although the markets may vacillate indecisively for a further period and at times show greater weakness, the important investment consideration is that business is making a slow turn for the better, as a result of which the next longer trend in the markets should be upward.

\* \* \*

### Stock Market Position

Although the month of April enjoyed a rebound from the pessimistic market which was seen at the end of March, stock prices have continued to move uncertainly. The price level seems to be affected now by hopeful, now by fearful sentiment.

There are possibilities that before any really pronounced trend gets under way, the market will be further influenced by the less cheerful side of things. At least no one should be surprised if a reactionary tendency should prevail for an interesting period as it did last week.

\* \* \*

There are two distinct schools of thought within the financial community which seem to be holding continuous debate on the present situation. The more optimistic contends that present earnings do not at all justify the present price level of stocks, but that the labor and political situations together provide no inspiration for an early revival in business activity and that, basically, the deflation in prices and wages which we have already had is insufficient to make a solid or healthy base from which recovery could proceed. Therefore, so this point of view holds, stocks must decline so as to become more in line with the present rate of earnings.

The other side of the argument is that while earnings are low in relation to prices in many individual cases, such a condition is inevitable at depression bottoms; that we have had sufficient deflation to permit a recovery slowly to get under way, wherefore the stock price level will come to be justified in no great length of time, since stock prices must reflect the future as well as the present; that some basically good things are happening from a political standpoint, such as the tax revision which is being undertaken, the increasing trend in Congress to act in such a way as to encourage business, and the breaking up of the solid New Deal front; that, in the meantime, the longer range fear of inflation (whether justified or not) tends to prevent liquidation of stocks and that another factor tending to support the stock price level is the extraordinarily low level of money rates, which makes for so little incentive for investors to switch into fixed-income securities.

\* \* \*

As long as recovery does not make its appearance—as long, that is, as the indexes of industrial activity show no gain—the more pessimistic view may, at any point, tend to have the better of the argument in the market itself. That is why reactionary trends of intermediate duration should

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Source: Bureau for Moody's Weekly Business Index (1926-1931) and Daily Commodity Index (Jan. 24, 1927) to date.

|                 |         |         |        |       |         |         |
|-----------------|---------|---------|--------|-------|---------|---------|
| Week Ended      | Apr. 29 | Apr. 12 | Apr. 1 | 31/3  | Mar. 27 | Mar. 12 |
| Business Index  | 142.5   | 142.8   | 142.1  | 141.0 | 138.8   | 138.0   |
| Commodity Index | 142.5   | 142.8   | 142.1  | 141.0 | 138.8   | 138.0   |

surprise no one. If the old lows of a month ago should be tested, it would be perfectly normal.

That the market will test the old low points is not, of course, at all a foregone conclusion. But it is a possibility based on the slowness with which business activity appears to be turning around. There is no question but that a lack of dynamic upward force exists in the present environment. And no new energy of this rapidly moving sort has been supplied by the Government's spending program, even though the net effect of it should be a stimulus.

\*\*\*\*\*

Nevertheless, as between the two viewpoints, the more hopeful one is the more logical. Current earnings statements do not in many cases, of course, make pleasant comparisons with existing stock price levels, but during all depressions the price-earnings ratios become abnormal in one direction or the other. Deficits are the rule in such times, yet no one pays to have stocks taken off his hands, although that would be the logical process if price-earnings ratios were to remain uniform.

The real question, therefore, is whether recovery will indeed develop before long. The economic and

financial reasons why such a movement should emerge from the present environment have been set forth from time to time, here, over the past six or seven weeks.

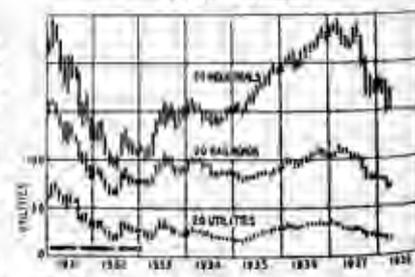
There is a propensity to say, at this time, the spring recovery has failed and that the next point of revival cannot be expected before autumn. The point of view is frequently expressed in print as well as by word of mouth. But to have recovery recognizable by fall, it would seem that the cyclical bottom of depression should be occurring now, or not later than June at latest.

Although it is not suggested that we must in the present instance follow precedents, it is interesting to note that in past experience business cycle low points have been far more frequently established in the first half of the calendar year, and in the early part of the first half—than at any other time. Thus the actual record of important cyclical low points of depressions since 1854 (excluding the Civil War period), according to the Annalist Institute of Business Activity, is as follows:

|               |               |            |
|---------------|---------------|------------|
| 1854—December | 1894—June     | 1921—March |
| 1856—January  | 1896—December | 1924—June  |
| 1871—March    | 1907—April    | 1929—March |
| 1884—February | 1914—December |            |

In a slow, rounding bottom, which is the sort of turn we seem likely to have in the present situation, the month which turns out to be the lowest will be extremely hard to recognize except later on, in hindsight. Ever since January the movements of business indexes, from month to month, have been at very gradual angles. The percentage change from month to month has been of a magnitude which might appear at any stage, even in a period

MONTHLY RANGE OF STOCK PRICES (Dow-Jones Average)



Note: Last data plotted is April 24, 1934.

of prosperity. So that when seasonal corrections are made it is difficult to say whether, for example, March will prove to have been higher or lower than April.

To have other than a slow, rounding bottom, it would seem necessary that a period of violent wage and price cutting should set in or that some other depressant should appear, so that a new sharp drop in business activity would first occur. But wage and finished goods price cutting does not seem to be occurring and the evidence from industrial areas is that general and widespread wage rate cutting is not in sight and that, in many lines, the efficiency or productivity of labor has increased greatly over the past few months. All of which suggests that the present price and wage level is being frozen into the structure for the present and in a way which will not induce manufacturers to defer operations on the expectation of reducing costs by the wage-rate route.

## Industry Prospects

Under this heading are discussed each week the industry or industries which are currently commanding the interest of investors, or which for important reasons should be considered by investors.

\*\*\*\*\*

### Agricultural Implement Industry

Earnings of agricultural implement manufacturers may be expected to show smaller declines this year than will the earnings of most industrial companies, but as a group, implement manufacturers appear to have less to gain in volume of business and increased earnings (with business recovery) than do many other groups. The shares of the leading companies are regarded as reasonably priced in the current market on the basis of 1937 and probable 1938 results, and these stocks may be expected to participate in any broad rise in the stock market, but as compared with shares in such industries as building, industrial machinery, electrical equipment, steel and motors, the stocks appear to offer less promise of growth and capital appreciation.

The longer this goes on, the nearer to fruition will come the government spending program and the better the inventory position will be. Consequently, it seems a very excellent possibility that the real low point in business is either just past or is at this time immediately upon us.

\*\*\*\*\*

Periods such as the present are extremely trying to the stock investor's patience. A year ago no such psychological difficulties beset him. The typical investor was then pretty fully content as to how things were going, even though, in actuality, he stood at the edge of a steep decline.

Today when no decisive movements are occurring in either direction and when pessimistic forebodings tend at times to overcome the market, he would seem to stand in no such real danger. He may have temporary anguish when these more hopeless moods overtake the market, but from a basic standpoint the market seems to be in the process of an irregular and confused turning for the better.

Two important factors have operated to produce the great increase in implement company earnings in the years since 1932. First and most important was the improved economic status of the farmer, resulting partly from political favor, and second, the successful and efficient motorization of smaller type implements, especially tractors.

From 1932 to 1937 total farm cash income of the nation increased from \$4.3 billions to \$8.5 billions and during the same period net cash income of farmers rose from \$1.5 billion to about \$4.5 billions. The curves of total cash income and net cash income of farmers are shown on an accompanying chart.

Purchases of agricultural implements and prosperity of implement manufacturers fluctuate with net income rather than with total cash income, inasmuch as implements are highly deferrable items and are bought in years when a good surplus remains after farmers' total production expenses which are relatively inflexible in some important respects. It may be observed that the curve of earnings of eight implement companies in the chart "Agricultural Implement Industrial Activity vs.

Farmers' Expenditures and Exports\* (shown on page 412) more closely parallels the curve of net cash income than the curve of total cash income, both of which are shown in the graph "Total Farm Cash and Net Income and Net Purchasing Power Per Capita."

Agricultural implement company earnings increased in each of the five years following 1932. In 1929 eight agricultural implement manufacturers earned a total of \$76.3 millions, but in 1932 showed a combined deficit of \$28.6 millions. In 1937 earnings of these companies had recovered to \$15.4 millions.

The position of the farmer has deteriorated over the past twelve months. It is quite early to estimate farm income for 1938, but on the basis of evidence available it seems not unreasonable to believe that total farm cash income in 1938 may be \$1 billion or more below 1937. This would indicate a figure between \$7 billions and \$7.5 billions. Indicative of the changed position of the farmer as compared with a year ago are the changes in

indexes of prices paid by farmers for articles purchased and prices received by farmers for products sold.

The index of prices received by farmers in the first three months of 1938 averaged 98 as contrasted with an average for the first three months of 1937 of 129. In contrast the index of prices paid by farmers averaged 126 in the first quarter of 1938 as compared with an average of 131 for the first three months of 1937. The ratio of prices received to prices paid measures the purchasing power of farm prices and this index of purchasing power declined from 98 in the first quarter of 1937 to 78 in the first quarter of 1938. This decline, of course, is offset to some extent by the large volume of marketings.

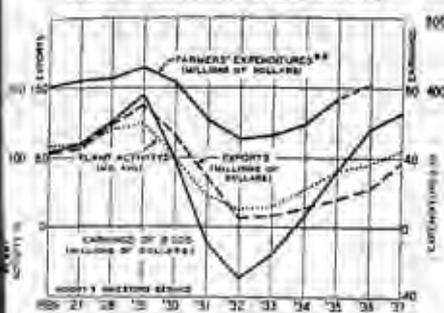
Farm income shows a seasonal increase from March to October and the next six months may bring about some improvement in the position of the farmer, especially with general business improvement, but that total farm income for 1938 will be below that of 1937 appears reasonably

COMPARATIVE STATISTICS—AGRICULTURAL IMPLEMENT STOCKS

| Company | 1937 | 1936 | 1935 | 1934 | 1933 | 1932 | 1931 | 1930 | 1929 | 1928 | 1927 | 1937   |             | 1936   |             | 1935   |             | 1934   |             | 1933   |             | 1932   |             | 1931   |             | 1930   |             | 1929   |             | 1928   |             | 1927   |             |
|---------|------|------|------|------|------|------|------|------|------|------|------|--------|-------------|--------|-------------|--------|-------------|--------|-------------|--------|-------------|--------|-------------|--------|-------------|--------|-------------|--------|-------------|--------|-------------|--------|-------------|
|         |      |      |      |      |      |      |      |      |      |      |      | Assets | Liabilities |
| Case    | 100  | 100  | 100  | 100  | 100  | 100  | 100  | 100  | 100  | 100  | 100  | 100    | 100         | 100    | 100         | 100    | 100         | 100    | 100         | 100    | 100         | 100    | 100         | 100    | 100         | 100    | 100         | 100    | 100         | 100    | 100         | 100    | 100         |

\*-1937 and 1938 are based on 12 months ending 12/31/37 and 12/31/38 respectively.  
 \*-1936 figures are based on 12 months ending 12/31/36.  
 \*-1935 figures are based on 12 months ending 12/31/35.  
 \*-1934 figures are based on 12 months ending 12/31/34.  
 \*-1933 figures are based on 12 months ending 12/31/33.  
 \*-1932 figures are based on 12 months ending 12/31/32.  
 \*-1931 figures are based on 12 months ending 12/31/31.  
 \*-1930 figures are based on 12 months ending 12/31/30.  
 \*-1929 figures are based on 12 months ending 12/31/29.  
 \*-1928 figures are based on 12 months ending 12/31/28.  
 \*-1927 figures are based on 12 months ending 12/31/27.

AGRICULTURAL IMPLEMENT INDUSTRY ACTIVITY AS INDICATED BY FARMERS' EXPENDITURES AND EXPORTS



Index of man-hours worked in agricultural implement factories (1927=100). \*\*Statistical term agricultural machinery, tractors and tools (U. S. Department of Agriculture).

gain. In the first three months of this year benefit payments of \$108 millions were below benefit payments of \$207 millions in the first three months of 1937, but increased benefit payments over coming months are virtually assured.

Under the new AAA the scope of Government financial support to agriculture is enormously increased and should tend to stabilize total farm income. Only a combination of an extremely plentiful harvest and a poor industrial situation could lower this year's farm receipts below the figures estimated above.

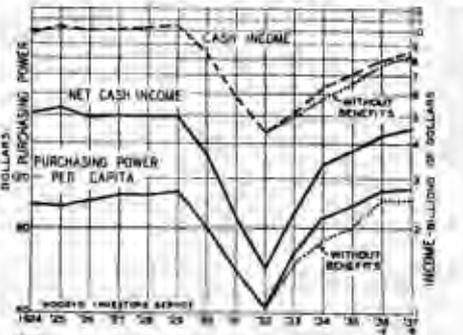
The farm implement industry has thus far felt the effects of recession to a far less extent than have most industries. An index of factory employment in agricultural implement factories, for instance, declined from October, 1937 to February, 1938, by only 26 index points as compared with a rise from November, 1936, to October, 1937 of 88 index points, and a rise from September, 1934, to October, 1937, of 129 index points. At a time when many industries are back to 1935 and even 1934 levels, maintenance of activity above 1936 levels constitutes evidence of unusual resistance to the forces of depression. The reasons are that the industry is reaping the benefits of the large farm income of last year and that farmers have been encouraged by a favorable planting season and assurance of liberal Government aid.

Activity in the industry may be reasonably well maintained for some further period, but some decline in activity is indicated for later in the year. It is not believed that there will be any drastic decline in the purchase of machinery, but it is probable that the conjunction of favorable factors that resulted in the large volume and good earnings in 1937 may not be repeated for some years.

Farmers stocked up heavily on machinery in recent good-income years, and although the new small tractor developed in recent years may continue to experience a good demand for a considerable further period, the industry will not have for the next several years at least the benefit of the huge replacement demand which existed several years ago.

Profit margins in the industry are not readily ascertainable, but doubtless these have been narrowed by higher costs in this industry as elsewhere. It is interesting to observe the impairment of financial condition experienced by the leading companies in 1937. In the attached table of "Comparative Statistics" it may be seen that each of the companies reported lower ratios of current assets to current liabilities at the end of 1937 as compared with 1936 and each reported an increase in inventories in 1937. All but one of the companies reported an increase in receivables. These trends are the natural reflection of a period of active business

TOTAL FARM CASH AND NET INCOME AND NET PURCHASING POWER PER CAPITA



\*Statistical term, average per farm family.  
 Note: Source for cash income, U. S. Department of Agriculture. Other figures are estimated by Moody's Investors Service on the basis of Government statistics. Purchasing power per capita is not income-adjusted for farm family cost of living and for farm population.

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and have not gone sufficiently far to cause any apprehension with respect to the financial standing of the companies, but may have some future effect on earnings in the event that business volume declines more than anticipated.

In view of the relatively favorable start the industry had in 1938, the good assistance it has shown thus far to depressed business conditions, and the usual lag shown in farmers' purchases of implements (as compared with farm income) earn-

ings of the industry in 1938 may be reasonably well maintained. The stocks at recent prices are considered unduly high and do not embody more than average market risk, but the strong suggestion that the industry passed a cyclical peak in 1937, which may not again be approached for a period of years, indicates that shares in companies in other industries, which show promise of cyclical revival over the future, offer more interesting investment opportunities at the present time.

### Individual Stocks

#### Watts Machine Company Stock

The company appears to have avoided and averted all depression and although benefits will accrue from improving general business conditions other companies are believed to offer superior opportunities for investment for capital appreciation.

| From                    | Earnings—1937 | Earnings—1938 | Dividends—1937 | Dividends—1938 | Recent Price |
|-------------------------|---------------|---------------|----------------|----------------|--------------|
| Watts Machine Co. Stock | \$2.81        | \$4.00        | \$1.75         | \$1.00         | 33 1/2       |
| Link Belt Co. Common    | 2.47          | 2.97          | 1.00           | 0.25           | 36           |

**Watts Machine Company** is one of the largest manufacturers of heavy machinery for steel mill operations. Recent years have witnessed a number of large installations of new plants by steel companies, especially plants for the production of light steel. Watts Machine has benefited directly from this expansion program as evidenced by the sharp recovery in earnings in recent years. Earnings per share of stock were \$1.47 in 1934, \$3.11 in 1935, \$4.26 in 1936 and \$4.67 in 1937.

Unfilled orders of the company were \$14.4 millions at the end of 1936, reached a peak of around \$24 millions on June 30, 1937, fell to around \$21 millions as of the end of September and were \$13 millions at the end of the year.

Last year the company made important additions to plant capacity and last spring in common with many other companies raised wages. It was reported last summer that the capacity of the company's plants had been increased 20 per cent. during the preceding year and that expenditure of another \$1 million for expansion would be required before the end of the year. Last March common labor was raised to 64 1/2 cents an hour and rates

of all other employees were increased 10 cents an hour. The increased overhead as a result of high wages and salaries and expanded plant are expected to weigh unduly on the company over a period of time, but the probable resultant lowering of profit margins and the improbability of an early recurrence of the sizable orders received by the company from practically all the leading steel companies in recent years suggest that considerable time may elapse before earnings can reach 1937 levels.

The financial position of the company at the end of last year was adequate; current assets were \$2 millions, current liabilities \$6.2 millions and net working capital \$5.6 millions. The company will benefit from improving general business conditions anticipated over the balance of 1938, but it is believed that the securities of other companies offer more favorable investment opportunities.

**Link Belt Company** sells to practically all manufacturing industries. The company makes products designed to lower costs and increase the efficiency of manufacturing operations. Conveying, elevating and transmission machinery, used for various assembling and distributing operations are the company's most important products.

Earnings expanded from 94 cents per share in 1934 to \$1.29 in 1935, to \$2.97 in 1936 and \$4.67 in 1937. Undoubtedly earnings for 1938 will be below those recorded for 1937 (earnings for the first quarter of the current year were equal to 64 cents per share compared with \$1.01 per share for the comparable quarter of 1937), but the intense competitive situation in most industries and the (long range) increasing burden of labor and material promise an early revival in demand for the

company's products with betterment in general business conditions.

The company was in strong financial circumstances at the end of last year. Current assets were \$14.7 millions, current liabilities \$2.7 millions and working capital \$12 millions. There are outstanding 709,177 shares of common stock and 32,775 shares of 6 1/2 per cent. preferred stock.

The company is in a type of business that is expected to show excellent growth over a period of years and for purposes of capital appreciation during a period of cyclical business improvement the stock holds considerable interest and attraction.

#### Union Pacific Railroad Company 4 Per Cent. Non-Cumulative Preferred

The stock appears attractive at current levels for semi-investment purposes and purchase is recommended.

|   | Earnings—1937 | Earnings—1938 | Dividends—1937 | Dividends—1938 | Recent Price |
|---|---------------|---------------|----------------|----------------|--------------|
| Union Pacific R.R. Co. 4% Non-Cum. Pfd. | \$17.74       | \$22.31       | \$4.00         | \$2.00         | 60           |

Just how quickly investment sentiment can change is well illustrated by Union Pacific Railroad Company 4 Per Cent. Non-Cumulative Preferred Stock. A little over a year ago this issue sold at 100, a new high record price for all time; recently it sold as low as 60—the lowest level recorded since 1933 and a price below which the stock was sold on only a few occasions since it was issued about 40 years ago.

From an earnings standpoint the preferred stock of the Union Pacific Railroad Company is situated as well as, if not stronger than, most railroad bonds of good quality. This is, perhaps, best indicated by the fact that fixed charges and preferred dividend requirements were earned about 85 times on the average in the seven years 1931-1937.

|                                    | 1937    | 1936    | 1935    | 1934    | 1933    | 1932    | 1931    |
|------------------------------------|---------|---------|---------|---------|---------|---------|---------|
| Times Fixed Charges Earned         | 124     | 141     | 127     | 129     | 141     | 139     | 130     |
| Times Preferred Dividends Earned   | 122     | 136     | 127     | 128     | 140     | 138     | 129     |
| Times Per Share of Preferred Stock | \$17.74 | \$22.31 | \$16.62 | \$12.50 | \$12.50 | \$12.50 | \$12.50 |

Despite the current low level of business and the low railroad earnings that are being reported, there is not much question but that Union Pacific will this year earn fixed charges and preferred dividend requirements and possibly as much as \$6 per share on the common stock, the dividend rate that has been in effect since 1932. That results for the current year will be as satisfactory as just out-

lined is probably not generally expected at this time, as may be gathered by the relatively low prices prevailing for the stock issues. However, as indicated below by the comparison of operating revenues and net operating income for the first quarter of 1938 with previous corresponding periods, there is nothing in earnings reported so far this year to indicate that satisfactory results will not be obtained by Union Pacific during the current year.

|                    | Operating Revenues | Net Operating Income |
|--------------------|--------------------|----------------------|
| First Quarter 1938 | \$7,477,000        | \$2,082,000          |
| First Quarter 1937 | \$7,421,000        | \$2,121,000          |
| First Quarter 1936 | \$7,200,000        | \$2,077,000          |
| First Quarter 1935 | \$7,477,000        | \$2,121,000          |
| First Quarter 1934 | \$7,477,000        | \$2,121,000          |
| First Quarter 1933 | \$7,477,000        | \$2,121,000          |
| First Quarter 1932 | \$7,477,000        | \$2,121,000          |

The company's financial position is unquestionably strong. At the end of February last, current assets were \$45,293,000 including \$5,091,000 cash, compared with current liabilities of \$18,609,000. In addition, there was an investment of \$163,787,000 in stocks and bonds of non-affiliated companies, including close to \$20,000,000 in United States Government bonds. All of these amounts are highly substantial in relation to annual fixed charges amounting to \$14,255,000 and annual preferred dividend requirements of \$3,984,000.

The dividend on Union Pacific Railroad Company 4 Per Cent. Non-Cumulative Preferred Stock is considered well protected and likely to be paid in bad years as well as good. At this time, that is, at prices in the 60's, attractive semi-investment value is offered and purchase is recommended.

#### First National Stores, Inc. Common

Earnings of the company appear to be in a long downward trend and are unlikely to be greatly aided by a period of general business improvement. An outlook from the common stock is rather bleak and purchase is not recommended.

|                                    | Earnings—1937 | Earnings—1938 | Dividends—1937 | Dividends—1938 | Recent Price |
|------------------------------------|---------------|---------------|----------------|----------------|--------------|
| First National Stores, Inc. Common | \$5.81        | \$4.17        | \$2.50         | \$0.00         | 27 1/2       |
| Fairbanks, Morse & Co. Common      | 2.45          | 2.42          | 1.00           | 0              | 30 1/2       |

From 1 dividend payment previous payment 20 cents on March 1.  
**First National Stores, Inc.**, for the fiscal year ended March, 1938, will probably report the smallest earnings for many years. The trend of earnings by quarters for the first nine months of the company's fiscal year is shown on the following page.

## FIRST NATIONAL STORES INC. QUARTERLY NET INCOME

| Three Months to June 30, 1937 | 1937        | 1936        |
|-------------------------------|-------------|-------------|
| Net Income                    | \$1,770,000 | \$1,770,000 |
| Per Share                     | \$1.25      | \$1.25      |
| Three Months to Dec. 31, 1936 | \$1,770,000 | \$1,770,000 |
| Net Income                    | \$1,770,000 | \$1,770,000 |
| Per Share                     | \$1.25      | \$1.25      |

Three Months to June 30, 1937 and 12 months to December 31, 1936.  
Three Months to December 31, 1937 and 12 months to December 31, 1936.

The company is a prominent New England grocery chain system which at last reports operated 2,473 units, of which 458 were markets. The unfavorable profit showing in 1937 was a reflection of higher operating costs and expenses, such as wages, social security taxes and other taxes and a highly competitive price structure within the grocery field. The recession in general business also had its effect.

Formerly declines in wholesale food prices widened grocers' margins to a fair extent, but recently the severe competitive situation has resulted in lower selling prices quickly following lower wholesale prices, without benefit to grocers' margins of profit.

The probability is that March quarter earnings will continue to reflect the unfavorable trend inasmuch as the adverse factors present in 1937 continue in form. The company, which constitutes a highly efficient unit in its field, may derive some benefit from an improving business situation later in the year, but the narrow profit margin resulting from intensely competitive conditions, the inherent stability of sales, the persistent rise in operating expenses and the relatively unfavorable political

environment of chain stores—all suggest limited participation by the company in a period of industrial revival and relatively limited appreciation prospects for the common shares.

**Fairbanks, Morse & Company's** business follows closely the trend of general business conditions so that with general business betterment the company's earnings may be expected to expand. The stock is regarded as one of the more attractive for investment for capital appreciation during a period of cyclical betterment.

In order of importance the company's several divisions of activity comprise the manufacture and sale of: (1) Diesel and other internal combustion engines; (2) scows; (3) electric motors, generators and magnets; and (4) pumps and pump equipment. The company also manufactures railroad equipment and a diversified line of home and farm appliances.

The company is in strong financial circumstances. Capitalization consists of \$5,661,263 Debenture & 1935, 10,958 shares of 6 Per Cent Preferred Stock (convertible into 2½ common shares until February 28, 1939) and 598,526 shares of common.

Any improvement in general business conditions should find quick reflection in the sales and earnings of Fairbanks, Morse & Company and appreciation of the common shares during a period of well rounded industrial recovery could assume substantial proportions.

## Review of Previous Recommendations

**Bethlehem Steel Corporation Common—The stock qualifies for retention.**

Bethlehem Steel Corporation reported net income of \$10,000 for the first three months of 1938, equal after preferred dividend requirements to a deficit of 27 cents per common share. This contrasted with \$1,200,000 reported for the comparable period of 1937, equal to the same basis to \$2.01 per share of common.

Operations in the first quarter of this year averaged 84.0 per cent of capacity as compared with 87.7 per cent in the first quarter of 1937, and 87.1 per cent in the first quarter of 1937. Unfilled orders in March, 31 were \$38.9 million as compared with \$25.5 million on December 31 and \$16.1 million on March 31, 1937.

The stock was last recommended in the Survey of March 18, 1939 (page 470). A recent price was 40½.

**Central Illinois Public Service Company 4½ Cumulative Preferred—Retention is advised.**

Earnings of the Central Illinois Public Service Company have held up well despite the provisions (decline that

has occurred in general business activity. Gross income in the first quarter of 1937 showed a gain of about 4 per cent. Although depreciation was again larger than in the corresponding period of 1936, total income rose materially, net after charges having been equal to \$1.31 per share of preferred as against \$1.25 in the fourth quarter of the previous year. A brief statement for the first quarter of 1938 indicates further improvement in gross revenues and total income though the extent of net gains was very small. Net after fixed costs was only \$1.18 per share; net in the corresponding period of 1937 was equal to \$1.02 per share.

Gross revenues for the twelve months ended March 31, 1938 amounted to \$18,102,000, a gain of 1 per cent. Net income approximated \$1,500,000, or \$1.47 per share of preferred, and compared with \$1,554,000, or \$1.46 per share as reported for the corresponding 1937 period.

Since operations and earnings had been affected to some extent during the early months of 1937 by the conditions along the Ohio River, it is quite possible that savings comparisons for the second quarter of the

year will not be as favorable as was the case in the first quarter. However, any drop should be moderate, particularly since the company has been able to maintain good control over general operating expenses. Third quarter earnings, the largest of any single period, will be determined to a considerable degree by weather conditions. Last year lower temperatures during the peak of the ice season caused a large percentage drop in ice revenues.

During 1937, \$1,870,000 was spent for property additions while funded debt was reduced by \$249,100 to \$49,260,400. Preferred and common stocks remained unchanged at \$26,815,000 and \$10,414,000, respectively. Working capital was again reported at approximately \$2,500,000.

Similar to previous dividend action, a quarterly payment of \$1 was made on the preferred on March 15. Arrears now amount to \$19.50 per share. The stock over recent months has fluctuated within a very narrow range. Bids from a market standpoint are moderate and considerable price recovery should be seen as business activity is general revival. The shares, reviewed previously in the Stock Survey of December 27, 1937 (page 90), are now selling at 45¼.

**General Motors Corporation Common—A policy of retention is recommended.**

General Motors reported net income of \$6.2 millions for the first quarter of 1938 as compared with \$4.5 millions reported for the first three months of 1937.

Dollar volume of sales was 25.6 per cent below a year ago. Depreciation charges were more than \$1 million greater than in the first quarter of 1937, more than \$2 million greater than in the first quarter of 1936.

First quarter 1938 earnings were equal to 14 cents per common share as compared with 95 cents per common share earned in the first quarter of last year.

The stock was last recommended in the Survey of March 21, 1938 (page 432) and recently sold at 29¼.

**Hinesapelli-Honeywell Regulator Company Common—The stock qualifies for retention as one of the more attractive equities available in the electrical equipment industry.**

First quarter operations of the company compared unfavorably with those of a year ago. Sales declined 32 per cent, costs, expenses 30 per cent, and operating profit was but \$15,000 as compared with \$224,000 reported for the first three months of 1937. Depreciation was \$24,000 greater than a year ago.

After other income and taxes and allowance for preferred dividend requirements, the company reported a deficit of 8 cents per share of common stock for the first three months of 1938 as compared with 90 cents per share earned in the first quarter of 1937.

Largely was the poor showing a reflection of unfavorable business conditions, but also it is to be realized that the first quarter of the year is normally the least profitable for the company. Products of the company are for the most part adapted to home heating apparatus, demand for which is usually concentrated in the third and fourth quarters of the year, with the result that normally the second half of the year is far and away the more profitable.

The past record of the company shows an impressive record of growth and it is confidently believed that with a return to more favorable general business conditions the company will again exhibit the previously evidenced upward trend of sales and earnings.

A dividend of 50 cents per share will be paid May 20 to common stockholders of record May 4. The stock was last recommended in the Survey of April 18, 1935 (page 438) and recently sold at 25¼.

**United States Steel Corporation Common—Retention is advised.**

United States Steel Corporation's report for the first quarter of 1938 was about as expected. With rate of operations averaging 82.5 per cent in the first quarter of 1938 as compared with average operations of 82.8 per cent in the first quarter of 1937, the corporation reported an operating profit of \$11.3 millions, as compared with an operating profit of \$8.3 millions a year ago, and a net loss of \$1.3 million as compared with a net profit of \$28.5 million for the first three months of 1937.

It is interesting to observe that depreciation, depletion and obsolescence was \$23 million less than the amount charged off in the first quarter of 1937. Had this amount equaled that of last year, the loss after interest for the first quarter of 1938 would have been in excess of \$3 million.

Directors last week declared a regular dividend of \$1.70 per share on the 3,502,311 shares of preferred stock. After allowance for preferred dividends, first quarter 1938 results were equal to a deficit of 37 cents per share of common stock as compared with \$2.05 per share earned in the first quarter of 1937, a deficit of 33 cents per share reported for the first quarter of 1936 and a deficit of 37 cents per share reported for the first quarter of 1935.

Shipments were less than half those of a year ago—1,655,244 tons in the three months to March 31, 1938 as compared with 3,698,041 tons in the first quarter of 1937.

The corporation's record for the first three months of 1938 indicates good control of expenses in the face of difficult operating conditions and suggests early emergence of the corporation to a profitable basis with general business improvement.

The common shares are among the more attractive stocks for capital appreciation during a period of cyclical improvement. They were last recommended in the Survey of March 23, 1938 (page 471) and recently sold at 42¼.

**Westinghouse Electric & Manufacturing Company Common—The stock qualifies for retention.**

The company reported net profit after depreciation and Federal income taxes of \$2,051,000 for the first quarter of 1938 as compared with \$5,942,000 earned in the first three months of 1937. These earnings were equal to 79 cents per share and \$1 per share on combined participating preferred and common shares for the respective periods. Unfilled orders at the end of March were \$58.8 million as compared with \$60.8 million at the end of 1937 and \$78.7 million at the end of March, 1937.

The stock was last recommended in the Survey of April 8, 1936 (page 439) and recently sold at 71¼.

NOTE—Moody's Investors Service has used the best available information in the preparation of this publication. The factual information has been compiled from sources of reliable authority, although not infallible. Events, when discovered, are promptly corrected. Opinions are based on the best available information and are subject to change without notice. They are not intended to constitute an offer of securities.

Extract from the President's Message to Congress on March 10, 1933, expressing his thanks for its action on the Banking legislation.

"TO THE SENATE AND HOUSE OF REPRESENTATIVES:

"The Nation is deeply gratified by the immediate response given yesterday by Congress to the necessity for drastic action to restore and improve our banking system. A like necessity exists with respect to the finances of the Government itself which requires equally courageous, frank and prompt action.

"For three long years the Federal Government has been on the road toward bankruptcy.

"For the fiscal year 1931 the deficit was \$462,000,000.

"For the fiscal year 1932 it was \$2,472,000,000.

"For the fiscal year 1933 it will probably exceed \$1,200,000,000.

"For the fiscal year 1934, based on the appropriation bills passed by the last Congress and the estimated revenues, the deficit will probably exceed \$1,000,000,000 unless immediate action is taken.

"Thus we shall have piled up an accumulated deficit of \$5,000,000,000.

"With the utmost seriousness I point out to the Congress the profound effect of this fact upon our national economy. It has contributed to the recent collapse of our banking structure. It has accentuated the stagnation of the economic life of our people. It has added to the ranks of the unemployed. Our government's house is not in order and for many reasons no effective action has been taken to restore it to order.

"Upon the unimpaired credit of the United States Government rest the safety of deposits, the security of insurance policies, the activity of industrial enterprises, the value of our agricultural products and the availability of employment. The credit of the United States Government definitely affects those fundamental human values. It, therefore, becomes our first concern to make secure the foundation. National recovery depends upon it.

"Too often in recent history liberal governments have been wrecked on the rocks of loose fiscal policy. We must avoid this danger.

"It is too late for a leisurely approach to this problem. We must not wait to act several months hence. The emergency is accentuated by the necessity of meeting great refunding operations this spring.

"We must move with a direct and resolute purpose now. The members of the Congress and I are pledged to immediate economy." . . . . .

Extract from the Radio Address of President Roosevelt,  
broadcast from the White House, Thursday evening, April 14, 1938.

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"\*\*\*\*\* I can hear your unspoken wonder as to where we are headed in this troubled world. I can not expect all of the people to understand all of the people's problems: but it is my job to try to understand those problems.

"I always try to remember that reconciling differences can not satisfy everyone completely. Because I do not expect too much, I am not disappointed. But I know that I must never give up -- that I must never let the greater interest of all the people down, merely because that might be for the moment the easiest personal way out.

"I believe we have been right in the course we have charted. To abandon our purpose of building a greater, a more stable and a more tolerant America, would be to miss the tide and perhaps to miss the port. I propose to sail ahead. I feel sure that your hopes and your help are with me. For to reach a port, we must sail -- sail, not tie at anchor, sail, not drift."

--oOo--

JR

GRAY

London

Dated May 2, 1938

Rec'd 11:15 a.m.

Secretary of State,  
Washington.

RUSH.

362, May 2, 4 p.m.

FOR TREASURY FROM BUTTERWORTH.

The London press has played down the financial aspects of the Anglo-French discussions. However, the first paragraph of an article by the Paris correspondent of the SUNDAY TIMES may be of interest in connection with my 356, April 29, 9 p.m.:

"Monsieur Daladier and Monsieur Bonnet have come back greatly pleased with their London visit. At least in a general way if not on every single point. Monsieur Bonnet was a little disappointed that financial questions such as the future of the franc and the Tripartite Agreement should not have been discussed and that his pet proposal concerning Anglo-French purchases of foodstuffs and raw materials on Danube -- a development of a Strasa plan of 1932 for a Danubian economic federation -- should not have been discussed more conclusively".

Incidentally

-2- #362, May 2, 4 p.m., from London.

Incidentally an official in a position to know tells me that it was through a Cabinet indiscretion on the part of Bonnet that the press learned of the Anglo-French "purchases of armament and raw materials with a certain amount of pooling of financial resources (TIMES April 29)" and that the arrangements thus far agreed to are not nearly so far reaching as Friday morning's press reports would indicate.

PLANET  
FOR

KENNEDY

KLP:CSB

JR

GRAY

London

Dated May 2, 1938

Rec'd 12:50 p.m.

Secretary of State,  
Washington.

563, May 2, 6 p.m.

FOR TREASURY FROM BUTTERWORTH.

Foreign exchange and gold market were virtually inactive, awaiting the issuance tomorrow of the French decrees.

KENNEDY

DDE:CSB

FEDERAL RESERVE BANK  
OF NEW YORK

OFFICE CORRESPONDENCE

DATE May 2, 1938.CONFIDENTIAL FILESSUBJECT: TELEPHONE CONVERSATION WITHFROM L. W. KnokeBANK OF FRANCE.

Mr. Cariguel called me at 2 o'clock and asked how the franc was behaving. I told him that business was almost at a standstill, the rate being 306 1/4 (162.67). Would I please call him at his home (Carnot 4338) if there were any appreciable change in the situation? I promised to do so.

LWK:EW

RECEIVED

MAY 2 1938

TREASURY DEPARTMENT  
RECEIVED  
MAY 2 1938

REB

GRAY &amp; SPECIAL GRAY

Paris

Dated May 2, 1938

Rec'd 3:35 p. m.

Secretary of State,  
Washington.

RUSH

683, May 2, 5 p. m.

STRICTLY CONFIDENTIAL FOR THE SECRETARY OF THE  
TREASURY FROM COCHRAN.

Minister of Finance Merchaudeau sent word for me to come to his office this afternoon at 4 o'clock. Upon my arrival he read to me a message which he wished communicated to Secretary Morgenthau at once. Rueff, who was also present, took the message in French and I took it down in English. Rueff and I then compared our copying and agreed on the following translation.

"The French Government is obliged to inform anew the Government of the United States of America that the expensive effort made by the stabilization fund, particularly during the recent period, can not longer be maintained. The French Government is therefore  
obliged

REB

2-#683, From Paris, May 2, 5p.m.

obliged, despite the fact that it has decided to impose from this week a new and important tax effort on the country, to choose between exchange control or the retreat of its currency. The rate at which the French Government has decided to stop is around 175 francs for one pound, with the will to lower progressively this figure in correlation with the economic improvement which it expects from its decrees.

(END SECTION ONE)

WILSON

CSB

Cable #683, Paris, dated May 2, 1938; Sec. 2, line 2: "16,000,000 should be 16,000,000,000 francs"

**PARTIAL PARAPHRASE OF SECTION TWO, TELEGRAM NO. 683  
of May 1, 1938, from Paris.**

31

The French Government recalls that from the first of last July taxes have been increased by 16,000,000 francs and that thereby it has shown its will to defend its currency by all possible means and that it remains still attached to this view within the framing of monetary liberty. It hopes therefore that in these conditions the setback which it is obliged to decide upon will appear to the Government of the United States of America as entirely in conformity with the provisions of the Tripartite Agreement."

The Minister of Finance told me that he would appreciate having the reaction of Secretary Morgenthau to the above statement as soon as it is possible for him to let us know. I asked Marchandeseu when the rate would be moved to 175 and he replied "tomorrow"; this will be one of several steps which are to be taken tomorrow simultaneously with the publication of certain decree laws. I asked the Minister whether the terms of the national defense loan would be made known tomorrow. His answer was that he was not sure whether they would be tomorrow or the day after. In any circumstances, he insisted, it is not possible to hold the present franc rate and that it is absolutely necessary to let it move to 175 to the pound.

END MESSAGE.

WILSON.

EA;LNU

REB

GRAY

Paris

Dated May 2, 1938

Rec'd 3:25 p. m.

Secretary of State,  
Washington.

685, May 2, 6 p. m.

FROM COCHRAN.

Paris exchange market has been quiet all day with the franc between 162 and 163, without any appearance of intervention by the French control. Forward francs against sterling have improved from 5 to  $4\frac{1}{2}$  for three months and from 3 to 2.40 for one month. Entire tendency is to await governmental decrees which were drawn up by Cabinet this morning, are being studied now by Council of Ministers and will be promulgated in the Journal Official beginning tomorrow. There is gossip on the market that the new national defense loan will be a 5% issue at 97.

WILSON

CSB

RE: FRENCH MONETARY SITUATION

May 2, 1938.  
5:00 P. M.

Present: Mr. Taylor  
Mr. White  
Mr. Lochhead  
Mrs. Klotz

H.M.Jr: For the record, I called Ambassador Kennedy this morning and asked him if he knew what had gone on between the French and the English when the French visited - made their visit last week. He said he had absolutely no information other than what Butterworth had sent me, and he said, "I go over all of Butterworth's cables with him very carefully." He said, "I am lunching with the Prime Minister Tuesday, and is there anything you'd like me to find out?" I said, "Yes, I don't want to be used as a cat's paw by the British in their relations with the French, and I want to be very careful in what I do with regard to the Tripartite Agreement, and I wish you'd try and find out from Mr. Chamberlain just what his attitude is." Ambassador Kennedy said that he would do that and would immediately telephone me after his lunch.

Around noon Mr. Cochran, at Paris, called me and told me he was sending me the information in Cable No. 683. I told him that I couldn't give them a couple hours' answer; that this was too important, and I said, "Furthermore, they are not asking my advice - they are simply telling me what they are going to do." Cochran then said - he said, "At no time have I pressed the French Treasury as hard as I have during the past ten days for information." I said, "That is quite right, and never have I pushed you as hard to get the information," and Cochran said, "I was unable to get anything."

Now, on the eve of their taking steps in regard to their currency, they ask that I, within a couple hours, give them an answer. I said to Cochran, "Furthermore, until we see what their decrees are, we can't make up our mind what we are going to do."

That's that. Now I had White's memorandum which I read very carefully. Give him (Hickman) that (White's memorandum) to put in as a part of the record.

.....Memorandum follows.....

## TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE April 30, 1938

TO Secretary Morgenthau  
FROM Mr. White

Mr. Lochhead has not seen this hurried memorandum but he heard the conclusions and said he agreed with them in the main, especially as they are merely a basis for further discussion here.

With more time we could have shortened and polished the memorandum but there is a summary statement appended should you be disinclined to read the several pages.

SUMMARYConclusion

1. Further depreciation of the franc is not justified.
2. Further substantial depreciation of the franc entails serious dangers to France and to international currency stability.
3. Further substantial franc depreciation would greatly weaken the effectiveness and future usefulness of the Tripartite Accord if France is permitted to remain as a "Club" member.
4. Imposition of exchange control over non-commercial transactions (for the purpose of (a) preventing the franc from falling to much lower levels, (b) safeguard present gold holdings, (c) avoiding additional trade barriers) is, in our opinion, the best of bad choices now confronting the French Government.

Recommendation

1. We recommend for your consideration an answer to the British Treasury which would indicate, in such manner that the two portions of the answer cannot be separated, that
  - (a) Continued substantial depreciation of the franc would constitute in our opinion a violation of the Tripartite Accord.
  - (b) We would not regard the imposition of exchange control over non-commercial transactions as a violation of the Tripartite Accord.
2. We recommend further that, if feasible, France be notified of our position, and that the possibility be considered of making our position public.

## TREASURY DEPARTMENT

## INTER OFFICE COMMUNICATION

DATE April 30, 1938.

TO Secretary Morgenthau  
FROM Mr. White

Subject: What should our answer be to the British Treasury as to our attitude toward further depreciation of the franc?

1. Depreciation of the franc during the past year has not improved the French economic position nor has it solved her acute exchange problem.

The franc exchange has fallen 30 percent since last April (from 4.496 to 3.087) yet her economic problems remain at least as acute this Spring as they were last Spring.

It is true that her international competitive position has improved during the past year but this improvement has been completely outweighed by other developments, which operate to maintain her unfavorable balance of trade at a dangerously high level. Her unfavorable balance is running about the same this year as it was last year, and last year she had an unfavorable balance of 18 billion francs, as compared with 10 billion in 1936, 5 billion in 1935 and 1934.

2. Neither the domestic nor the international underlying economic situation in France justifies a further reduction in the franc rate.

There is no price deflation in France, which in itself might justify resort to further depreciation as a means of reversing the price trend. Prices have remained stable in France during the past six months despite declining world prices.

Her international competitive position, all pertinent aspects considered, has substantially improved since last year. The fact that her unfavorable balance of trade continues at a dangerous level has been due not to an unfavorable exchange or price position, but rather to other factors connected with international domestic and political situation.

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Prepared with the aid of Mr. Glasser.

3. There is no reason to believe that further depreciation to the figure of 190 to 200 (mentioned in the cable) will of itself solve France's economic or exchange difficulties.

If the franc keeps falling sharply not only will her present difficulties continue but new and serious dangers will be introduced into the situation.

(a) Intermittent and prolonged depreciation of the currency sooner or later reaches a point at which the rate of fall becomes increasingly rapid and may even go beyond the control of the Government. In our opinion France is rapidly approaching the rate and conditions of decline which make this danger real and near. This danger is particularly acute because of the disturbed international situation and because the French Government will attempt to conserve its gold resources as a war chest.

(b) The franc rate is rapidly approaching a level which may be regarded by other countries exposed to French competition as involving an attempt to secure an unwarranted international competitive advantage. Sooner or later it may initiate another round of competitive depreciation and extended use of multiple currencies which would wipe out many of the advantages arising out of the existence of the Tripartite undertaking.

4. Further substantial depreciation of the franc in the near future would have the grave danger of discrediting the Tripartite Accord as an instrument designed to aid international monetary stability - unless France were dropped as a "club member".

Not to drop France from the "club" with the franc dropping to much lower levels would be to greatly jeopardize the future usefulness of the Accord. It were better under those circumstances both for France and ourselves to drop France from the "club" and later readmit her when she gives satisfactory evidence that the franc will be stabilized at levels satisfactory at that time.

5. How can France solve the acute stage of her present crisis? There are three ways open to her:

(a) Floating a loan on the British market.

This is a possibility, but such a loan to France could be successfully floated only with the active promotion and encouragement of the British Government.

Secretary Morgenthau - 3

This encouragement will be forthcoming only at a political price -- a price which will probably greatly increase France's political dependence upon England both with respect to her internal as well as external affairs.

How successful such a loan would be in relieving France's immediate problem would depend upon the size and terms of the loan. On the basis of past experience it is safe to say that only a very large and long term loan will do the trick.

(b) She can continue to attempt to hold the franc above 165 at a cost of substantial amounts of gold and with the aid of greatly increased obstacles to imports.

It is quite clear that she will not permit herself to lose much more gold at this time, and her ability to hold the franc at present levels without losing much gold has been substantially reduced by the amount of talk going on of letting the franc fall to a level much lower than the present one.

This has been the method which France has been using to hold the franc. The decline in the past month indicates the hopelessness of sole reliance on this method.

France has been raising import duties on items not involved in trade agreements, and if she means to continue to attempt to hold the franc without aid of exchange control she may resort to an extension of import restrictions by either or both higher tariff and smaller import quotas.

(c) The imposition of exchange controls.

If France is to impose exchange controls over non-commercial transactions it would probably be wiser for her to do so at something a little lower than the present rates; or, what may be even more desirable from her point of view, to permit the franc to drop to possibly 170 or 175 (to the pound) and then push it back to a higher figure -- say 165 to 160 -- holding it there with the aid of effective exchange controls. In the maneuvering down to low levels and then up again, the French Stabilization Fund can make a handsome profit if operated properly and can, moreover, administer some severe losses to speculators in the franc. However, the present French Government is either opposed to adoption of exchange controls, or is of the opinion that it would violate the Tripartite Accord.

Secretary Morgenthau - 4

### Conclusion

1. Of the three ways open to France to attempt to solve her acute exchange situation, the imposition of exchange controls over non-commercial transactions (for the purpose of (a) preventing further substantial declines in the franc, (b) safeguarding her present gold holdings, and (c) avoiding additional barriers to trade) seems to us now, as it has in the past, to be the best of the bad choices confronting her. Notwithstanding the administrative difficulties such a procedure involves if it is to be successful, we believe it is possible for the French Government to develop exchange controls within a reasonable time sufficiently effective to hold the franc at somewhere near present levels.

The position, it seems to us, that we can logically take now is that we would regard anything more than a very moderate drop in the French franc within the near future as a violation of the Tripartite Accord (we have in mind a point somewhere between 165 to the pound -- or 3 cents --, to 170 to the pound -- or 2.94 cents).

If France knows this ahead of time she will make every effort to keep the franc from falling below that level because, for France to be read out of the Tripartite Accord at this juncture would increase the pressure against the franc and make it even more difficult than ever for her to borrow abroad or stabilize her currency. In addition fear of inflation at home, and domestic disturbances will become much intensified with the rise in domestic prices following further sharp depreciation of the franc.

2. Unfortunately the present French Cabinet (as well as previous ones) seem to be definitely opposed to adopting exchange controls on non-commercial transactions. We do not know whether the continued weakness of the franc has altered their attitude on this matter. In any case if we are to take the position that further substantial declines in the franc will rule them out of the "club" we must provide them with an alternative course of action. We have no intention of investing large sums in francs. France can not float large loans here. The only alternative we can offer to France is the privilege of adopting exchange controls over non-commercial transactions. Indicating to France that she can adopt such controls without being dropped from the "club" would be consistent with our earlier position.

Secretary Morgenthau - 5

It therefore appears wise that should we state our position again it should be phrased in a manner which will leave no room for either doubt or equivocation. You might even consider the pros and cons of making such a statement public. You remember you thought of that possibility in a previous French crisis. Certain objections which existed then would seem to have disappeared in the light of developments.

3. It is barely possible all the important cabinet members of the French Government may not clearly understand that she can impose exchange controls against non-commercial transactions without violating the Tripartite Accord either in spirit or in letter. It is even possible that England in attempting to pursue certain political ends may somehow or other have studiously given her the impression that adoption of exchange controls at this juncture would be regarded as a violation of the spirit of the Tripartite Accord.

(It is significant to remember that Bonnet's position has been against exchange controls on the grounds that it would violate the Tripartite Accord. You will remember the position he took when he was Finance Minister and the way in which he tried to inveigle you to make a statement to that effect.)

4. But it may well be asked if we drop France from "club" membership unless she holds the franc rate at somewhere near present levels, aren't we:

- (a) Removing an important prop now sustaining France in her role as a first-rate power and as a democracy?
- (b) Helping France to disintegrate economically?
- (c) Driving France to greater dependence on Chamberlain!

To drop France from "club" membership would unfortunately have effects in the above directions. But the very knowledge that those may be the consequences will impose great pressure upon France to prevent the franc rate from dropping to levels which would rule her out of the "club". If France could do so only by securing aid from Great Britain, France would doubtless be willing to pay a very large political price.

But France has the alternative of adopting exchange controls. If France is made clearly to understand that the adoption of exchange controls is not in our opinion a violation

Secretary Morgenthau - 6

of the Tripartite Accord, we may accomplish two purposes by taking the position that she will be dropped from the group if the franc drops more than very moderate amounts from present levels.

(a) We will keep France in the "club" and thereby avoid the dangers listed above.

(b) We will be helping France to adopt what appears to be the only measure that has a reasonable chance of checking further and dangerous declines of the franc and of safeguarding her gold holdings, and of reducing her reliance upon trade restrictions.

#### Tentative Recommendation

We suggest for your consideration the feasibility of sending to England an answer to her inquiry which would state our position as being somewhat as follows:

(1) We would regard anything beyond a very moderate reduction in the franc from present levels in the near future as constituting a violation of the Tripartite Accord.

(2) That we feel if France finds it necessary to adopt effective exchange restrictions against non-commercial transactions as a necessary instrument to prevent her exchange from falling we would not regard such action as a violation of the Tripartite Accord either in spirit or in letter.

It is essential that both points be made together. There is the ~~grave~~ danger that should we indicate to England only that our position is that we would regard a reduction in the franc rate below a very moderate amount as a violation of the Tripartite Accord without repeating our attitude on the matter of exchange controls that England may be tempted to use that information to force France to accept England's way out, which may not be wholly in accord with our objectives.

It would be preferable if we could let the French know our attitude on both points directly so that there could be no possibility of misunderstanding. If, however, you find it inadvisable to let the French know directly, I think it is ~~very~~ important that the information given to the British should be couched in such terms as to make it impossible for them to separate our attitude on both matters, or to in any way enable them to use one portion of the information for their own purposes.

(There is the possibility that by Tuesday the French will have approached us directly in which case we will be able to let the French know directly as well as the British.)

- 2 -

I - the thing that bothers me is this: I don't know whether the French can pull themselves out of this situation or not. But I hate to be party to giving them a death blow, especially where, for years, we have nursed them along.

Kennedy also told me that Halifax, the Foreign Minister of England, had told him that the Germans had, in their own minds, just wiped the French out as a country of any importance, and from now on they are just not even going to think about the French. They don't even think they are worth while to bother with.

Furthermore, I don't think - that if we should decide to say that through this action on the part of the French, that out of the Tripartite - that we could take such a step without consulting the President, and furthermore, I don't see why we can't wait a couple of days. We have nothing to lose.

Another thing Cochran told me - he is cabling me an analysis of a statement by Professor Rist, in which Rist has made a very careful analysis of what he thinks the franc should be. As I remember, Professor Rist said "Around a hundred sixty-two francs to the pound."

All right, Wayne Chatfield Taylor.

- Taylor: Present. We've got - you mean, in view of these other things that have happened, these drafts probably you don't need.
- H.M.Jr: Have you agreed on one?
- Taylor: I don't think so.
- Lochhead: We agreed on one for discussion on the basis of Butterworth's cable, but of course this other cable throws it out.
- Taylor: It's 190 to 200, but this stuff supercedes it.
- H.M.Jr: (Over telephone.) Secretary of State Hull, please.
- Lochhead: I don't think we can agree to allow an action of this kind to be forced on the Tripartite members.

- 3 -

H.M.Jr: What do you mean by that?

Lochhead: For them to say "We are depreciating."

H.M.Jr: (Holds side conversation with Mrs. Klotz.)

(Over telephone.) Tell Mr. Upham if he doesn't know who's coming in tomorrow he can come in and talk with Mrs. Klotz if he wants to check. Please. Well, see if Mr. Sumner Welles is there.

The Secretary of State left.

(To Mr. Lochhead.) What were you going to say?

Lochhead: In other words, even if the facts or conditions might make us lean toward going along with the French to a hundred seventy-five, we couldn't set a precedent to allow them to do their business in that way without giving us a chance to express an opinion on it. Then, if they leave it down to a hundred seventy-five the one point that comes up tomorrow is that - afternoon time - they may give us an order to sell francs in this market on the basis of one seventy-five, and we hand them gold -----

H.M.Jr: Do what? .

Lochhead: Give them gold.

H.M.Jr: Give them gold?

Lochhead: Yes.

H.M.Jr: Well, we could do something like this: We could say, "Yes, we'll do this, but this doesn't commit us to any future action."

Lochhead: And secondly, we would have a chance to consult with the British before we did it, because they would have to make a decision before they'd do it.

H.M.Jr: (Over telephone:) Hello. He's in or out? Who says that? Well, he left word with his secretary - any time - you get his secretary and tell her I want to talk to him, and see if she gives you the same answer.

- 4 -

Well, that point can be covered by saying - by saying, "Well, now, we're going to do this today; what we're going to do tomorrow we don't know." See?

(Over telephone:) Hello. It's all right. Let it go.

Taylor: I don't think one or two days makes any difference.

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

Taylor: I think we've got to feel our way along here, because it's going to be a damned serious thing if we decide to drop them out, and having nursed them as long as we have, why, certainly, I don't think we ought to take the initiative in kicking them out, but we will probably find that the British will or will not have decided what they want to do.

H.M.Jr: Who is Chief of the European Section?

Taylor: Moffat - Pierrepont Moffat.

H.M.Jr: All these people ..... (Over telephone:) Cancel my call for Mr. Welles and see if Mr. Pierrepont Moffat is in, will you please? Pierrepont Moffat, in the State Department.

Lochhead: What I don't like about it is their actions - saying they have to do it, and they are going to do it tomorrow, for this reason; for today the franc was not under any particular pressure. We've not had any word whether the gold lost for them this morning. However, in this market, the franc tightened up a little bit and we sold a few francs this afternoon. It indicates that there is nothing pressing.

H.M.Jr: The two things bothering me - the first place, of Bullitt walking in here and trying to sell me the idea of letting the French seek their own level - I was amazed. Number two - that the French bankers have been banking on this thing, and the thing happens.

Lochhead: I mean, in other words, right now .....

- 5 -

Taylor: They picked one seventy-five, too.

Lochhead: .... right now, with the frank the way it is, if they can continue to hold the franc at one sixty-two for several days - because these boys are so short that you can tell it was Dreyfuss that bought a small amount of francs, so you can tell how hard pressed they are.

H.M.Jr: (Telephone:) Is there anybody in the office of the Secretary of State. See if there's anybody in the office of the Secretary. I don't care if it's the charwoman - I'll talk to her. If there's anybody in the office of the Secretary of State. Please.

Taylor: Going to be working late.

H.M.Jr: (Laughing) I'm kind of hollow, but I'll get warmed up, after coming down from eight thousand feet. ....shame I'm back now in Washington. Joe Kennedy says, "How is it over there in the United States?" I said, "Up on the farm it's beautiful." He says, "Any change from just the way it was?" I said, "No, Joe, just the way it was when you left." He said, "I've got the best job in the world."

Klotz: He thinks so.

H.M.Jr: (Telephone.) Hello. All right. Hello. Who is this, please? All right. Now look - I tried to get Mr. Hull, without success; I tried to get Mr. Sumner Welles - he's too busy to talk to me; I tried to get Pierrepont Moffat - he's not available. Now, at eight-thirty tonight, at my house, I'm having a discussion in regard to the Tripartite Treaty, in lieu of cable number 683, which just came in. Mr. Feis can come at nine o'clock. I think it's important enough that Mr. Pierrepont Moffat is there to give me the political background. Well, I think it's important enough, because quite frankly, if you will look at 683 - I mean, they've put the gun right to our head and I've got to make up my mind tonight and tomorrow. Pardon me. Well, it's - it's not necessary; either he will or won't come. It's 2211 Thirtieth - off Massachusetts Avenue, so he doesn't go to Georgetown. It's 2211 Thirtieth, off Massachusetts. Herbert Feis

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said he could get there at nine. I said, "No, this is terribly serious - I'm giving up my evening, and I want help." Yeah. Right.

Lochhead: Was that the charwoman?

H.M.Jr: Rentschler - he seemed to know what it was all about.

This is a tough nut to crack, gentlemen; this isn't an easy one, and believe me, I'm going to play my cards awfully carefully, and if I can't I'm going to make the British talk first, and I don't see why we can't.

What I would think about, is this - the possibility - between now and eight thirty - of drafting some kind of an answer, which would let them know we are displeased. Would we put them on a twenty-four hour basis? We'll sort of serve notice on them - see? Simply say, "Now, this comes as a great surprise - we have been asking for ten days; you don't give us a chance to consult." Doesn't the thing say "consult"? This is not consultation; this is telling us. "In view of that fact we feel that we ought to inform you that from now on that the Tripartite is on a twenty-four hour basis until we can evaluate this thing." See? Now, even still - I could even still get Cochran and tell him to tell those boys that. See?

White: I think the second is better.

H.M.Jr: What?

White: I think the second is better - to tell Cochran.

H.M.Jr: I don't like this, in view of this. I want them to know we consider we are on a twenty-four hour basis until I can make up my mind. And then I'd like to ask Cochran - "Does Marchandean know of the things that I told Blum?"

Lochhead: (Nods "Yes.") It's the way.

White: What indications do they give that they can support it at that level? There is absolutely none there. We find ourselves in the position of being let down into places we don't want to go. Not even the slightest suggestion here of what they are going to do.

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H.M.Jr: (Telephone:) Put in a call for Cochran, please. Utmost secrecy. Is the French phone open - if the French phone is open, all right. If not, it doesn't matter. Will you stand by till I go, please. Yes. Oh. Oh, well, it isn't necessary to have Mr. Pierrepont Moffat! Let me - oh - oh, well then, tell them all right - we won't need Mr. Moffat, then. O. K.

Mr. Feis has prepared himself; he's had a discussion with Hull, Welles, and Moffat, so he's prepared.

White: Then, there is an amazing .....

Taylor: "The French Government is therefore obliged, despite the fact that it has decided to impose from this week a new and important tax effort on the country, to choose between exchange control or the retreat of its currency."

White: It is an amazing decision, because if we have a choice .....

Taylor: Their choice.

Lochhead: Well, but they don't say what kind of exchange control.

White: They are choosing between the two.

Taylor: They are choosing between the two and they've chosen this.

White: The assumption is they can hold it at that and drop the exchange control at one sixty, or something like that.

Lochhead: All the figure of one seventy-five means - it's nothing magic - its immediate effect - let the boys cover in their position and take another look at that position.

H.M.Jr: Well, look! What harm can there be to serving notice on them? That we are on a twenty-four hour basis on this thing until I get a chance?

Lochhead: No harm at all.

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- H.M., Jr: I know - if he goes in to see <sup>Mr.</sup> Marchandean - "The Secretary of the Treasury, quite frankly, is shocked at this message; he hasn't had a chance to evaluate it; he won't make any changes before Tuesday, but he wants to inform you that any action that he takes Tuesday does not mean that he is approving the step that you are taking."
- Taylor: That's O. K.
- Lochhead: Did you want to make any effort to let the British know of that decision before the market opens.
- H.M., Jr: Oh yes. We'll do it the same way.
- (Telephone:) Find out where Bewley is and tell him, if he's anywhere around, I want to talk to him, please. Have you put in the call for Cochran?
- It seems to me that after all, it's like a contract sales agency - the fellow suddenly changes his commission from ten per cent to fifteen per cent. Well, he serves notice - "After tomorrow I am going to charge you fifteen per cent commission." Well, then I do business - well his business is acceptable, but if I serve notice I'll do business for Tuesday but I don't know what I'll do Wednesday, that protects me - it's the same thing. If you're a representative for a house and you're selling on a commission and you were doing it at ten per cent and suddenly say, "No, it's going to be fifteen per cent"--I don't know but what it's a point of common law, if you do business then, that it extends a contract for a year, and you accepted, but if I say, "I'll do business one day on that basis, but I don't know whether I will do business on Wednesday."
- White: It seems to me you're in position that you can't do anything but that, because if you were to do anything else you are confronted with one or two alternatives.
- H.M., Jr: (Telephone.) Tell Oliphant to come in please. What? He was here all day wasn't he? O. K. All right.
- He's as bad as the men in the State Department.

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Klotz: (Over White House telephone:) Hello. Just a moment. Mr. Welles.

H.M.Jr: Hello. Hello Sumner. Uh-huh. All right, Sumner, anything you say goes with me. Sumner, I'm terribly upset over this French situation, and I don't know whether you saw the last cable that came in. Well, it's the one where they served notice on us that they are going to go to a hundred seventy-five francs - this Marchandean. Well, you want to read it and then call me back - because I - I am thinking of taking - doing something now. I'll wait until you've read it.

Incidentally, the former President of United States Steel ....(inaudible - talking to Mrs. Klotz....) foreign office in Berlin, and got black marks and everything else. I mean, he knows the business.

Taylor: Who?

H.M.Jr: The former head of United States Steel.

Taylor: Myron Taylor. Oh yes.

H.M.Jr: He's marvelous - wonderful. I mean, they can't laugh that fellow off.

Taylor: Oh no.

Lochhead: So far as taking - some of those business fellows get into public service.

H.M.Jr: I - I - the more I think of it, - I mean, I always put these things down in a practical application.

(Telephone.) Hello. Thank you. Hello Sumner. Sumner, this is what I am thinking of doing, via Cochran. We want to take several days to think this over and also, naturally, talk with the British. I talked to Kennedy today; he knew nothing; he said he was having lunch tomorrow with Chamberlain. What they are doing, they are changing the rules. What I was thinking of doing - I've got a call in for Cochran - is to say this: "Please call up Mr. Marchandean and say I was very much surprised that he notified me and didn't consult with me. I'll carry out the agreement on Tuesday, but I am making no promises what I'll do on Wednesday or the day after." In other words, it's like

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I told the people here - you have an agent selling at ten per cent commission. Well, he serves notice on you he's going to charge fifteen. You go ahead and do business, and you more or less accept the contract. If I simply serve notice on Mr. Marchandeu I will do business with him for one day, but I want several days to think this over, does that make horse sense to you? Yes. That's right. That's right. I spoke to Cochran today and Cochran said that at no time since he's represented the Treasury has he pressed so hard for information and received none, during the last ten days, except denials. He said, "I never pushed them so hard to get information and without success." Under the Tripartite they are supposed to consult with members, but - no chance to consult - they tell us what they are going to do and, naturally, when it comes to say - if we should decide to say, "You're out of the Tripartite" - but I wouldn't want to do anything like that without first talking with you and Mr. Hull and getting the President's consent. It doesn't mean that we acquiesce. Well, no, and they have nothing. No, because Kennedy said that he goes over Butterworth's cables very, very carefully and he has nothing. They know nothing, and don't even know what was agreed to when the French went over last week. They knew absolutely nothing.

The way I look at it, what harm can come to the United States Government by just putting these people on notice? No. And on the other hand, if we do business with them for tomorrow and execute their orders, then it looks as though they could very well say, "You did business; what right have you to break it?" and the people in my shop here agree with me. All right. Well, I'll go..... Oh, I can't - well, the thing I don't know - the thing that we don't like here is that the French bankers have known this was coming; they knew the rates and they have unquestionably speculated on it at exactly the rates that have happened. That doesn't smell very good. See, they have made money out of this thing consistently. Now there is a way out; there's a way out to say that the Tripartite, to save the trade treaty, and that is they could put it on the movement of capital and not on goods. We feel very strongly that they would get somewhere on that basis, but why they don't

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do it just doesn't make sense to us, see? Right. Now Feis is coming tonight, and I understand he's talked with Mr. Hull and you. Well then, he's talked to Mr. Hull. But I thought I'd shoot on this. And then we'll see tomorrow what happens, but after all, I can't undertake a thing like this lightly.

Incidentally, I am simply delighted at the appointment of Myron Taylor. I thought that was a wonderful selection. Yes. Yeah. Yeah. Well, he felt he couldn't do it physically, but he's just - he made up his own mind - I mean, I didn't have a thing left out of it, but he felt he couldn't do it physically. I agree with you. Thank you. (Hangs up telephone.)

(To Mrs. Klotz:) What was that call (during above conversation)?

Klotz: Bewley's out playing tennis.

H.M.Jr: I'm warming up.

White: Mr. Secretary, do you think there's any chance of a misunderstanding of this cable? I read it over again. There is this possible interpretation which would change the situation. It says, "The French Government is therefore obliged, despite the fact that it has decided to impose from this week a new and important tax effort on the country, to choose between exchange control or the retreat of its currency." It doesn't say it's going to retreat from its currency. It may be - this is a possibility - that this one seventy-five is not what they regard as a retreat but what they regard in connection with exchange control.

H.M.Jr: He had a big fight with them over the word 'retreat.' He said the word 'retreat' - the French word 'retreat' in English does not mean retreat. He explained that - Cochran said a true translation would have been "devaluation."

(Telephone.) Hello. Bewley, will you be available through the Embassy? Can I call you? Well, it will be after eight-thirty. Pardon - I can't hear you. Well, do you have people on duty at the

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Embassy at night? I mean, if I call and leave a message? Well, it would be after eight-thirty, and if I did want you it would be really important. See? So, if you would, please. Thank you.

He's dining out at Herzog's. I don't know - all of this thing - I mean, here what we are talking about is the balance of power of Europe, and everybody's so busy .... Oh golly! I'll never learn.

(Over telephone.) Well, what about - you haven't, huh? Six.

Lochhead: .... past twelve - daylight saving over there - six hour difference.

H.M.Jr: (Telephone.) Oh, are they trying his home; have you got his number?

Klotz: Don't realize he may be asleep.

Taylor: I don't know - the Rue - is that a good place?

Lochhead: After all these calls I think you're learning - I mean, they are not going to let them force you, in one hour. I think you shouldn't be required to answer in a couple hours.

H.M.Jr: I do feel - I do feel that I want to serve notice on those people. You (Lochhead) raised the point. "All right. We'll do business with you on Tuesday; I don't like it; I don't know what I'm going to do, but the fact that we do business doesn't commit us to anything."

Taylor: That is - I think that is just right.

H.M.Jr: O. K.

Taylor: And that gives you two days, three days, or a week to look it over.

H.M.Jr: Sure.

White: I am still troubled about this interpretation. You will have a chance to check up, won't you?

H.M.Jr: Cochran said that "retreat" is not a true translation; that "devaluation" would be more nearly correct.

Taylor: This other part here helps answer that, Harry, where it follows: "The rate at which the French Government has decided to stop is around 175 francs for one pound, with the will to lower progressively this figure in correlation with the economic improvement which it expects from its decrees."

I mean, it's what they were talking about in some of their earlier cables - shrink down a long way and fight back. This is exactly what he's talking about. He went into that in some detail.

Lochhead: I'd love to be an operator, working on this over in France - get your position - you cover up at 175 tomorrow and let it go back again, and sell out again if it goes back to 170 or 165.

H.M.Jr: (Holds side conversation with Mrs. Klotz.)

Well, what I think I'll do is - I think I'll go home and then - go home and tell them, if I can get Cochran at six - I can handle this just as well from my house, except that I can't make a record, but that's all right - I'll make Cochran make a record, and I'll tell them - (Over telephone:) Release Mr. Upham and tell him to pick me up at home tomorrow morning at eight-thirty. Doesn't Cochran's phone answer - is that the trouble? Oh well, I'm going to go - well, I'll let you know when I go.

I think that's the thing, and if we can't get him on the phone, we can write a cable along these lines.

(To Hickman:) And incidentally, Naster is coming to the house tonight, see, and will you arrange for somebody - that they should send a typewriter - so that he can have a typewriter, paper and carbon at the house. You know how to do that?

Hickman: Yes sir.

H.M.Jr: That's all. Anybody think of anything else? I think that's all.

Monday  
May 2, 1938  
5:22 p.m.

HMJr: Hello.

Operator: I have Mr. Bewley.

HMJr: Oh. Thank you.

O: Go ahead.

HMJr: Hello.

T.K.  
Bewley: Hello.

HMJr: Hello, Bewley.

B: Yes.

HMJr: This is Henry Morgenthau.

B: Yes.

HMJr: I may need you tonight.

B: All right.

HMJr: Where will you be - available - through the Embassy can I call you?

B: Ah - what time will you be likely to call ... ?

HMJr: Well to be - after eight-thirty.

B: After eight-thirty. Ah - well, I was going to dine out at the restaurant tonight ...

HMJr: Pardon me - I didn't hear you.,

B: Well, I was going to dine out at <sup>Henry's</sup> Restaurant, but I think you'd better catch me at the Shoreham - I'll be back there by eight-thirty.

HMJr: Well, do you have people on duty at the Embassy at night?

B: Ah - the messenger will be here.

HMJr: I mean if I call and leave a message - ?

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B: Yes, you could leave a message at the Embassy.  
I'll ring them up and find out.

HMJr: Well, it would be after eight-thirty and if I  
did want you it would be really important.

B: Yes. All right.

HMJr: See?

B: Yes.

HMJr: So ...

B: All right, I'll keep in touch with him.

HMJr: If you would, please.

B: Yes.

HMJr: Thank you.

B: All right.

Monday  
May 2, 1938  
5:42 p.m.

HMJr: Hello.

Operator: I have the overseas operator.

HMJr: Who?

Operator: Go ahead.

HMJr: Hello.

Overseas  
Operator: Yes, sir.

HMJr: This is Mr. Morgenthau.

O.O.: Yes, sir.

HMJr: Haven't you got any circuit to Paris?

O.O.: Yes, we have a circuit to Paris, Mr. Morgenthau, but you want the maximum privacy and we have to line the circuit up with it.

HMJr: I'll take any circuit you've got.

O.O.: Well, the circuit is now lined up with the maximum privacy and the call will be coming through in about three minutes.

HMJr: I'll make you a bet that it doesn't.

O.O.: You want to bet me it doesn't?

HMJr: Yes.

O.O.: Oh, (laughs) you know it will if I say it will.

HMJr: Well. All right. I want you to win though.  
(Laughs)

O.O.: (Laughs) What will you send me - I mean, how much are you betting?

HMJr: (Laughs)

O.O.: (Laughs) I'm taking you up on it.

HMJr: All right. If it comes through in three minutes you get a box of candy.

O.O.: Good. All right.

HMJr: Well, what - wait a minute -

O.O.: (Laughs)

HMJr: What's your name, so I know who to send it to?

O.O.: I'll see what I can do and then if  
the call goes through, well -

HMJr: You tell Miss Spangler who is my operator.

O.O.: (Laughs)

HMJr: All right.

O.O.: O.K.

HMJr: Thank you.

(Short pause)

HMJr: Hello.

Operator: It looks like you loose.

HMJr: Hello.

Operator: Here he is.

HMJr: Thank you.

Operator: Go ahead.

HMJr: Hello.

H. Merle  
Cochran: Hello.

HMJr: Hello, Cochran.

C: Yes, Mr. Secretary.

HMJr: I'm at the Treasury.

C: Yes.

HMJr: And I have your cable now, you see, and before  
telling you what I have in mind we wanted to ask  
you particularly about that word "retreat" -

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"...to choose between exchange control or the retreat of its currency..." - You told me that that was not a correct translation from the French.

C: Well, I mean when he said that, Chancellor he said the military effects - I mean when I questioned the word -

HMJr: Yes.

C: And I said "depreciation" and he said, "No, drawback."

HMJr: "Drawback?"

C: Yes.

HMJr: Well...

C: In another place where I used, "setback"...

HMJr: Yes.

C: ... they used the word "reprieve"

HMJr: Yes. Well, - ah - this isn't - we've only had a preliminary talk, but - have you got a pencil?

C: Yes, Sir.

HMJr: Well, this is the thought that I had in mind: - ah - that you should let Mr. Marchandean know tomorrow morning the very first thing ...

C: Yes.

HMJr: ... that I am shocked at his message.

C: You what?

HMJr: I'm shocked.

C: Uh huh.

HMJr: Surprised.

C: Yes.

HMJr: I am shocked. Ah - that under the Tri-partite Treaty we are supposed to consult...

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C: Yes.

HMJr: I don't consider this consultation.

C: Uh huh.

HMJr: That's number two. Ah - number three, I have not got time to decide what the United States Treasury will or will not do. Hello.

C: Yes, I'm here.

HMJr: Therefore if they give us orders tomorrow to buy or sell francs for their account...

C: Yes.

HMJr: ...we will execute those orders on Tuesday. But by doing so we don't want them to think that we are acquiescing...

C: Yes.

HMJr: ...in their plans.

C: Yes.

HMJr: That it will take us a number of days to decide just what we are going to do.

C: Yes.

HMJr: We wish to naturally consult - underline consult - with the British.

C: Yes.

HMJr: But, pending that consultation we will carry on the orders for Tuesday.

C: Yes.

HMJr: But what we will do after that we don't know but we will let you know in plenty of time.

C: I see.

HMJr: Now, would you mind repeating that please, as you understand it?

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- C: I'm to let Marchandean know in the morning as soon as I can see him that you were shocked - that you were surprised at this message.
- HMJr: Yes.
- C: That under the Tripartite that the people involved are supposed to consult.
- HMJr: Yes.
- C: You do not consider this a consultation.
- HMJr: Yes.
- C: That you have not time - this Country is not giving time to decide what the Treasury Department will do.
- HMJr: Yes.
- C: And to say that will execute any orders that may be given to buy or sell on Tuesday but this does not mean that you acquiesce. You will consult with the British on Tuesday.
- HMJr: Yes.
- C: Underscore consult.
- HMJr: Yes.
- C: And then you will let them know through <sup>me</sup> /in due time.
- HMJr: That's - you got it a hundred percent right. Now, - ah - in order to save me time and expense..
- C: Yes.
- HMJr: I wish you would call Butterworth.
- C: Yes.
- HMJr: And give him this message, that I have given you; and tell him to get it to the British Treasury the very first thing, see?
- C: The message that ... ?
- HMJr: That I have just given you.

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C: Yes. Yes. Let him give that to the British Treasury.

HMJr: Yes. But I want you to get him still tonight.

C: Yes. All right.

HMJr: Now, furthermore, I am sending for Mr. Bewley.

C: Yes.

HMJr: The British Financial Attache and telling him just what I'm telling you.

C: Yes.

HMJr: You see?

C: Yes.

HMJr: But I'd like you please to call Butterworth still tonight and tell him what I've told you.

C: All right.

HMJr: Now, just a minute - see if I've overlooked anything.

C: Did you want me to get the French tonight. I can still get Rueff but I doubt if I can get Marchandean.

HMJr: Yes, I would make a distinct effort to get Rueff tonight.

C: All right.

HMJr: Now, just a moment please.

C: All right.

(Short pause)

HMJr: Hello.

C: Hello.

HMJr: Now one other question, which has nothing to do with this message.

C: Yes.

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HMJr: Have you any way of knowing that the information when I put up that question ....

C: Yes.

HMJr: ... to Mr. Blum ...

C: Yes.

HMJr: ... in regard to exchange control, did he ever give that information to anybody else? - I mean did he pass that to the rest of the cabinet?

C: ... about that.

HMJr: ----- Hello.

C: - sent a telegram a day or two after I called up, you know, that the Governor of the Bank had called me up ...

HMJr: Yes.

C: And he asked me a certain question.

HMJr: Yes.

C: And I wouldn't reveal the nature ...

HMJr: Yes.

C: ... of my talk with the head man.

HMJr: Yes.

C: Now whether he ever told him any more or not, I don't know.

HMJr: Uh huh.

C: But it's never come to me from any source...

HMJr: Yes.

C: ... that this man had revealed it.

HMJr: Yes. Well..

C: That's the only time - when he was there at the bank.

HMJr: Yes. Well, I'm not - this is simply for you to use in case they say anything.

C: Yes.

HMJr: If we had had time to consult, see?

C: Yes.

HMJr: I might have been able to make a constructive suggestion.

C: Yes.

HMJr: But they haven't given me that opportunity.

C: No.

HMJr: You see?

C: Yes.

HMJr: Now, let me ask your advice. Do you think that what I am telling you in the message, do you think that's - it's all right?

C: Yes. I mean we shouldn't just take this without letting them know that we're a little unhappy about it. Now that's the question.

HMJr: Well, I'm more than a little unhappy.

C: Well, I'll put it, "more than a little."

HMJr: No - I am shocked.

C: Yes.

HMJr: And we just simply - if I carry out their orders tomorrow without saying anything they might perfectly well feel that I am acquiescing.

C: Yes. Well, I think we should not let them feel that.

HMJr: Well. All right. Well....

C: It's a grand idea to get in touch with one or both of them yet tonight.

HMJr: Yes. Well, you think this makes sense, don't you?

C: I what?

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HMJr: You like this message?

C: Yes, I think it's all right.

HMJr: All right. Well, then - make an effort to get either to Marchandean or Rueff and then get Butterworth on the telephone at his home.

C: Yes. I'll call the French first.

HMJr: Oh, yes.

C: Yes.

HMJr: And if you want to call me back - I'm home tonight.

C: You're home there?

HMJr: Yes.

C: All right. I'll see - if they have any message to get right back why I'll call you.

HMJr: Yes. But you've got it ....

C: I won't call you.

HMJr: And before calling you I discussed this in detail with Summer Welles, and he's in hearty approval of the action I am taking.

C: You've been in touch with him?

HMJr: Yes. And he heartily approves of what I'm doing.

C: Yes. Yes.

HMJr: Summer Welles.

C: Yes. Fine.

HMJr: Yes. He heartily approves.

C: Yes.

HMJr: O.K.

C: Surely.

HMJr: All right.

C: No, the only point I made this afternoon - or that I tried to make - was that their action here

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through that little play which they made preparatory to going over to London ...

HMJr: Yes.

C: ... has made this franc almost psychologically inevitable, I mean, this rate.

HMJr: Yeah.

C: Even though it may not economically at present. But I say all of that difference in them is from a better approach to us on this.

HMJr: Yes. Well, the thing that Sumner Welles said, every time you've asked them about this they've denied it.

C: Yes.

HMJr: And for ten days they've been denying it.

C: And he not only denied it to me but when Wilson saw him he got the same story.

HMJr: That's right.

C: I mean he was thrown in contact with him.

HMJr: That's right.

C: At the same time we knew all the time - I knew it through the banker ....

HMJr: Yes.

C: ... that's the little fellow you know ...

HMJr: Yes.

C: Ah - was betting on this.

HMJr: Sure.

C: And also that the man who is interested in silver you know - Patenotre.

HMJr: Oh, Indo Chine?

C: - didn't understand that it was going to come to this.

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HMJr: He understood what?

C: That there was going to be a one hundred and seventy-five franc.

HMJr: Ah - that's the Indo Chine?

C: No, Patenotre.

HMJr: Oh yes. Oh yes. Oh yes.

C: You remember that message?

HMJr: Oh yes, very clearly.

C: Yes.

HMJr: Well, as Archie Lochhead and I said, we wish we were in business on the other side of the water.

C: I certainly agree.

HMJr: It must be lots of fun and very profitable.

C: Yes. For some people here certainly made a clean-up, I can tell you that.

HMJr: Yeah. Well, I don't want to be party to it.

C: Well, I assure you I'm not a party to it.

HMJr: What?

C: I say I'm - I can assure you that I'm not in ...

HMJr: Oh, no, no, no, no, Cochran, don't even say that joking. Because I wasn't even by inference suggesting any such thing.

C: That's all right.

HMJr: No, no, no, no, no - not even by inference.

C: No - please.

HMJr: No. All right.

C: Fine. Well, I'll get in touch with - with them yet tonight.

HMJr: No, I was talking about the government.

C: Surely.

HMJr: All right.

C: Fine. All right. Well, I'll get busy on Butterworth and Rueff both.

HMJr: O. K. Goodbye.

C: Goodnight.

CONFIDENTIAL

68

CONFIDENTIAL

FROM: PRESIDENT U.S.  
TO : SECRETARY OF TREASURY

0003 AS FAR AS I CAN MAKE OUT THE ACTION PROPOSED BY FRANCE IS WEAK AND GETS NO WHERE IN THE LONG RUN. I AGREE WITH YOUR LINE OF THOUGHT. OFFHAND IT SEEMS TO ME THAT SUPERVISION OF CAPITAL MOVEMENTS AND GOLD CONTROL SIMILAR TO OURS WOULD OFFER A MUCH MORE PERMANENT SOLUTION. AND IF THAT FAILS THEN A MORE DRASTIC FORM OF EXCHANGE CONTROL. (I HOPE SIMON AND YOU WILL HAVE A PLEASANT TELEPHONE CONVERSATION 2125)

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PARAPHRASE

# CONFIDENTIAL

69

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**FROM: PRESIDENT U. S.**  
**TO: SECRETARY OF TREASURY**

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FROM: PRESIDENT U. S.  
TO: SECRETARY OF TREASURY

gpp3 AS FAR AS I CAN MAKE OUT THE ACTION PROPOSED BY FRANCE IS WEAK AND GETS NO WHERE IN THE LONG RUN. I AGREE WITH YOUR LINE OF THOUGHT. OFFHAND IT SEEMS TO ME THAT SUPERVISION OF CAPITAL MOVEMENTS AND GOLD CONTROL SIMILAR TO OURS WOULD OFFER A MUCH MORE PERMANENT SOLUTION, AND IF THAT FAILS THEN A MORE DRASTIC FORM OF EXCHANGE CONTROL. I HOPE SIMON AND YOU WILL HAVE A PLEASANT TELEPHONE CONVERSATION 2125

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**CONFIDENTIAL**

71

**COPY**

**FROM: PRESIDENT U. S.**  
**TO: SECRETARY OF TREASURY**

~~OFFS~~ AS FAR AS I CAN MAKE OUT THE ACTION PROPOSED BY FRANCE IS WEAK AND GETS NO WHERE IN THE LONG RUN. I AGREE WITH YOUR LINE OF THOUGHT. OFFHAND IT SEEMS TO ME THAT SUPERVISION OF CAPITAL MOVEMENTS AND GOLD CONTROL SIMILAR TO OURS WOULD OFFER A MUCH MORE PERMANENT SOLUTION, AND IF THAT FAILS THEN A MORE DRASTIC FORM OF EXCHANGE CONTROL. I HOPE SIMON AND YOU WILL HAVE A PLEASANT TELEPHONE CONVERSATION 2125

**TIME OF RECEIPT CODE ROOM 2150**  
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**DISTRIBUTION:**  
**SECRETARY OF TREASURY**

FROM PRESIDENT U.S.

TO: SECRETARY OF TREASURY

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## RE FRENCH MONETARY SITUATION

May 2, 1938.  
8:30 p.m.

Present: Mr. Taylor  
Mr. Lochhead  
Mr. White  
Mr. Feis (later)  
Mr. Bewley ( " )

H.S.Jr: Whatever the time is now, 8:30, Cochran telephoned me from Paris; he had been in to see Rueff and delivered my message to Rueff. Rueff took it in to Marchandeu, who evidently was in bed. After a conference, Rueff came out and said he was disturbed that I felt upset; that his message to me was one of principle, no instructions have been issued, and that he very much wanted me to consider that his message was one of consultation. Then, as I remember it, Cochran reminded Rueff that repeatedly they had informed him that they were not going to 175 francs to the pound and he had passed this information along to me.

Rueff then went back and had another consultation with Marchandeu and came out and made this proviso: that no instructions would be issued unless some unforeseen pressure made action imperative before they could get a reply from me, but in any event they would communicate first with Cochran; but that Marchandeu urged me very strongly to try to get my answer to him as quickly as possible.

Taylor: I don't think that does any harm at all.

Lochhead: I think the first that you gave them tonight was still the best one.

H.S.Jr: Now let's just see, I've got to send this to the President. Want a piece of paper to give to Mr. Bewley when he comes. You fellows help me.

The following is the message that I gave to Cochran, as best I can remember it:

"1. Please inform Mr. Marchandeu that I was very much ...."

White: "Shocked" was the word you used.

H.S.Jr: "... shocked and surprised ...."

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Taylor: "... and surprised," meaning that ...

H.M.Jr: "... shocked and surprised at the message which Marchandean sent me.

"2. That I did not consider that under the tri-partite agreement that we had been consulted, but that he had simply informed us.

"3. That we would execute any orders on Tuesday that we received from the French to buy or sell francs for their account, but that in doing so we in no-way acquiesced in the new French proposal, and, while I agreed to do this Tuesday, that we were not committed beyond Tuesday.

"4. That before we committed ourselves in any way I wished to consult with the British."

\* \* \* \* \*

H.M.Jr: That's the whole story, and if we had spent one whole day we might change five words.

White: I did spend a few hours.

H.M.Jr: What?

White: I did spend a few hours.

H.M.Jr: Isn't that ....

White: Yes, that's all right.

H.M.Jr: Incidentally, did McReynolds ever get out your order?

White: Yes, the order creating the two different divisions.

H.M.Jr: Yes.

Lochhead: I got a photostatic copy. Copy came around to my office. Don't know how much publicity was given to it.

H.M.Jr: I kind of like this, Wayne. Huh? Think I'll go back to the farm tomorrow and get another one.

Taylor: Well, I tell you, we are now in process of consulting

-3-

with the British, see? This is good, I think, only until we have had a chance to do so.

White: It's good for a couple of days.

Taylor: It is until we have had a chance to do what we say. "Before we commit ourselves in any way, I wish to consult with the British." Well, this is the start of doing that.

H.M.Jr: I called up the White House about cables and they said the later I send them down tonight the better; said after ten o'clock nobody sent any cables from the President, so they could receive them and get them off.

So what I thought we'd do - that afterwards we'd fix up a message, not necessarily of advice, but - you see, I sent that one - you (Lochhead) sent that one on Saturday, didn't you?

Lochhead: Yes.

H.M.Jr: Well then, we'd send this next one, the one that came in from Marchandean and my answer, and then the one from the British, you see. And then I could say to the President and myself, "I'm now going to wait to see what happens."

White: Going to send their answer to that?

H.M.Jr: No, I'm going to get all off tonight what happened as of tonight.

White: Yes, their answer to that, which includes Cochran's reply to that.

H.M.Jr: That's right. And then say to the President, "Any suggestions you have I'll be glad to receive." What?

White: I'd like to call your attention to two paragraphs here on page four. Page four.

Lochhead: Of the British.

White: Yes, of the British.

H.M.Jr: Yes.

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White: One paragraph beginning with: "Nevertheless, this would constitute the first occasion when a tripartite country had deliberately depreciated its currency as an instrument of policy and there was no blinding the fact that it directly contravened the provisions of the tripartite agreement."

I would question that very definitely - that it contravenes the provisions. It depends on why they depreciated their currency, because they depreciated their currency directly as a matter of policy one of the earlier times. What would constitute a violation would be any attempt to depreciate their currency in order to get a competitive advantage.

Taylor: Well, I think that's just words, Harry.

H.M.Jr: Harry, if they believe this, ...

White: Then why are they saying what they are?

H.M.Jr: If they believe this, then why do they say ....

White: ... that it's all right with them?

H.M.Jr: Why do they say ...

White: ... they're not going to take exception, which is equivalent - a little different way of saying, "It's all right."

Then another thing ....

Lochhead: Excuse me, Harry. This paragraph on page four was just a conversational paragraph, it was not a paragraph that they gave to the French. This is not a part of their reply to the French.

White: I say if they believe that .....

Lochhead: After all, this is the message. The other is just some side comment.

H.M.Jr: But Harry is right in pointing it out. This is what they think, on page four; and then the message to the French doesn't check.

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- White: And the paragraph below that - second one below. "However, he said he thought exchange control was the greater evil but he did not conceal that he had no great confidence in this being the final depreciation." That is, he recognizes .... X
- H.W.Jr: Which is all the more reason to stall.
- White: Yes, I think so. I think there are two things involved that require careful thought.
- H.W.Jr: I think what the British are doing is this: taking a leaf out of my book, hoping to Heavens that we'll kick the French out and save them the trouble. Huh?
- Taylor: Well, I think that there may be something in that, but then - I wonder whether we would do it. That is ...
- White: Well, there must be some limit to this thing.
- H.W.Jr: Must be what?
- White: Some limit to this thing. " ... exchange control was the greater evil but he did not conceal that he had no great confidence in this being the final depreciation." 175 is not the final depreciation - 185, 200 - and yet it's better than exchange control. I don't understand that at all. X
- H.W.Jr: Well, I think what you've got to understand is that it is terrifically important to the British to have military cooperation just now with the French, and at the same time the French come to these boys and say, "O.K., you want us to keep the franc at 160; well, lend us some money."
- Taylor: "Lay it on the line." Sure.
- H.W.Jr: Sure.
- White: Well, that's why I don't understand why they don't come back and say, "Why, you can keep it at 160 by imposing exchange control."
- Taylor: Well, I think you'll find, Harry, that when you get the political background and so on, which is also

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brought out in some of the other - in the earlier cables, that this crowd that's in has just as strong a commitment against exchange control as the previous government did.

White: They're opposed to it.

Taylor: Yes. Therefore, it's tied up with the existence of this government.

Lochhead: I would say one of your important paragraphs is the first paragraph on page four - "that it contained severe tariff and 'readjustments' which in some respects were as, if not more, serious to Great Britain than the proposed currency action." Now, that's where you're likely to have some trouble.

White: Can't violate the tripartite merely because they do that.

Lochhead: The statement of the tripartite was that you would not take action that would harm trade.

White: But they hoped it would have that effect - the spirit - but you'd have a hard time in demonstrating the letter of it.

Lochhead: When you have Dr. Feis over tonight, that's probably the paragraph that he's going to ....

Taylor: I think that's the paragraph we ought to be damn well interested in.

H.M.Jr: What's that?

Taylor: First paragraph on top of page four - much more than the rest of them.

White: We haven't seen their decree which includes that.

H.M.Jr: What page is this?

Lochhead: Page four of the British cable.

Taylor: British Treasury says they haven't been told either. "He said that the French had not revealed to the

-7-

British Treasury the whole of their decree program but that it contained severe tariff and 'readjustments.'

White: They have that information, which we didn't have.

Lockheed: I'm a little bit surprised that the British came over as fast as they did.

Taylor: I'm not.

Lockheed: You mean on account of their other consideration, the political consideration.

Taylor: Bet your life.

Lockheed: And the fact that they don't want exchange control means they'd have to put up some money, and they're dodging out. X

Taylor: That's right. And if you go back to Bonnet's - what we have, the information that Bonnet gave to Sir John and so on about the alternatives, see - and remember, he was damn smart in saying that.

White: Well, apparently, the opposition of the French group to exchange control is not what has caused Phillips to oppose it, because he says he thinks it is a greater evil; so he wouldn't recommend it in any case. X

Taylor: All right, Harry, but what you have is your choice of three things which are put up to the British: 1. To hold it at 160, and so on. "We've got to have help. Will you give us a credit?" You see? "Will you take francs?" All those things that Bonnet put up.

Then Bonnet says, "Well, of course, there are two schools of thought in this cabinet, and one of them believes in letting her go to 190 to 200." He says, "I believe the other one, but in order to do that I've got to have something laid on the line."

And in addition to that you have all these military things. And you have the fact that this government is committed against exchange control. Therefore, they feel they can work with this government better

-8-

than they could work with some of the ones that they had before. So they'll take anything that this crowd tells them, except putting up some money.

Lochhead: Mr. Bewley.

H.M.Jr: He's not coming in. I'm going to see him a couple minutes. I'll explain to him we're not quite ready.

(H.M.Jr. goes out)

Taylor: I don't think they've got any choice.

White: Who?

Taylor: Saying yes on this.

White: Saying yes on this British cable?

Taylor: The British haven't got any choice.

Lochhead: I still think if we had a chance to talk to them first, before we gave the answer, we would have done the same thing we did, stall them a day.

Taylor: They've stalled.

Lochhead: Oh well, they - it's one of these things - they may have stalled them, but they've done it in such language that the French would wiggle out of it. I think they have hard work convincing an outsider because they didn't stall them in the statement; they've stalled them in supplementary ....

Taylor: I'm talking about what they have done already. They haven't given this answer to them. Read the first page.

(H.M.Jr. returns)

H.M.Jr: What I thought we could do - we could do this thing in a way - in two bites. I think we could show Bewley - let him read in here Cochran's cable which came in, then my answer, then Cochran's telephone message to me, and then the message I got from his (Bewley) government, which came in as far as we're concerned, last.

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Taylor: Yes, it did.

H.A.Jr: Last. Then I'd make my little speech to him that I've got to have time to think this thing over.

Taylor: You see, here's one - the first page - they've done exactly the same thing that you have, see?

H.A.Jr: Yes. Well - and my suggestion to the British is that they do the same as we do until we can think this thing over; do it on a day-to-day basis and keep the French on the hot spot until we get a chance to see the decree.

Taylor: Say we're consulting.

H.A.Jr: Until we see the decree. See?

Now, in talking we've got to keep in mind the salient points so we can send Butterworth a cable tonight, Cochran a cable, and the President. We've got to do it all tonight, regardless of difference in time.

I don't see why we should wait for Feis. Got so damn many cables to get off. You know Feis, he's never on time.

Taylor: I think we can certainly ...

H.A.Jr: It takes him time to read this thing.

Taylor: Got Bewley here, haven't you? I think you can certainly tell him what you're doing and that you suggest that, inasmuch as we're not ready, why, maybe they can wait a little bit.

H.A.Jr: Get him in here, will you (Lochhead)?

(Lochhead goes out for Bewley)

We'll let him sit here.

Taylor: He could not give him a definite answer until after he had consulted Washington, you see? So that gives you a chance to both stall.

(Lochhead returns with Bewley)

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H.M.Jr:

Let me tell you - I'll try to do this thing now in the order in which it happened, as near as I can get it. Well now, this came in first. You can read that if you want to; make some notes, it's all right.

Now, that came in and then as a result of that message I phoned Cochran and I typed that out for you - I told him to communicate that to Marchandean.

Bewley:

Yes.

H.M.Jr:

And then as a result of that Cochran went in about one o'clock this morning and saw Rueff, and Rueff said that Marchandean had gone to bed but he'd go in and see him, which he did. And I wrote this down over the phone. And Marchandean said, oh, this message to me, which I guess you'd call an aide memoire, because you'll see that you people got the same thing in a minute - this message was just one of principle and no instructions had been issued and they very much wanted it to be considered a matter of consultation. Then Rueff came out and gave that message to Cochran. Then Cochran reminded him how for the last ten days we have been asking them what they were going to do and every time we asked about this 175 francs which have been rumored and the French speculators are playing, they had always flatly denied it. Well, there was some argument about that.

So Rueff went back again and saw Marchandean, then came back with this; what he had said the first time was all right, but if any unforeseen pressure made action imperative before my reply comes, they would first communicate with Cochran if they had to do something. In other words, they were hedging, you see. The first time they said, now, this was simply a matter of principle, no instructions had been issued, they wanted us very much to consider this a matter of - that they were consulting. Then he goes back and has another talk. Then he comes out and says, "But if something unforeseen happens, we'll go ahead, but we'll tell you first." Then, after this, .....

Do you want to write it down?

Bewley:

No, it's all right. I can remember this. Just make a note of it.

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H.M.Jr: ... that thing I gave you was the only - and incidentally, I did that from memory, just my own memory on the telephone.

Then in comes this, which was delivered to me at 8:30.

You (Lochhead) haven't got the one that came in on Saturday there, have you?

Lochhead: The one from Paris?

H.M.Jr: No, the one from London.

Taylor: The one from London on Saturday.

H.M.Jr: This will supersede that.

Taylor: Oh yes.

H.M.Jr: This is to give him the background.

Taylor: Well, he may have it.

(Lochhead hands requested cable to H.M.Jr)

H.M.Jr: Well now, this - I don't know whether they - how much they keep you informed, but here's one .....

Bewley: They told me about Bonnet's interview, but that's all I have.

H.M.Jr: The four propositions that Bonnet put up ....

Bewley: Three, weren't there?

H.M.Jr: No, four. I take it this supersedes that. Right?

Bewley: I would assume so.

H.M.Jr: In cabling you might say that I consider that what is happening tonight supersedes that.

Bewley: Yes. May I just see that to see that the two are exactly the same.

-12-

- H.M.Jr: Please.
- Bewley: Oh yes, this is the same one exactly. Well, the end of it - the end of it I haven't got, but the rest of it .....
- H.M.Jr: It's all in there; but take a look at it.  
I remember Number four was the only thing that bothered us.
- Lochhead: Uh-huh.
- Bewley: I wasn't given the figure of 190 to 200.
- H.M.Jr: Huh?
- Bewley: I wasn't given the figure of 190 to 200 here.
- H.M.Jr: Well, now you've got the whole thing.
- Bewley: Yes.
- H.M.Jr: Now, if you don't mind my saying, I think the verbal part, the conversation between Sir Frederick Phillips and Butterworth is a little bit different than what he sent the French. I mean because in this thing he says here - he says here - he says here on 4: "Nevertheless, this would constitute the first occasion when a tripartite country had deliberately depreciated its currency as an instrument of policy, and there was no blinding the fact that it directly contravened the provisions of the tripartite agreement." You see? Now ....
- Bewley: Yes.
- H.M.Jr: Now, that's what he's telling me, but he doesn't tell that to the French.
- (Feis comes in)
- Feis: Sorry I'm just so late. I really couldn't help it.
- H.M.Jr: Harry, take Herbert Feis and just bring him up to date, so I don't have to do it twice. Do you mind? Would .

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you just take - would you mind going with him a minute?

(White and Feis leave)

- Bewley: If he didn't tell the French the same - but in the telegram to me I certainly got the impression he had told the French that. That was the telegram - if I had it with me - but it certainly was in the telegram that he had sent that to the French.
- H.M.Jr: Well, you read here .....
- Saylor: This hasn't been sent to the French yet.
- Bewley: This new one, no, but I mean in his conversation.
- H.V.Jr: This is a draft of an aide memoire to the French.
- Bewley: Oh, I see, what he's going to send.
- H.M.Jr: This is the proposal. But in his conversation with Phillips they say that they think this is contrary - I mean on page four was where I was reading - second paragraph.
- Bewley: Yes, it doesn't altogether - "Majesty's Government are prepared in the circumstances not to take exception to what is proposed as being inconsistent with the tripartite agreement." You feel that we ought to take exception?
- H.M.Jr: No, no, I'm just ....
- Bewley: Oh, there is a contradiction, I agree.
- H.M.Jr: I simply say, in this cable - in this proposal of what he says to the French and then what he says on page four - that there is ....
- Bewley: I agree they aren't the same.
- H.V.Jr: No.
- Bewley: Well, I suppose they may have felt that it was contradictory, but that if it was going to be done in

-14-

any case, there was no point in saying so. I don't know.

H.M.Jr: Well, that is, of course, what your government and ours are consulting about now.

Bewley: That's right. Well, this, after all, hasn't gone.

H.M.Jr: No, no. I'm going to wait a minute until Herbert comes in.

I love the French saying, "Well, we haven't got our instructions yet."

(White and Feis return)

What's this? I haven't seen this one?

Taylor: Oh yes, but I thought it was amusing in view of the bedside conversation, you see.

H.M.Jr: Oh. Yes.

Well, this - we'll consider you part of the family, and Herbert Feis has got the right to make faces at me, see? So you've got this message now which I've sent to Marchandeu and his answer.

Bewley: Yes.

H.M.Jr: That he's going to wait. My telling him also that we're going to consult with the British. My also telling them that we will act for them tomorrow, but what we will do after Tuesday we don't know.

Bewley: Yes.

H.M.Jr: Frankly, I don't see how either the British Government or our government can act intelligently on this until we have a chance to see the decrees, see?

Bewley: Yes.

H.M.Jr: And I'd like to wait. I don't see what we've got to lose by it. I think we've got everything to gain. Now, that's the way I feel.

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- Bewley: Of course, I suppose the French may want to issue the decree simultaneously with our ....
- H.M.Jr: The decrees are out.
- Bewley: The decrees are out, are they? ....
- H.M.Jr: Cochran told me they were out one o'clock this morning.
- Bewley: But nothing about the franc?
- H.M.Jr: Well, I can only repeat. Excuse me, have you got a cable there - on the back - may I see it? All I can say is what he said, that no instructions had been issued.
- Bewley: I see. About the franc.
- H.M.Jr: Yes. That's Marchandau at one o'clock this morning.
- Bewley: You think that when the decree is out it will be easier to decide?
- H.M.Jr: Well, you notice that - now, for instance, he says ....
- White: On top of page four.
- H.M.Jr: Well, I'd put it this way. The French - what they propose to do with the franc is only a part of a whole plan, and after we have seen the decrees and have had a chance to study them, we'd have some chance to make our best guess as to whether they can hold the franc to 175.
- Bewley: Yes.
- H.M.Jr: Whether they're not going to let it go to 200. So if, for instance, after studying it we say, "Well, this is only just a short resting place, and she's going to go to 200, and..." - well, let's just say that we know we won't stand for 200; we might just as well say no at 175 if we feel she's going to go to 200 anyway.
- Bewley: Yes.
- H.M.Jr: I mean here's a whole program. It's like the President

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sends a message to Congress, which he did two and a half or three weeks ago, and he has a whole program. One part of it - "What do you think of this?" I mean until you see the whole program how can you evaluate it? That's the way I feel.

Bewley: Yes.

H.M.Jr: And we feel here that we have everything to gain by stalling for a day or two, and we don't see what we've got to lose.

Bewley: Yes.

H.M.Jr: And I don't know - of course, this part here - if you want to make a couple notes - this part here - this came in today at - it left Paris at 3:35, arrived here at five. "The Minister of Finance told me that he would appreciate having the reaction of Secretary Morgenthau to the above statement as soon as it is possible for him to let us know. I asked Merchandean when the rate would be moved to 175 and he replied 'tomorrow'."

Bewley: Uh-huh. But then, subsequently they have withdrawn that, as I understand it.

H.M.Jr: On account of the message that I sent.

Bewley: Yes, yes. Well, are you proposing to telegraph back to Butterworth or ....

H.M.Jr: Well, what I'm going to do is this.

Bewley: ... or shall I telegraph the Treasury, or shall we do both?

H.M.Jr: I'd like you to, and then I'm going to tell - I'm going to send Butterworth a summary of where the thing stands.

Bewley: Yes.

H.M.Jr: As of tonight.

Bewley: Yes.

H.M.Jr: You see?

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Bewley: Yes.

H.M.Jr: But I don't think it would do any harm if you'd send a cable and we'd send one to Butterworth as well.

Bewley: Oh yes, I'll send a cable, certainly.

H.M.Jr: Because it's an advantage for me to have you here just as it is to have Butterworth there. I'd send a cable.

Now, the other thing which I thought I'd like to feel my way on is this. I frankly think that, from the French standpoint, leaving any other country out of the picture, this is a stupid move. It isn't going to be any good. They have never asked our advice. And this theory which has been reported to us again and again, that if you let the franc seek its own level - and this is the theory - let's say 200, that when it reaches that the French investor will think, "Well, this franc is so cheap," that they'll send back their money. Well, to use the vernacular, I think that's just the bunk.

Now, the amazing thing to me is that the French haven't put in what I called - like to call a modified exchange control, which is a supervision over the movement of capital, but not exchange control affecting trade. In other words, if a man wants to send some - whatever you want to call it, bad money or frightened money, out, purely to move his capital out, why, they don't supervise it. You people have a method of supervising it. We have a method of supervising it here, and we do it. We have, as you know, a volunteer reporting.

Bewley: Yes.

H.M.Jr: And I'm sure if we suddenly saw a lot of money moving out we'd seriously consider stopping it, and I'm sure you would also.

Bewley: Yes. We have no method of doing it at present. I mean we have control of foreign loans but we have no control of sending money abroad to buy stocks.

H.M.Jr: But you have of foreign loans.

Bewley: Oh yes.

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- H.M.Jr: I mean we accept volunteer reporting; that's all we have.
- Besley: I think we have always rather argued against that with the French, on the ground that once they begin they won't stop. I mean once they begin .... X
- H.M.Jr: Well, that's what I want to - that's what I want - I'm sending out as a feeler.
- Besley: Yes.
- H.M.Jr: I personally feel that as alternatives - as between letting the franc drop to the invisible, which is evidently what they have in mind, and then our having - the two governments' having to say to these people, "We're terribly sorry, but this is competitive depreciation and we'll have to ask you to step out until you get your house in order" - I mean that's the way it's going, and very rapidly, in that direction - I mean it's just as clear - or the possibility of our saying, "Well, look here, old man, why don't you think of putting in some kind of control on the movement of capital?" Now, the question is, which will put the French on their feet? I frankly don't think that this way that they are suggesting will, and I think that in the not too distant future we will have to ask them to step out, which I would do with the utmost regret - I mean we have seen them through one trouble after another, and it is terrifically important to keep them going, and certainly we don't want to add anything to their troubles. And the other way is that they have - we have no assurances, but the other way is that if they did put in what I call modified control of their movement of capital, I feel, and the people in the Treasury feel, that the chances of success in trying that are better than what they are talking about.
- Besley: Yes. I think we have always - in fact, I know we have for the last year rather taken the opposite view, because there are two arguments against it. One is that once you begin controlling movement of capital, the chances of capital that has already gone abroad returning are rather small, because they'd feel it was under control and they would not be able to use it freely again; the other being that once you begin

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to control, like in Germany, you get more and more completely limiting control.

H. V. Jr: All true. But we're faced with the real facts now, and we've got the two things. Here we see the franc going down and down, and the chances are two out of three that it will go to 175 to 200. Incidentally, the part that I don't like about it is that there is a group of French bankers that have been saying it's going to 175, and 175 has been the figure for two weeks, and they've been gambling on that.

Realey: Yes.

H. V. Jr: I don't like that. We don't do business that way here, and you people don't do business that way. But they picked the number and that's the number, and, by golly, that's where she's going. Now, if she goes to 175, the chances are she'll go to 200, and then there isn't much left, I think, for both of us to do except to ask them to step out. Now, seeing that, do we want to consider the possibilities of suggesting the other alternative, although it isn't something - I mean we have gone so far with the Scandinavian countries - I mean at different times they have talked to us, but we've been so high-minded about exchange control. Because Denmark has exchange control - "Why, we're very sorry, we can't talk to you." That's how high-minded we've been about it, see?

Realey: Yes.

H. V. Jr: I mean they've been - you know, talked different times. But we find ourselves doing a lot of things today that we wouldn't even have done a year ago, and here's the situation. And there was a remark which I don't know - I think - I'm not sure; I don't want to be held to this - but I had the impression that somebody in the British Treasury dropped a remark to Butterworth - as I say, I haven't checked my cables - that this thing that I'm talking about would not be too repulsive to them. Now, I haven't read my cables, but I just had an impression.

Anybody check me on that? Well, I got that impression from some place. Now, I don't know where. I don't know where I got it from. But don't count on that, because,

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as I say, I haven't read my cables back.

- Bewley: Well, when I left England - well, that's six weeks now - the attitude certainly was that we were afraid that exchange control was pretty likely, but we regretted - we'd rather see them fight without it. Things have gone further since then, and the attitude may have changed.
- H. S. Jr: Do you get what's going through my mind?
- Bewley: Oh yes, I do.
- H. S. Jr: Well, that I'd like you - I'm not going to attempt to put that in a cable to Butterworth, because we'd be up here all night arguing about words. And therefore I'm going to let you (Bewley) have a sleepless night. I mean ....
- Bewley: Oh yes, I'll give them that.
- H. S. Jr: I mean if you could - I mean I've ...
- Bewley: Oh yes, that's quite clear.
- H. S. Jr: You get that. And I think, say, pending that thought, we'd be more than willing ... Then another thing is, I couldn't give a final answer anyway until I've heard from the President. I can give a final answer, "Yes, this is all right," but if, for instance, we wanted to take positive action and say, "No, we're very sorry, gentlemen, this is not within the tripartite," I'd have to - I mean I'd have to communicate with the President, and that might take I don't know how long to get an answer.
- Bewley: Yes. Yes. In the meantime, you would - your suggestion really is that we shouldn't send any answer.
- H. S. Jr: Yes, that's my - yes.
- Bewley: Or if the English send an answer, it should only be a provisional answer, because they haven't had an opportunity of getting your final view. You probably prefer that we should send no answer at all.
- H. S. Jr: Well, what I had hoped we could do when we do send an

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answer - I hoped we could send the same answer. I did send this one before I heard from you people, but certainly ....

Bowley: Oh well, after all, that's ....

H. L. Jr: I mean when you read that - through your cable, I'd say your people would sign that one.

Bowley: Oh, certainly.

H. L. Jr: What?

Bowley: Oh, certainly. Certainly, yes.

Taylor: That's just what the first page of the cable from Butterworth - that's exactly what did happen, which was, "The Chancellor of the Exchequer had reminded the French Ambassador that the tripartite agreement was a triangular matter and that he could not give him a definite answer until after he had consulted Washington."

Bowley: That's the same.

Taylor: That's exactly what we said.

H. L. Jr: I'd like to stop and ask Herbert Feis whether he thinks I'm going too fast, or does he have any suggestions? He hasn't had a chance to talk.

Feis: I'm not sure that I yet ..... Can I ask one question first? Is that message in that cable from Butterworth - has it been delivered actually to the French?

Taylor: Oh no, that's the point that I was making. Sir John Simon simply told whoever it is he's talking to, the French Ambassador - did a little grumbling and said that he has to consult with us before he gives an answer. That's on the first page. The quoted part is a suggested answer. Now, over on page five ....

Feis: Well, I understand that. Well then, I must confess, Henry, I think - I don't see anything to be gained by not going at once and promptly as far as that message

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goes. You've got in the Daladier government the first promising government you've had in France for a long time. I think probably it stands more chance of making headway in getting that thing in - French affairs in stable order than any government they have had. I don't think they're seeking deliberate advantage in competitive depreciation. These fellows face a terrific load in expenditure on competitive armament, and they've spent all they had in their fund over the last thirty days in trying to keep the franc around 160. They haven't done it. I don't think there is the slightest chance that they can do it, and by opposing the move to 175 what I think you're doing is giving them a choice between losing a lot more gold, which I think would be unwise, or immediately going into exchange control - modified exchange control. I don't think I'd force them into that at once.

I'd let them go down, and if the British can take it - and they must have gulped when that message was drafted - I think I'd take it. And then I'd continue right with the idea that you have expressed and outlined to Mr. Bewley, with which I wholly agree - that they should introduce a modified system of control. I believe they'll need both. I'd give them everything I could give them.

H.W.Jr: Well, the only place we differ is, do you think we ought to take the 175?

Feis: Right now, just the way the British would take it - and the tone.

H.W.Jr: This is so fast - I know Bewley so well I don't mind discussing these things in front of him. I couldn't get anybody when this all - but I could get Sumner Welles, and I told him about this message. And before I sent this message to Marchandean, I read it, talked it over - and Sumner Welles heartily approved it.

Feis: Well, luckily - and this is rather cross-wise - before you telephoned it I had discussed it with Mr. Hull at quite some length, thinking that it was important to discuss with Mr. Hull.

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H.M.Jr: Well, I couldn't get Mr. Hull.

Feis: Welles doesn't know the background of this stuff, and ...

Hewley: Well, I don't know that it's my business, but I'd rather like to back up what Herbert says. It seems <sup>my 12</sup> to me - but I'm not - it's your position, not mine.

H.M.Jr: It's all right. I've asked for it and, as I say, we're being - sort of a family affair here. But I'm sorry, I don't agree in the sense of as of tonight. All I'm saying is, as of tonight I want time. I want time to see these decrees, I want time to study these decrees. I don't want to tell the French I want to go to 175 francs. I'm in disagreement with what Herbert Feis says there. We've gone along inch by inch. There's such a thing as making the tripartite agreement just a laughing stock in the sense it becomes useless. No one has been more patient with the French than I have. I usually take the attitude that you gentlemen are taking tonight, and you people in England have been usually a little bit stiffer than I have, and this is the first time that our roles are reversed - for the first time.

Feis: That's right.

H.M.Jr: What?

Feis: That's right.

H.M.Jr: But this time my Treasury people and myself are all in agreement on this, because we had a chance in the Treasury to talk this thing over. But it's always been the other way around.

Now, all I'm saying tonight is this, that if you'll tell Sir John Simon that as far as I'm concerned I want more time, maybe my message to Marchandau will have the effect that he will not put it in and maybe he won't have to put it in. We didn't have any indications today that they had any trouble holding the franc.

Lochhead: No, it was a very small market. Didn't seem to have

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any difficulty on the other side. We didn't get any final figures. But in our market at the close the franc was strong, and we had to sell francs to keep them from going up this afternoon.

- H.T.Jr: There was no indication... And as I say - all I'm saying - and this gives me a chance to talk it over with Mr. Hull and to think. This is terrifically important, and I'm just not going to commit myself. Now, I'm willing to go along for tomorrow, and we'll see what happens, and tomorrow morning's papers here will have the decrees and we can read them and study them.
- Bailey: Yes.
- H.T.Jr: And if the franc continues at the rate it is and - I mean maybe they'll feel differently tomorrow.
- Taylor: Of course, there is this one thing about it, that - suppose - let's say that they have a rate tomorrow of, say, 163 or 165, or whatever it may be, and then for some reason things don't act very right and you have a slide; why, then you're in twice as bad shape as if - and then you decide that that's all right.
- H.T.Jr: Well - yes.
- Taylor: You're just in twice as bad shape, or they're in just as bad shape, as if they go to the bottom of what they're talking about now - and starting out with this "hurrah," with the new decrees, the new rate and so on, they might be able to get it up a little bit from there. But if by stalling around for a couple days they don't get the full effect of it, why, Christ knows what will happen; then you do go down on the other side.
- H.T.Jr: Well now, I'm just - I'm not going to budge tonight. I mean I'm just not going to budge.
- Taylor: Well, I wasn't suggesting that you should, but I think you ought to have that very much in your mind. If you just fuss around here and everything isn't right with them ....
- H.T.Jr: There isn't any - as far as a matter of handling their money, they're not handling it any better than anybody

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in the French Government has handled it in the last three years. I mean they're not handling it one bit better today than they were a month ago, a year ago, or two years ago. I mean whoever - the inside ring are still in control - I mean as far as finances are concerned. What?

Wiley: Yes, yes.

W.C.Jr: Whyne,.....

Wiley: You say the bankers already knew the figure of 175.

W.C.Jr: Oh, there's no question of it. And I'm just going to mark time for a day or so. And I would very much like you to get that cable off.

Wiley: Oh yes, I will.

W.C.Jr: You know exactly how I feel. I'm sorry that I didn't have a chance to talk to Herbert Feis before, but these cables have kept coming in and we had to keep shooting. I didn't have a chance to talk it over and, frankly, I've made up my mind. And I think what I'd like to do - we should do is to continue to consult hourly until we can see a little daylight. Because Heaven knows, for what is it, two years, three years now, we've done the Boy Scout deed with the French on their franc, and they just won't do the courageous thing themselves, that's all.

Now, would you like to ask me anything else?

Wiley: No, I think it's all pretty clear.

W.C.Jr: Do you want to ....

Wiley: What's the history - I haven't got the exact history of what the French said about it. They originally told you they were going to drop it to 175 tomorrow.

W.C.Jr: I thought I gave you that. I thought I showed it ....

Wiley: It was that which you said this was the answer to. Yes.

W.C.Jr: This is the - the history is this. This comes in, and

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we have what your government undoubtedly has, in which they say the "French Government is obliged to inform anew the Government of the United States of America" so forth and so on. It's that message. "The rate at which the French Government has decided to stop is around 175 francs for one pound, with the will to lower progressively this figure in correlation with the economic improvement which it expects from its decrees."

Bewley: Yes.

H.M.Jr: Based on that, I phoned this message back, and then got their reply ...

Bewley: I think I got that.

H.M.Jr: ... announcing, well, they hadn't done anything about it and they wouldn't - that they did want to consult.

Bewley: Yes, yes. I think I've got that.

H.M.Jr: And then, after I've done this all with the French, in comes a message from your people. And now what I'm saying is, I'd like to have a couple days to think this over.

Bewley: Right.

H.M.Jr: And I can't tell what will happen. Nobody can tell. And we've begged them to tell us now for two weeks. For two weeks we've begged them. And there was that one time when I sent for you when nobody could see Marchandesu. Remember?

Bewley: Yes, I remember.

H.M.Jr: And from that time on we just begged them to tell us, and we've gotten constant rumors they were going to do 175 francs, and they've constantly said they won't. And now in the afternoon they suddenly say, "We're going to do it tomorrow morning." Now, I just don't like it. Now, that may be the sign of a very strong government, but I beg to differ with my friend and adviser, Mr. Herbert Feis. I love to be on the opposite side; for three years I've been on his side, I've taken the side he has.

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- Taylor: My hunch is they're going to do it anyhow.
- H.M.Jr: I agree with you.
- Taylor: Yes.
- H.M.Jr: I agree with you. I agree with you.
- Bewley: Yes, I would think so.
- Taylor: and they're also going to do it tomorrow anyhow.
- H.M.Jr: Maybe.
- Lochhead: In other words, the franc may go to 175 tomorrow and they won't put up any opposition to it. On the other hand, it may not go down. They'll not just notify the market that it's going to be 175, but they won't put up any resistance if it does start to go towards 175.
- Taylor: Well, however it gets there. But they'll start that off with this program, so that they've got a place that they can jump from rather than a place that they have to deteriorate to.
- White: Not tomorrow - I don't think.
- H.M.Jr: Well, anyway, this is the best I can give you.
- Bewley: That's all quite clear.
- H.M.Jr: I have the responsibility in the absence of the President of the United States. I've got to take responsibility. I can't consult him. And this is the best that I can do. Just pray for the best.
- Bewley: Would it be possible for me to borrow a couple of those (cables)?
- H.M.Jr: Would you mind ....
- Bewley: I could easily return them.
- H.M.Jr: That's entirely up to Feis. Feis, you'll have to pass on that. It's the property of the State Department. I can't tell you.

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- Bealey: Well, I read them, but ... I would be very glad to return them to you.
- Wells: I can't - I'm not acquainted enough ....
- Bealey: Well, I don't very much mind.
- Wells: Well, it's their property, and they're very strict about it.
- Timley: No, sir, I can manage all right. I just wanted a little ...
- Weyton: There is one - on the last page, there is one point here. This is quoting Phillips. "He hoped that Simon would not be asked a question in the House of Commons tomorrow, that no doubt he would be on Wednesday and that if it was agreeable he would reply along the lines indicated in the text quoted above." In other words, you're - I don't know how long you can stall off over there on answering a Parliamentary question.
- Bealey: Just depends on who asks it. If it's a Conservative, you can ask him not to ask the question. If it's a member of the Opposition, you can't very well - more or less got to answer it. Got to answer it the best you can.
- W.S.Jr: I know what I'd answer.
- Bealey: Say, "The matter is under consideration."
- W.S.Jr: Say, "I'm conferring."
- Bealey: You can always find an answer.
- H.S.Jr: I'd say, "I'm conferring."
- "Well, does that mean that you're thinking of breaking the tripartite?"
- "Well, I'm just conferring."
- Bealey: Yes.
- H.S.Jr: I don't know what the answer would be, which I don't - I mean if we're asked.

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Fels: If the story spreads that the tripartite agreement is going to break, they won't be able to hold the franc at 175.

H.W.Jr: Well, I don't have to see the press until Thursday. I won't see them until Thursday.

Fels: That's what has me disturbed.

H.W.Jr: Well, I won't see them until Thursday, and there will be no leaks from the Treasury, and if they ask us we can truthfully say that the tripartite is still in force, which is the thing that I answer about once every two weeks when the rumor comes up. About every two weeks. "Well, it is still in force as of today" - which will be true. It comes up regularly once or twice a month.

Bewley: Might I read those two telegrams through once again?

(Fels hands Bewley cables)

Fels: This is the part I'm raising my hand about. "Phillips went on to quote Monick to the effect that the French national income was now not more than 220 milliards while state and municipal requirements were 115 milliards."

H.W.Jr: Herbert, that's your government. That's your present French Government.

Fels: It is my present French Government. It is also my favorite lecture over the past three years about France, Mexico, and the United States - that I've delivered periodically for three years past. "Such a condition could not go on indefinitely and unless rectified would continue to require the remedy of depreciation. Phillips pointed out that of course the figure 220 milliards did not depend solely on the price level but on the state of business activity multiplied by the price level." And that leads directly into the conclusion that you suggest.

H.W.Jr: What?

Fels: That during an interim period at least, while they're

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getting their affairs in order, there ought to be some control over capital movements. I mean it leads right into that conclusion.

H.S.Jr: Well, if the British would say to us, "Of the two alternatives, we prefer a limited..." - let's use "supervision over capital movements."

Feis: That's better.

H.S.Jr: See, get away from the exchange control. If they'd come back and say, "All right, of the two alternatives we'll take supervision of capital movements," and we could get that to the French and get that to them in the next 24, 36 hours, I think that would be a step in the right direction.

Taylor: I don't think there is much argument about that. But these fellows have a commitment against it. That's one of the things.

H.S.Jr: Well, it's just too bad that the L'Indo Chine crowd should lose a little money.

Feis: I hope his message to the Chancellor of the Exchequer will draw a reply whether the French have any commitments to the British about any supervision.

Bowley: Commitment? Not at all. They've advised - I mean each successive Minister of Finance has always said - including the present government - they're not going to institute exchange control. I mean nothing more than that. I think I can tell you definitely - nothing more than that.

H.S.Jr: Feis is a suspicious cuss.

Bowley: I think you've always asked them. Always said the same thing. They can't be ...

Taylor: They've said it to their own people. That's how they got in.

Feis: But that's the difference. Have they also given it in the form of a pledge to the British Treasury?

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H.S.Jr: What the British should have done - I mean this facetiously now - is, say, "All right, we're willing to have a Frenchman command the two armies, provided you have an Englishman command the two treasuries."

Feis: An excellent idea.

H.S.Jr: What?

Feis: Excellent idea.

H.S.Jr: I think you people overlooked something.

Taylor: Well, I think Bonnet almost suggested that, but he had a price that he put on it, you see.

Feis: The rest of that first cable from Paris is what you're looking for, aren't you?

Bewley: No, the rest of the English message, just to see I don't overlook anything.

(Secretary goes out)

Feis: Cochran delivered that message, as I understand it, and have we got a report of that conversation?

Taylor: Yes.

Feis: In cable or over the telephone?

Taylor: Over the telephone.

Feis: And the substance was that Marchandean said he would not put the franc at 175.

Taylor: Had given no instructions, and that she wouldn't until a situation developed which was unforeseen.

Lochhead: He first put up that he wanted us to understand this message about 175 as merely a question of consultation rather than as a statement that they had already given instructions on.

Bewley: Will you be telegraphing also to Butterworth tonight or sending any reply to Butterworth tonight?

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Taylor: Probably give him a summary.

Bewley: Yes.

Taylor: But no - no instructions other than ....

Bewley: I mean the British Treasury will be making his life miserable by bringing up certain things tomorrow morning.

Taylor: Well, we'll send him something tonight.

Bewley: Yes. Well, I'd better go off and begin dropping my stuff, I think.

(Secretary returns)

H.M.Jr: You all right?

Bewley: Yes, sir. I'll go off.

H.M.Jr: All right, and we'll get our cables off.

You got a car?

Bewley: Yes, I've got a car.

H.M.Jr: I can get you one.

Bewley: No, I've got a car.

(Bewley leaves)

H.M.Jr: Now we'll get this started and then we can do a little arguing afterwards.

This is for the President of the United States. This has to go tonight.

(Dictates attached cable to President)

May 2, 1938.  
11:30 P.M.

FOR THE PRESIDENT OF THE UNITED STATES

STRICTLY CONFIDENTIAL

RECEIVED THE FOLLOWING MESSAGE MAY 2, 5 P.M. FROM COCHRAN,  
PARIS:

"STRICTLY CONFIDENTIAL FOR THE SECRETARY OF THE  
TREASURY FROM COCHRAN.

"MINISTER OF FINANCE MARCHANDEAU SENT WORD FOR  
ME TO COME TO HIS OFFICE THIS AFTERNOON AT 4 O'CLOCK.  
UPON MY ARRIVAL HE READ TO ME A MESSAGE WHICH HE  
WISHED COMMUNICATED TO SECRETARY MORGENTHAU AT ONCE.  
RUEFF, WHO WAS ALSO PRESENT, TOOK THE MESSAGE IN  
FRENCH AND I TOOK IT DOWN IN ENGLISH. RUEFF AND I  
THEN COMPARED OUR COPYING AND AGREED ON THE FOLLOWING  
TRANSLATION:

"THE FRENCH GOVERNMENT IS OBLIGED TO INFORM  
AHEAD THE GOVERNMENT OF THE UNITED STATES OF  
AMERICA THAT THE EXPENSIVE EFFORT MADE BY  
THE STABILIZATION FUND, PARTICULARLY DURING  
THE RECENT PERIOD, CAN NOT LONGER BE MAINTAINED.  
THE FRENCH GOVERNMENT IS THEREFORE OBLIGED,  
DESPITE THE FACT THAT IT HAS DECIDED TO IMPOSE  
FROM THIS WEEK A NEW AND IMPORTANT TAX EFFORT  
ON THE COUNTRY, TO CHOOSE BETWEEN EXCHANGE  
CONTROL OR THE RETREAT OF ITS CURRENCY. THE  
RATE AT WHICH THE FRENCH GOVERNMENT HAS DECIDED  
TO STOP IS AROUND 175 FRANCS FOR ONE POUND,  
WITH THE WILL TO LOWER PROGRESSIVELY THIS  
FIGURE IN CORRELATION WITH THE ECONOMIC  
IMPROVEMENT WHICH IT EXPECTS FROM ITS DECREES.

"THE FRENCH GOVERNMENT RECALLS THAT FROM THE  
FIRST OF LAST JULY TAXES HAVE BEEN INCREASED  
BY 16,000,000 FRANCS AND THAT THEREBY IT HAS  
SHOWN ITS WILL TO DEFEND ITS CURRENCY BY ALL  
POSSIBLE MEANS AND THAT IT REMAINS STILL  
ATTACHED TO THIS VIEW WITHIN THE FRAMING OF  
MONETARY LIBERTY. IT HOPES THEREFORE THAT IN  
THESE CONDITIONS THE SETBACK WHICH IT IS OBLIGED

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TO DECIDE UPON WILL APPEAR TO THE GOVERNMENT OF THE UNITED STATES OF AMERICA AS ENTIRELY IN CONFORMITY WITH THE PROVISIONS OF THE TRIPARTITE AGREEMENT.'

"THE MINISTER OF FINANCE TOLD ME THAT HE WOULD APPRECIATE HAVING THE REACTION OF SECRETARY MORGENTHAU TO THE ABOVE STATEMENT AS SOON AS IT IS POSSIBLE FOR HIM TO LET US KNOW. I ASKED MARCHANDEAU WHEN THE RATE WOULD BE MOVED TO 175 AND HE REPLIED 'TOMORROW'; THIS WILL BE ONE OF SEVERAL STEPS WHICH ARE TO BE TAKEN TOMORROW SIMULTANEOUSLY WITH THE PUBLICATION OF CERTAIN DECREE LAWS. I ASKED THE MINISTER WHETHER THE TERMS OF THE NATIONAL DEFENSE LOAN WOULD BE MADE KNOWN TOMORROW. HIS ANSWER WAS THAT HE WAS NOT SURE WHETHER THEY WOULD BE TOMORROW OR THE DAY AFTER. IN ANY CIRCUMSTANCES, HE INSISTED, IT IS NOT POSSIBLE TO HOLD THE PRESENT FRANC RATE AND THAT IT IS ABSOLUTELY NECESSARY TO LET IT MOVE TO 175 TO THE POUND."

ON RECEIPT OF THAT TELEGRAM I TELEPHONED THE FOLLOWING MESSAGE TO COCHRAN, WHICH HE DELIVERED 1 A.M. MAY 3 TO MARCHANDEAU:

"PLEASE INFORM M. MARCHANDEAU THAT:

- "1. I WAS VERY MUCH SHOCKED AND SURPRISED AT THE MESSAGE WHICH MARCHANDEAU SENT ME.
- "2. I DID NOT CONSIDER THAT UNDER THE TRIPARTITE AGREEMENT WE HAD BEEN CONSULTED, BUT THAT HE HAD SIMPLY INFORMED US.
- "3. WE WILL EXECUTE ANY ORDERS ON TUESDAY THAT WE RECEIVE FROM THE FRENCH TO BUY OR SELL FRANCS FOR THEIR ACCOUNT, BUT IN DOING SO WE IN NO WAY ACQUIESCE IN THE NEW FRENCH PROPOSAL, AND, WHILE I AGREED TO DO THIS TUESDAY, WE ARE NOT COMMITTED BEYOND TUESDAY.
- "4. BEFORE WE COMMIT OURSELVES IN ANY WAY, I WISH TO CONSULT WITH THE BRITISH."

-3-

ON RECEIPT OF THAT MESSAGE MARCHANDEAU SENT WORD TO ME THAT NO INSTRUCTIONS HAD YET BEEN ISSUED IN REGARD TO LETTING THE FRANC GO TO 175 TO THE POUND AND THAT HE WISHED THAT I WOULD CONSIDER THAT HE WAS CONSULTING ME UNDER THE TRIPARTITE AGREEMENT; HOWEVER, THAT IF UNFORESEEN PRESSURE SHOULD DEVELOP ON TUESDAY AGAINST THE FRANC THIS MIGHT MAKE IT IMPERATIVE FOR THE FRENCH TO TAKE ACTION.

LATER IN THE EVENING I RECEIVED THE FOLLOWING CABLE FROM BUTTERWORTH:

\*STRICTLY CONFIDENTIAL FOR THE SECRETARY OF THE TREASURY FROM BUTTERWORTH.

\*SIR FREDERICK PHILLIPS SENT FOR ME TONIGHT TO SAY THAT ABOUT SEVEN O'CLOCK THE FRENCH AMBASSADOR HAD SOUGHT AN INTERVIEW WITH THE CHANCELLOR OF THE EXCHEQUER TO PRESENT THE FRENCH AIDE MEMOIRE.

\*AT THE SAME TIME MONICK, FRENCH FINANCIAL ATTACHE, HAD CALLED UPON HIM.

\*PHILLIPS SAID THAT HE UNDERSTOOD A COPY OF THE FRENCH AIDE MEMOIRE WAS LIKEWISE BEING PRESENTED AT WASHINGTON.

\*THE CHANCELLOR OF THE EXCHEQUER HAD REMINDED THE FRENCH AMBASSADOR THAT THE TRIPARTITE AGREEMENT WAS A TRIANGULAR MATTER AND THAT HE COULD NOT GIVE HIM A DEFINITE ANSWER UNTIL AFTER HE HAD CONSULTED WASHINGTON.

\*PHILLIPS HANDED ME THE FOLLOWING DOCUMENT WHICH HE SAID HAD BEEN APPROVED BY SIMON IN SUBSTANCE BEFORE IT WAS ACTUALLY DRAFTED BUT OF COURSE NOT IN PHRASEOLOGY:

\*HIS MAJESTY'S GOVERNMENT HAVE STUDIED THE AIDE MEMOIRE LEFT BY THE FRENCH AMBASSADOR WITH THE CHANCELLOR OF THE EXCHEQUER ON THE 2ND MAY AND REGRET TO LEARN THAT DESPITE THE ADDITIONAL TAXATION THEY HAVE DECIDED TO IMPOSE THE FRENCH GOVERNMENT HAVE REACHED THE CONCLUSION THAT IT IS NOT POSSIBLE TO DEFEND THE CURRENT RATE OF THE FRANC BY THE USE OF THE EQUALIZATION FUND.

-4-

\*AT THE SAME TIME THE FRENCH GOVERNMENT HAVE NO DOUBT MATURELY CONSIDERED ALL POSSIBILITIES AND HAVE THE RESPONSIBILITY FOR REACHING A DECISION.

\*HIS MAJESTY'S GOVERNMENT NOTE THAT IT IS THE INTENTION OF THE FRENCH GOVERNMENT TO ACHIEVE AS THE EVENTUAL RESULT OF THEIR POLICY A RATE CORRESPONDING TO THE ECONOMIC POSITION OF FRANCE WHICH WILL GIVE TO FRANCE NO COMPETITIVE TRADE ADVANTAGE.

\*IT IS FOR THE FRENCH GOVERNMENT TO DETERMINE WHAT IS THE BEST PROCEDURE FOR ACHIEVING STABILITY AT SUCH A RATE, AND HIS MAJESTY'S GOVERNMENT ARE PREPARED IN THE CIRCUMSTANCES NOT TO TAKE EXCEPTION TO WHAT IS PROPOSED AS BEING INCONSISTENT WITH THE TRIPARTITE AGREEMENT THOUGH THEY FEEL IT RIGHT TO MAKE IT CLEAR THAT THEY DO NOT REGARD PRESENT ECONOMIC CIRCUMSTANCES AS JUSTIFYING A RATE MORE FAVORABLE TO THE FRANC THAN ABOUT 160.'

\*PHILLIPS POINTED OUT THAT PARAGRAPH THREE ABOVE DID NOT ARISE OUT OF THE FRENCH AIDE MEMOIRE BUT OUT OF BONNET'S STATEMENT REPORTED IN PARAGRAPH NUMBERED FOUR OF NY 356, APRIL 29, 9 P.M.

\*PHILLIPS ALSO SAID THAT NOTE SHOULD BE TAKEN OF THE FACT THAT THE REPLY DID NOT CONTAIN AN UNEQUIVOCAL YES TO THE QUESTION IN THE LAST PARAGRAPH OF THE AIDE MEMOIRE, THAT THE STEPS 'ENTIRELY CONFORMED TO THE TERMS OF THE TRIPARTITE ACCORD'. PHILLIPS WENT ON TO QUOTE MONICK TO THE EFFECT THAT THE FRENCH NATIONAL INCOME WAS NOW NOT MORE THAN 220 MILLIARDS WHILE STATE AND MUNICIPAL REQUIREMENTS WERE 115 MILLIARDS; THAT SUCH A CONDITION COULD NOT GO ON INDEFINITELY AND UNLESS RECTIFIED WOULD CONTINUE TO REQUIRE THE REMEDY OF DEPRECIATION.

\*PHILLIPS POINTED OUT THAT OF COURSE THE FIGURE 220 MILLIARDS DID NOT DEPEND SOLELY ON THE PRICE LEVEL BUT ON THE STATE OF BUSINESS ACTIVITY MULTIPLIED BY THE PRICE LEVEL.

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"HE SAID THAT THE FRENCH HAD NOT REVEALED TO THE BRITISH TREASURY THE WHOLE OF THEIR DECREE PROGRAM BUT THAT IT CONTAINED SEVERE TARIFF AND 'READJUSTMENTS' WHICH IN SOME RESPECTS WERE AS, IF NOT MORE, SERIOUS TO GREAT BRITAIN THAN THE PROPOSED CURRENCY ACTION.

"NEVERTHELESS, THIS WOULD CONSTITUTE THE FIRST OCCASION WHEN A TRIPARTITE COUNTRY HAD DELIBERATELY DEPRECIATED ITS CURRENCY AS AN INSTRUMENT OF POLICY AND THERE WAS NO BLINDING THE FACT THAT IT DIRECTLY CONTRAVENED THE PROVISIONS OF THE TRIPARTITE AGREEMENT.

"AS INDICATED IN PARAGRAPH ONE OF MY 335, APRIL 22, 8 P.M., PHILLIPS HOLDS THAT THE SUITABLE RATE IS NOT 175 BUT BETWEEN 155 AND 160 TO THE POUND.

"HOWEVER, HE SAID HE THOUGHT EXCHANGE CONTROL WAS THE GREATER EVIL BUT HE DID NOT CONCEAL THAT HE HAD NO GREAT CONFIDENCE IN THIS BEING THE FINAL DEPRECIATION.

"I ASKED WHETHER IN HIS OPINION A GOOD FACE COULD BE PUT UPON THE FRENCH ACTION OR WHETHER THE TRIPARTITE ACCORD WOULD IN EFFECT DISAPPEAR INTO A TISSUE OF FICTIONS.

"HE SAID, SPEAKING PERSONALLY, IT SEEMED A LARGE ORDER AT THE MOMENT TO REWRITE THE DECLARATIONS AND THAT HE BELIEVED THAT THE FRANC WOULD GRADUALLY MOVE TO THE INDICATED LEVEL, THE LEAKS FROM GOVERNMENTAL SOURCES IN PARIS BEING WHAT THEY WERE.

"HE HOPED THAT SIMON WOULD NOT BE ASKED A QUESTION IN THE HOUSE OF COMMONS TOMORROW, THAT NO DOUBT HE WOULD BE ON WEDNESDAY AND THAT IF IT WAS AGREEABLE HE WOULD REPLY ALONG THE LINES INDICATED IN THE TEXT QUOTED ABOVE.

"PHILLIPS SAID THAT HE DID HOPE THAT IT MIGHT BE POSSIBLE FOR WASHINGTON TO REACH A DECISION TONIGHT BUT IF NOT THE CHANCELLOR WOULD VERY MUCH APPRECIATE IT IF REPLY COULD BE HAD EARLY TOMORROW.

"AN ADDED REASON FOR AN IMMEDIATE REPLY LIES IN THE FACT THAT THE AMBASSADOR HAS AN APPOINTMENT TO SEE SIR JOHN SIMON AT NOON TOMORROW."

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ON THE RECEIPT OF THIS CABLE WE CONFERRED AT MY HOUSE WITH MR. BEWLEY, BRITISH FINANCIAL ATTACHE. I SENT WORD TO SIR JOHN SIMON VIA MR. BEWLEY THAT THE UNITED STATES TREASURY WISHED TO DELAY ANSWERING THE FRENCH UNTIL WE HAD SEEN A FULL COPY OF THE DECREES WHICH THEY ARE SUPPOSED TO ISSUE ON MAY 3 AND THAT FURTHERMORE I WOULD NEED TIME TO GET THE BENEFIT OF ADVICE FROM THE PRESIDENT OF THE UNITED STATES.

I FURTHERMORE ASKED THE BRITISH WHETHER THEY WOULD NOT RATHER SEE THE FRENCH PUT IN A SYSTEM OF SUPERVISION OVER CAPITAL MOVEMENTS, RATHER THAN SEE THE FRANC CONTINUE TO FALL. I ASKED BEWLEY TO TRY TO GET AN ANSWER FOR ME ON THIS QUESTION PROMPTLY.

IN THE TREASURY WE SERIOUSLY QUESTION THE WISDOM OF CONTINUING TO GO ALONG WITH THE FRENCH IN THEIR PROPOSED POLICY OF PERMITTING THE FRANC TO SEEK ITS OWN LEVEL.

IT WOULD BE MOST HELPFUL IF YOU WOULD CARE TO EXPRESS YOUR OWN OPINION IN REGARD TO THIS MATTER.

HENRY MORGENTHAU JR.

HSE

TELEGRAM SENT

May 2, 1938

12 p.m.

AMEMBASSY

PARIS (FRANCE)

RUSH

247

FOR COCHRAN FROM THE SECRETARY OF THE TREASURY.

Have fully informed Bewley this evening of course of interchanges today between myself and French treasury. Have suggested to British that we take no action until opportunity afforded for further consultation and examination of text of French decree.

I also asked Bewley informally to ascertain whether the British Treasury did not think that introduction by the French Government of modified supervision of capital movement might not be preferable alternative policy for the French Government to pursue rather than prospective continued decline of franc.

I withheld direct comment upon Simon's message as conveyed in Butterworth's 364 of May 2.

HULL

(HF)

EA:HF:EDA

SAME TO: Amembassy, London, England as Department's

No. 108, May 2, midnight.

*See previous of last page*

EDA

PLAIN

LONDON

Dated May 2, 1938

Received 6:10 p.m.

Secretary of State

Washington

RUSH

364, May 2, 11 p.m.

STRICTLY CONFIDENTIAL FOR THE SECRETARY OF THE  
TREASURY FROM BUTTERWORTH.

Sir Frederick Phillips sent for me tonight to say that about seven o'clock the French Ambassador had sought an interview with the Chancellor of the Exchequer to present the French aide memoire.

At the same time Monick, French Financial Attache had called upon him.

Phillips said that he understood a copy of the French aide memoire was likewise being presented at Washington.

The Chancellor of the Exchequer had reminded the French Ambassador that the tripartite agreement was a triangular matter and that he could not give him a definite answer until after he had consulted Washington.

Phillips handed me the following document which he said had been approved by Simon in substance before

it

EDA - 2 - #364, May 2, 11 p.m. from London

It was actually drafted but of course not in phraseology:

"His Majesty's Government have studied the aide memoire left by the French Ambassador with the Chancellor of the Exchequer on the 2nd May and regret to learn that despite the additional taxation they have decided to impose the French Government have reached the conclusion that it is not possible to defend the current rate of the franc by the use of the equalization fund.

At the same time the French Government have no doubt maturely considered all possibilities and have the responsibility for reaching a decision.

His Majesty's Government note that it is the intention of the French Government to achieve as the eventual result of their policy a rate corresponding to the economic position of France which will give to France no competitive trade advantage.

It is for the French Government to determine what is the best procedure for achieving stability at such a rate, and His Majesty's Government are prepared in the circumstances not to take exception to what is proposed as being inconsistent with the tripartite agreement though they feel it right to make it clear  
that

EDA - 3 - #364, May 2, 11 p.m. from London

that they do not regard present economic circumstances as justifying a rate more favorable to the franc than about 160".

Phillips pointed out that paragraph three above did not arise out of the French aide memoire but out of Bonnet's statement reported in paragraph numbered four of my 356, April 29, 9 p.m.

Phillips also said that note should be taken of the fact that the reply did not contain an unequivocal yes to the question in the last paragraph of the aide memoire, that the steps "entirely conformed to the terms of the tripartite accord". Phillips went on to quote Monick to the effect that the French national income was now not more than 220 milliards while state and municipal requirements were 115 milliards; that such a condition could not go on indefinitely and unless rectified would continue to require the remedy of depreciation.

Phillips pointed out that of course the figure 220 milliards did not depend solely on the price level but on the state of business activity multiplied by the price level.

He

Cable #364, London, dated May 2, 1938: Page 4, line 3: Insert word "quota" before "readjustments". Will then read "quota readjustments".

EDA - 4 - #364, May 2, 11 p.m. from London.

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He said that the French had not revealed to the British Treasury the whole of their decree program but that it contained severe tariff and "readjustments" which in some respects were as, if not more, serious to Great Britain than the proposed currency action.

Nevertheless, this would constitute the first occasion when a tripartite country had deliberately depreciated its currency as an instrument of policy and there was no blinding the fact that it directly contravened the provisions of the tripartite agreement.

As indicated in paragraph one of my 335, April 22, 8 p.m. Phillips holds that the suitable rate is not 175 but between 155 and 160 to the pound.

However, he said he thought exchange control was the greater evil but he did not conceal that he had no great confidence in this being the final depreciation.

I asked whether in his opinion a good face could be put upon the French action or whether the tripartite accord would in effect disappear into a tissue of fictions.

He said, speaking personally, it seemed a large order at the moment to rewrite the declarations and that he believed that the franc would gradually move to the indicated level, the leaks from governmental sources

in

EDA - 5 - #364, May 2, 11 p.m. from London  
in Paris being what they were.

He hoped that Simon would not be asked a question  
in the House of Commons tomorrow, that no doubt he would  
be on Wednesday and that if it was agreeable he would  
reply along the lines indicated in the text quoted above.

Phillips said that he did hope that it might be  
possible for Washington to reach a decision tonight  
but if not the Chancellor would very much appreciate  
it if reply could be had early tomorrow.

An added reason for an immediate reply lies in the  
fact that the Ambassador has an appointment to see Sir  
John Simon at noon tomorrow.

KENNEDY

NPL

one of principal  
no instructions  
had been issued  
wanted it to be  
considered consultation

---

if unforeseen pressure  
made action imperative  
before my reply comes  
they would communicate  
with you.

## RE FRENCH MONETARY SITUATION

May 3, 1938.  
9:30 a.m.

Present: Mr. Taylor  
Mr. Oliphant  
Mrs Klotz  
Mr. Gaston  
Mr. Harrison  
Mr. Knoke  
Mr. Lochhead  
Mr. White

H.M.Jr: (On phone) Put in a call for Cochran over the French phone - utmost secrecy, whatever they call it, please.

This is the story, briefly, of what's happened - rather rapid thing. I mean sometimes we ask you (Harrison) down and nothing happens; sometimes we ask you down and by the time you get down lots happens, see? But I'll try to give it to you chronologically.

Harrison: Yes, sir.

H.M.Jr: I don't know whether you've had a chance to see the cables.

Harrison: No, I haven't.

H.M.Jr: Have you (Knoke)?

Knoke: Yes, I saw them.

H.M.Jr: Yesterday afternoon ....

(White comes in)

Hello, Harry, sit down.

.... Marchandean sends for Cochran and tells him that "Tuesday morning we're going to put the franc to 175."

Harrison: That's today.

H.M.Jr: That's today. And I get this thing and I'm upset, and I call up Cochran and say, "In the first place, I'm very much upset over this message and I don't feel that this comes under the spirit of the

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tripartite, because they haven't consulted, they're telling us; and furthermore, I can not give them an answer, which they have asked for by tomorrow morning, because I have to consult with the British."

Cochran gets that message to Marchandeseu at one o'clock in the morning, when he's in bed, and via Rueff he tells Cochran that "Well, we haven't given any orders; that's just an expression of policy. Oh, we want to consult very much. No orders have gone out." And then Cochran argues with them and tells them, "Now, we've been asking you this for two weeks and you constantly said you're not going to go to 175," and gets into an argument with Rueff, and Rueff goes back to refresh his memory with Marchandeseu, and Marchandeseu says, "Well, tell Cochran that we will not go to 175 unless the pressure gets so great that we have to go, but then if we do have to go we'll call up Cochran and tell you we're going to do it. But please ask Mr. Morgenthau to hurry."

Well then, when I get back here I find a message from Sir John Simon, with a draft - they have also gotten this message - and with a draft of their communique or aide memoire, whatever you call it, to the French, which says to the French every way possible, "We don't like this, but we'll go along and hold our nose." And then in the latter part of the cable he goes on to tell us that he considers that by doing this thing the French have broken the tripartite agreement.

Then I send for Bewley and tell him that I can't give Sir John Simon an answer by noon on Tuesday and that I've got to have time to think this thing over; that I agreed with the English there's no economic reason for the French to go to 175; that if they go to 175 it won't be long before they go to 200, and that this isn't going to answer any purpose; and that I think we've got everything to gain by stalling. I don't see anything to gain by giving them a yes or no.

He says, "Well, do you want me to say to Simon that you don't want him to send that message?"

I said, "No, I'm not saying that. But I'd like to have time to think this over. And furthermore, I can't say

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to the French, 'You're out of the tripartite' without consulting the President, and that may take a couple days to get an answer."

"But while we're talking," I said, "I want to make the suggestion to you people ...." - how did I put this? I said this - I asked Bewley informally to ascertain whether the British Treasury did not think the introduction by the French Government - we got a new one here - of modified supervision of capital movements - which I think is a "honey" - might be preferable - I mean the way of describing exchange control - whether modified supervision of capital movements might not be preferable to the alternative policy, rather than the prospective continued decline of the franc. See?

In other words, I'm saying to the British, "Before we agree to this, what would you think of suggesting to the French that they put in some kind of supervision over movement of capital, because we think that if they did that they'd get control of their situation, if they did it properly, whereas this other thing is just going to let the thing go down and down."

I didn't use this example there, but I used it with Feis and the others. I said that when Italy went into Ethiopia and bombed civilian populations, they shocked the world and it was a new kind of warfare, but nobody said anything. Then they've done it in Spain, they've done it in China, and now if somebody suddenly says, "Oh my, isn't it terrible, this bombing!" - "Way, what's terrible? That's modern warfare." I said, "If we simply let the French go down and drop this franc I don't know where, then the Japanese start to do it, you wouldn't say that it - why get excited about us doing it?" I mean you establish a custom. And I said, "The only thing that the tripartite has done is to stop competitive devaluation in the world." And we did. We stopped it, didn't we?

Now, Bewley let us know that the British didn't like that thought. But he passed it along. I mean he's a good reporter.

Up to this have I missed anything?

Lockhead: (Nods no)

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H.V. Jr:

Now this is the part you don't know. At five o'clock this morning Ambassador Kennedy called me. He was very much excited and thought that I was making a terrific mistake by advocating exchange control for France, and that we are simply urging France to follow in the footsteps of Germany.

So I said, "Well, I'm very sorry, I don't agree with you."

and he said, "Well, I'm going over to see Sir John Simon in a little while, and I want to know what the arguments are." So I gave them to him, stressing the fact that there comes a time when the people of the United States very well may ask the question, "Well, how long is Morgenthau going to tie up with a country which is permitting its currency to continue to depreciate? He continues to be a partner with a country for three years; he's been practicing loose fiscal policy." And I said, "The time will come when they can't help but criticize us for continuing to be a partner."

So I told Kennedy - I said, "After all, this thing happens four times a year, and every time up to now I've had to take the position, 'Let's go along with the French and stretch this thing,' and the English have always wanted to break off," and I said this was the first time the roles were reversed.

He said, "Well, that's a good point."

"So we've thought this thing over very carefully, and we feel that if the French would do this, this offers a solution, while permitting them to let the franc seek its own level we think offers no solution. And we've thought this thing over very carefully and this is what we'd like to offer."

"Well, that's going to add to the troubles over here."

I said, "I can't help it. We're not adding; the troubles are there. But the time has come for us to think of the United States and the moral - the morsel of our own financial structure. I mean as

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long - I mean there comes a time, in my opinion, where if we continue to be a weak partner - a partner with a very weak country that's followed very loose, bad fiscal policy, sooner or later we get painted with the same brush."

That's what I think. Now God knows nobody wants less than I to shove France over the precipice. But I think there does come a time when we've got to think of ourselves.

So Kennedy said he'd go over and as soon as he saw them he'd call me back. But after all, they'll get the message straight. I'm sure Kennedy will deliver it. Furthermore, I gave it to Bewley, and Bewley will give it just as I gave it to him. But the unfortunate thing is that before Bewley left Bewley had the same idea that Kennedy had, in this way: Bewley was under the impression that it was much better to let the franc go, just let it go. I don't know whether that's the State Department's philosophy or not.

(On phone) Hello. - Fine. (Conversation with Cochran follows:)

Tuesday  
May 3, 1938  
9:41 a.m.

HMJr: Hello.

Operator: Mr. Cochran.

HMJr: All right.

O: Go ahead.

HMJr: Hello.

H. Merle  
Cochran: Hello.

HMJr: Good morning.

C: How are you, Mr. Secretary?

HMJr: Oh, wonderful? How are you?

C: Oh, a little bit groggy this afternoon.

HMJr: Well, - what's happened?

C: I just phoned to the                    - the secretary is  
getting back                                .....

HMJr: Wait a minute. Who did you see?

C: I say, I was at the Bank of France this noon.

HMJr: Yes.

C: Have you received my cablegram on that?

HMJr: Listen, old man, I - I - in the first place  
there's six hours difference and then you've got  
to add about six hours more and by that time I  
get your cable.

C: I see.

HMJr: Yeah.

C: When I was out there at twelve o'clock...

HMJr: Yeah.

- 2 -

C: ... they had yielded fifty-four thousand pounds.

HMJr: Well that ....

C: And the rate had gone from one sixty-three and one half when the banks opened - it had gone from there to one sixty-five.

HMJr: Yeah.

C: And while I was there London telephoned...

HMJr: Yes.

C: ...and said that there was a pretty fair demand there for sterling against francs ...

HMJr: Now just hold the wire a minute - just wait a minute.

C: All right.

(Short pause)

HMJr: Right. Thank you. (Secy speaking to someone in his office.)

HMJr: Hello. We closed the window.

C: Yes.

HMJr: Now, as I understand it up until noon they lost fifty thousand pounds.

C: Yes.

HMJr: Well, that's not much.

C: No. And they instructed London to spend one hundred thousand pounds to hold it around one sixty-five.

HMJr: Uh huh.

C: The order was given while I was there.

HMJr: Yes.

C: I was talking to our friend who was on the phone with London when the Governor himself came in and gave the instruction.

- 3 -

HMJr: I see.

C: And the rate now is one sixty-four seven eight to one sixty-five.

HMJr: Well, that's - that's ....

C: They've held it there steadily and my market friend and the Guaranty said that there is not - well, they're doing quite a bit but nothing too big.

HMJr: Uh huh.

C: I mean a fair amount. But they are holding it there where they stopped it this noon.

HMJr: Well, that doesn't seem very expensive, does it?

C: Well, I haven't any figures since I was there, but of course

HMJr: Well, weren't they pleased?

C: Well, the Governor was very anxious to know what your answer was going to be.

HMJr: Uh huh.

C: See they told him about this last night.

HMJr: Well now, you got my cable didn't you?

C: Yes, yes. I have that.

HMJr: And did you talk to Butterworth this morning?

C: Ah - I phoned him and he also had your cable.

HMJr: But did you give him those ....

C: I gave him the whole information.

HMJr: You gave him all the information?

C: All the information of our two conversations.

HMJr: Yeah.

C: Then I sent you a cable concerning the conversations of last night.

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HMJr: Well I guess after you talked to Butterworth Mr. Kennedy called me up.

C: Yes.

HMJr: Very much excited ...

C: Yes.

HMJr: ... because he didn't like my suggestion - to the British.

C: Ah -

HMJr: I mean the one in my cable two forty-seven.

C: Yes. Yes.

HMJr: See?

C: Yes.

HMJr: But I asked him please to let it go as I instructed.

C: Uh huh.

HMJr: See?

C: Yes.

HMJr: I mean a lot of people have got this rather old fashioned conception of exchange control, I mean old in the sense that - maybe six months old.

C: I don't hear that.

HMJr: Well, I say some people don't quite understand just what exchange control may or may not be.

C: I see.

HMJr: But I am going to sit tight now until I hear from the British.

C: You've had no reply from them yet?

HMJr: Well, I couldn't - I most likely won't get any until about six or eight o'clock tonight at the earliest.

C: I see.

HMJr: You see, if London sends me a cable at eleven o'clock their time the earliest I can get it is eight o'clock Washington time.

C: Yes.

HMJr: And that's what happened yesterday.

C: Yes.

HMJr: So I doubt if I'll get anything from them tonight.

C: I see. The Treasury here has not called me at all.

HMJr: Well ...

C: I've had no word from them today and I got this latest rate just while we've been talking you see.

HMJr: Well, I'll call you again this afternoon, oh - let's see - ah - is eight-thirty a good time for you?

C: It's a good time, yes. I'm home then.

HMJr: Well I'll call you after eight o'clock - what time is in Paris now, four?

C: Ten minutes to four, yes.

HMJr: Well, we have - there's six hours difference now you see.

C: Six hours, yes, with daylight saving ....

HMJr: Well, I'll call you after eight o'clock and you'll be at home.

C: All right. I'll be there.

HMJr: Yes. All right, Cochran. That's all.

C: Good. Goodbye.

HMJr: Goodbye.

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- H.W.Jr: Well, that brings us up to date. Now, what do you think?
- Harrison: Well, I - realizing what the subject of this meeting probably would be, I've been thinking it over a lot on the way down. I had a short talk with Knoke yesterday afternoon. And my general impression, I think, is slightly different from yours.
- H.W.Jr: O.K.
- Harrison: And I know you wouldn't want me to be anything but perfectly frank.
- H.W.Jr: Just a minute.
- (On phone) Hello. - Put him on. - O.K.
- Kennedy's calling now. See, he's had lunch with Chamberlain.
- Harrison: Oh, I see.
- Oliphant: Chamberlain, not Sir John.
- H.W.Jr: Well, he was to call on Sir John and have lunch with Chamberlain.
- Harrison: I think the exchange rate is not an object in itself. It is a reflection of internal conditions in one country as related to conditions in other countries. And the trouble with the franc, as I see it, is not that it is too high or that it is too low, and not really that they haven't had exchange controls, but rather that they have not done a job at home economically.
- H.W.Jr: Complete agreement. There's no argument.
- Harrison: And that what they ought to be doing is to clean house, because the three-cent franc is too low, I think, if they've got a sound economy, and it's too high if they don't do something at home. And nobody's smart enough now to say where it ought to go in either one of those events.
- Therefore, I should like to think that you might

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perhaps take the position that you will fire them from the tripartite if they don't clean house at home; and by that I mean taxes and increased production and all the things that they need to do to repair their economy. And I was just wondering - I'm a little fearful whether your cable might not be construed as a cure in itself, whereas you don't mean that; the cure is this internal problem that they've got. Now, it may be that some sort of modified supervision of capital movements is a corollary to or supplement to these other things; but I think the main objective should be their courageous attempt to do something with their own economy domestically, which I think they haven't done.

W.S.Jr:

There's no disagreement between us. But you've got the - you get a cable today, or yesterday, the way I did, and they want a definite answer - "Will you go along?" There is that communique, the part that has - the French communique. I don't want to try to paraphrase it. "Will you go along with us? We'll let the thing go." And I've got to say, "I want to stall," "I'll go along," or "I won't." I had three alternatives. Now, under those ...

Let Mr. - read the communique aloud. I only had three, see? And I chose the one, "I want to stall."

Harrison:

Well, I think that's quite all right. And I think if they're smart they'll stall until after this Rome meeting is over anyway, because if there is going to be any disintegration in the French position prior to the settlement of whatever these talks are about in Rome, they're going to expose themselves to the - to very strong attack, morally anyway, from both the Italians and the Germans.

W.S.Jr:

Which country?

Harrison:

The French. I think that if - for instance, supposing you and the British decide to fire them from the tripartite today. I think that would be the worst possible position, politically, that the French could be put in vis-a-vis Germany and Italy, especially with this meeting going on. And therefore I think you're a godsend to them in suggesting that they stall. I

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think they ought to stall, especially if the alternative means they're going to be fired from the tripartite. That ought not to happen, from their standpoint - I shouldn't think they'd want it to happen until after this Rome meeting is over. I think you're quite right in stalling.

As I interpret your cable, though, I think it implies - at least I thought it implied - that you'd be willing to go along provided they put on a limited supervision of capital movement - "and I don't know that I'd go along even if you did that."

H.H.Jr: That's something different.

Now, have you(Lochhead) got it?

Lochhead: Do you want the cable - the first one that ....

H.H.Jr: The one Cochran sent me yesterday afternoon.

Lochhead: The one Cochran sent us yesterday afternoon.

H.H.Jr: Just the French message.

Lochhead: "The French Government is obliged to inform the Government of the United States of America that the expensive effort made by the stabilization fund, particularly during the recent period, can no longer be maintained. The French Government is therefore obliged, despite the fact that it has decided to impose from this week a new and important tax effort on the country, to choose between exchange control or the retreat of its currency. The rate at which the French Government has decided to stop is around 175 francs for one pound, with the will to lower progressively this figure in correlation with the economic improvement which it expects from its decrees.

"The French Government recalls that from the first of last July taxes have been increased by 16 million" - there's a question mark on that, what that figure should be - "16 million francs, and that therefore it has shown its will to defend its currency by all possible means, and that it remains still attached to this view within the framing of

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monetary liberty. It hopes therefore that in these conditions the setback which it is obliged to decide upon will appear to the Government of the United States of America as entirely in conformity with the provisions of the tripartite agreement."

That's the end of the message. Then Cochran goes on to say, "The Minister of Finance told me that he would appreciate having the reaction of Secretary Morgenthau to the above statement as soon as it is possible for him to let us know. I asked Marchandean when the rate would be moved to 175, and he replied 'tomorrow'. This will be one of several steps which are to be taken tomorrow simultaneously with the publication of certain decree laws.

"I asked the Minister whether the terms of the National Defense loan would be made known tomorrow. His answer was that he was not sure whether they would be tomorrow or the day after. In the circumstances, he insisted, it is not possible to hold the present franc rate, and that it is absolutely necessary to let it move to 175 to the pound."

Decision: Well, I don't know whether that's typically French or typically German, that message.

S. J. J.: What I'm getting at is, we don't have time - let me be frank; at the same time I don't want to be discourteous - to philosophise about the internal situation in France. I mean we're faced - they put - for two weeks we've begged and implored them to tell us what they're going to do, and every time we go there - Cochran says, "At no time have I put so much pressure on them" - at no time has he put so much pressure on the French, see, and every time he goes they say, "We don't know, but we assure you we're not going to let it go to 175." And then they give me two hours' notice to do this.

Now, I say, having no choice and not being able to run the French political thing, and not wanting to run it, not being able to run it - I have the choice, as I say, to answer that message by saying, "I'm sorry, you're out," or "O.K., we'll go along with

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you," or "I want to stall. And, in stalling, have you considered an alternative?" Now, that's what we have. See what I mean?

Amore: But, Mr. Secretary, is that really an alternative? Isn't it really just exactly the same thing as exchange control? I don't care what you call it - modified supervision over capital movements, or ....

H. J. Jr: Just as an alternative.

White: Exchange control over non-commercial transactions.

H. J. Jr: The alternative is to go along with this group in the French Cabinet who want the French franc to fall, they think, to a level so low that it will attract the Frenchmen because it is cheap and they'll begin to buy and she'll go back up again. Now, that's this one school of thought, see? And that's the school of thought which - I gravely question whether the United States Government wants to go along with them.

Now, the other alternative is, if they feel they've got to do something, the suggestion which I made - do they want to put on a modified exchange control? See?

Harrison: with a view to keeping the franc ...

H. J. Jr: Oh, I'm not going to mention that.

Harrison: I was just wondering what your ....

H. J. Jr: Oh, I agree with you.

White: As long as there is some indication, some assurance we have that steps are being taken that appear to us to have some reasonable opportunity for preventing the franc from sliding indefinitely .... And it is all very well to wish for fundamental economic changes; we quite agree with you. But in the first place, you're not going to get them just this way. They've had that fight for at least three years. And in the second place, as you suggest, even if they attempted to make those changes, one of the preliminary requisites to give them a breathing spell might be to hold the franc stable by use of

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exchange controls over these non-commercial transactions.

And I think that as between the French situation on exchange control and the German situation on exchange control, the comparison is wholly out of order. The incentive to get capital out of Germany, the reasons for which exchange control were imposed, were entirely different than in the French situation, and the assumption that France is going the way of Germany merely because she imposes exchange control, I think, is little short of nonsense. It disregards what has happened in other countries, it disregards the difference between the French situation and Germany, it disregards the particular situation which France is in, and furthermore it disregards the kind of exchange control which the Secretary has suggested they put on.

So that I, though I think you're quite right in saying that they must correct their fundamental situation before they can hope to maintain indefinitely the stability of the franc - I think all we can ask or expect is some kind of reasonable assurance as against the alternative course of letting it slip to a point at which it will be cheap; because, even though it is cheap at 200, it is not as cheap at 200 as it is at 300, and it will be still cheaper at 400. If any way, that's the way Germany went. If the assumption is that a currency reaches a point at which it is cheap while you're not correcting the underlying forces and while you're permitting speculating movements in exchange - why, there is no bottom.

So it seems to me that those of us who are asking that we get some assurance that they will do something that we can expect they will do, not that we hope they will do, are wanting them not to go the way of Germany.

H.M.Jr: (On phone) Hello. (Conversation with Kennedy follows:)

Tuesday  
May 3, 1938  
9:58 a.m.

HMJr: Hello.

Operator: Ambassador Kennedy.

HMJr: Hello.

Joe Kennedy: Hello, Henry.

HMJr: How are you?

K: How do you feel now?

HMJr: Fine. I love to have you call me in the middle of the night.

K: If anybody did that to me I wouldn't even speak to them.

HMJr: Ah - (Laughs) you'd do more ....

K: That's a hell of a trick, I know, and I don't do it as a rule. I thought I'd better have a word with you before I went over and saw him and I'm glad I did.

HMJr: Yeah.

K: I saw him at twelve o'clock...

HMJr: Yes.

K: And then after I - well, I stayed with him until one o'clock and then I went over and saw the Prime Minister.

HMJr: Yes

K: Now, first of all, let me - let me tell you exactly what their plan is - they're just as sore, at least they say they are, that this thing is going on, as you are.

HMJr: Yeah.

K: They do not believe in exchange control because they believe that that is only the beginning of the end; that - that France won't stay around and see if we do have exchange control because,

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he says, these fellows are - will start public shopping and doing everything else and they'll immediately go to a hundred and seventy-five and you'll get the disadvantages of exchange control.

HMJr: Yes.

K: At that time I used the argument that you gave me; I said, well that makes a pretty lousy affair if we contact them at all".

HMJr: Yeah.

K: And their answer to that was that it wasn't the most attractive situation in the world ...

HMJr: Yeah.

K: But, after all, what are you going to do. Mr. Hitler walked in on Rome today and he's going to bust this thing wide open - ah - because it isn't going to cost anybody any money to let them go along and it's going to hurt England a hell of a lot more than it's going to hurt America.

HMJr: That's right.

K: Because of the trade effects. And it isn't going to cost any money. They believe that the psychological effect would be very bad if it were busted up.

HMJr: Yeah.

K: Particularly at this time.

HMJr: Yes.

K: I mean I think so I went over  
and saw the Prime Minister.

HMJr: Well, wait a minute, wait minute.

K: ... exchange control would be very serious because of the type of people that they are.

HMJr: Wait a minute, Joe.

K: Yes.

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HMJr: What you've been telling me now is your conversation with Simon?

K: That's right.

HMJr: Now you're going on to your one with Chamberlain?

K: That's right.

HMJr: O. K.

K: No, and Chamberlain said that the situation was just about that; he said that exchange control was a great - was a very serious thing because it was the beginning of the end and it was against all the policies that we've been trying to advocate.

HMJr: Yeah.

K: That is, trade and all that sort of thing and that there were many potential governments behind the scene and one minister - one government would be in there and they'd go along a certain way and then the next group would come in and they'd turn on the bucket another way.

HMJr: Yeah.

K: And he thought that the greatest argument of course was that - he said they were going to - to go back to Simon, Simon said that they expected a great deal of trouble with their trades people here because he thought that France was going to get probably some added advantage and be able to sell a good deal of goods here as detriment to the British much more than affecting the United States.

HMJr: That's right.

K: I told that to Chamberlain and he said of course that was true, that they had these troubles but that he thinks that now he has a chance to work on the Government financially and that - and especially he thinks that because of Hitler's visit to Rome it would be almost a calamity if at this time these fellows broke up. Now, particularly when it wasn't going to cost any money.

HMJr: Uh huh. Well, did you get the impression from

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- HMJr: Uh huh. Well, did you get the impression from Mr. Chamberlain that he was absolutely opposed to this suggestion?
- K: That he was?
- HMJr: That he was?
- K: That he was opposed to exchange control?
- HMJr: Yes.
- K: Yes.
- HMJr: You did?
- K: I don't think that he opposed it - as a matter of fact there's no question about it - if you - that they won't do anything unless you agree to it.
- HMJr: Uh huh.
- K: I'm convinced of that. Simon made that fairly clear. He said, "After all, this is - this is as much Morgenthau's baby - and more than it is anybody else's, because he was the fellow who first put it into effect and he is the fellow who up to this time has kept it going."
- HMJr: That's right.
- K: But, on the other hand, he said, "We won't do anything - he said that when Bonnet came over there the other day he gave him a quick send off on it - he didn't give it to him very very definite, he said, "This is something we will have to take up in a couple of days."
- HMJr: Yes.
- K: He showed me a copy of the letter that he delivered to Bonnet as he got into the plane.
- HMJr: Got what?
- K: I told him that this was a complete getting away from the agreement; that they had no right to do any such a thing and I suggested that if you agree to this what are the possibilities of saying to these fellows that they - as an excuse for this -

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that they must put their house in order if they expect to get any cooperation from the United States and England.

HMJr: Who said this?

K: I said how about making that suggestion as coming from you if you agree to it.

HMJr: Yeah.

K: I said that you couldn't make it strong enough as far as we were concerned.

HMJr: I see.

K: I said, "As far as we're concerned, we're not going to lose any money, it isn't going to cost us anything."

HMJr: Uh huh.

K: "But, it's a question whether you want to do it." But both of them, both Simon and Chamberlain, and they didn't have time out to get together because I just walked out of one door and walked into the next - ah - felt that psychologically it would be a terrible thing to throw a bomb shell into the world. Simon thought that it would knock the hell out of their market here

HMJr: Yeah.

K: But Chamberlain viewed it not so much from the financial aspect but from the aspect that he says he wouldn't want to have Mr. Hitler open a telegram and say, "Tri-partite Agreement broken up," and hand it to Mr. Mussolini.

HMJr: That's right.

K: That's exactly what he said.

HMJr: He did?

K: Yes.

HMJr: Well, now, ah - I - what you're telling me is most useful...

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K: Yes.

HMJr: got to be the of the Treasury people  
and - ah - you know what's happened with the franc  
today?

K: No. What's the last on it?

HMJr: I mean I've got it.

K: One sixty-five?

HMJr: Yes. But let me tell you what's happened - ah -  
I just talked to Cochran before you called.

K: Yes.

HMJr: And up to that time it only cost the French fifty  
thousand pounds.

K: Yes.

HMJr: And they had given an order to the Bank of England  
to defend the franc up to a hundred thousand pounds.

K: Yes.

HMJr: But up to this - up to about noon it only cost them  
fifty thousand and they were holding it around a hundred  
and sixty-five.

K: They're holding it because of you.

HMJr: I - ....

K: They're holding it because they don't want anything  
to happen until you make up your mind.

HMJr: Well, now, Joe, this is what's going through my mind,  
because I sent this all off last night - to the  
President - he's got it by now, see?

K: Yeah.

HMJr: Because I sent him - oh - pages on this whole thing,  
see?

K: Yeah.

HMJr: Supposing we mark time another day...

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- K: Yeah.
- HMJr: And the French continued to hold the thing where it is...
- K: Yeah.
- HMJr: That wouldn't be the worst thing, would it?
- K: Well, I don't think it would do any harm. We can just say - I'd be glad if you sent over this suggestion here - follow-up to the President because I think the political repercussions here he ought to know as well as the financial ones.
- HMJr: Well, I'm conscious of those and don't worry, the State Department has pointed them out to me very sharply, these ...
- K: I haven't talked to them about this at all.
- HMJr: No, but I say they - they had a representative at my house last night all evening.
- K: Oh, I see.
- HMJr: Well, I mean I always ask them to. See?
- K: I see, yes.
- HMJr: I mean, whenever I have these meetings I always have a representative sit in so that Hull knows what's going on.
- K: Yes.
- HMJr: So I mean there's no crossing of wires.
- K: Right.
- HMJr: I mean, they know what I've done - everything up to this minute. But, what we've got to do is to weigh the whole situation and I'm not - I'm fully conscious how serious this thing is.
- K: Yes.
- HMJr: But, I'm also of the firm belief that if the French let it go a hundred and seventy-five or let it go two hundred it's only going to be question of a week or a month before we will have to act and then - and then what?

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Et: Well, I mean of course Chamberlain's answer to that was - I gave him the same argument - Chamberlain's answer to that was: well, if that happens - if you bust it up now you know the worst has happened - there isn't anything else that you can do.

HMJr: Yes.

Et: Whereas if you go ahead with this situation and try to carry it on you might get something better - you may get an improved condition. He says if there is an idea of fatalism about the possibility of making any deal in Europe why we might just as well all finish off because there's no hope for us - under existing conditions unless we can make some deal.

~~HMJr:~~ Well, of course I said this rather facetiously to Bewley, <sup>last night</sup> but I hope he repeated it. And that is when the English and the French got together and agree that in case of a war it'll be a French General in charge of all the armies - why didn't they suggest that an Englishman should be in charge of the two banks.

K: Yes. (Laughs)

HMJr's: What?

K: (Laughs) I think

HMJr: But, of course ...

X: That's a job. I think they realize that they've got a hell of a lot of trouble but he believes that - he's hoping that he'll get a national government in there.

HMJr: Uh huh.

K: And that they will try to do something. If they don't do anything the dollar falls but Chamberlain's theory is on the basis that he's going ahead on the Italian and the Irish is that as long as they're in there working to try and do something that the worst hasn't happened.

HMJr: Yeah.

K: Let it go to hell then - then it - then it has happened and then to hell with everything.

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- HMJr: Yeah. Well, I'm going to do the best I can and I'll think it over very carefully.
- K: All right, Henry. There's nothing further you'd want me to do?
- HMJr: Ah - now let me just think a minute - let me ask the people in the room whether they've got anything. Would you mind waiting a minute?
- K: Surely. Go ahead.
- HMJr: No. We'll work on this thing and I - Mr. Hull is calling me now and I am going to talk to him and see what he's got.
- K: I see.
- HMJr: And I'm going to talk it over with him. And in any case, Joe, I'm not going to take any positive action until I hear from the President.
- K: O. K., Henry.
- HMJr: And the argument which you advanced - the one that Chamberlain advances - that by waiting we might get something better and by taking of action now why we ...
- K: We'd put it in the archives.
- HMJr: Yes. That's a good argument.
- K: Yes, that's a very good one, particularly with Hitler in Rome.
- HMJr: That's<sup>a</sup>/good one.
- K: Yes.
- HMJr: But how long is Mr. Hitler going to stay in Rome?
- K: Well, they don't know. Of course, they made no commitment to the French but of course he's working like hell to try and get something done here.
- HMJr: Yes.
- K: And if he doesn't do it, Henry, it won't make any difference whether you get that place over there or anything, you can just go right up on that farm. This place is only three leagues off of first base anyway.

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HMJr: Uh huh.

K: For instance they're just - they're - under cover they're going to be just like us.

HMJr: Who?

K: England.

HMJr: How do you mean like us?

K: Right in the s -house.

HMJr: I see.

K: Yeah. You know what I've been talking about for months?

HMJr: Yeah.

K: Yeah. Well, that's it. That's what we - I told you we were going in it.

HMJr: Uh huh.

K: Well, they just wrote a nice article about you over here.

HMJr: They did?

K: I just read a nice article about you.

HMJr: Where is that, Joe?

K: Oh, in a paper here. Somebody sent me a clipping. It said you were going to be a great statesman now that you were - you were going nutty trying to keep the United States Government money sound.

HMJr: All right. Send it over to me.

K: All right.

HMJr: I got a scrap book for funny articles.

K: (Laughs) All right.

HMJr: O. K.

K: All right. Well, I'll tell Chamberlain that I'm waiting to hear from you.

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HMJr: That's right.

K: O. K.

HMJr: Thank you.

K: Goodbye.

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Oliphant: What's Chamberlain's prescription?

H.M.Jr: Mr. Kennedy's choice of language has not improved by association with the King and Queen of England. If he didn't know - I apologize for you, Mrs. Klotz. I'm sorry. But I should know by now.

Harrison: At least you know what he means.

Lochhead: He's been ....

White: He'll have the King and Queen speaking that way in a year.

Oliphant: What's Chamberlain's prescription for keeping Hitler from handing that message to Mussolini?

H.M.Jr: Yes.

Oliphant: What is it?

H.M.Jr: What Mr. Chamberlain says to me is this: "Let this thing slide, drift."

Oliphant: Stall.

H.M.Jr: "Do nothing, just go along with them with the hope that out of this something better will come."

Oliphant: Well, he withdraws his suggestion of his message closing with them.

H.M.Jr: Oh, his message ....

Oliphant: Didn't go.

H.M.Jr: No, no, his message goes along. In their message they go along. You read his message. The English message to the French says they go along.

Oliphant: I thought the final paragraph said that ....

H.M.Jr: No, no, definitely go along.

Harrison: But that hasn't been sent.

White: That hasn't been sent.

H.M.Jr: No.

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Harrison: And he's not going to send it until he gets agreement with you.

H.M.Jr: That's right. It's my baby now.

White: Mr. Secretary, I don't think the issue is whether we should - exclusively or simply whether we should kick them out now. I think that no one here has had that feeling for the moment. It's a question as to whether the answer shall be couched in such terms that, if we do keep them in, as I think in view of the political situation we might well consider doing - that it should be couched in such terms that we'll be putting some kind of pressure on them. I don't think we can ask them to put their house in order, because they might turn around and ask us to put our house in order. But we can put it in such terms as to give us some kind of assurance that they feel it's going to stay at that level, and at the same time give them the very definite impression that they're getting near the end of their rope. That is, it's not a question of kicking them out so much as of establishing the principle on which we're going to fight. It isn't - the 175 doesn't worry us; it's their talk of 200 and their talk of that principle which the Secretary enunciated, that they're going to let it go so low until it attracts a return of capital. It is that philosophy that we don't like.

H.M.Jr: (On phone) Hello. Secretary of State Hull.

Harrison: Well, isn't this what you would all prefer, both you and the British? I don't care how you word it. That for the time being the French keep the franc about where it is, whether they do it through exchange control or whether they do it through the use of the gold, and to maintain that position until after events in France, whatever they are, determine whether the franc should be 150 or 250. In other words, it might be one or the other, and nobody is smart enough to determine now which it should be. And that therefore, until their situation is clarified, we think that they should use all powers at their command, whether gold or some modified exchange control, in order to maintain the status quo for the time being. And don't put yourself in the position of telling them which thing they should do to attain that objective,

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because you don't know whether exchange control will do it or whether they've got enough gold to do it.

White: All we want is some assurance that they're doing something that seems reasonable to us - gives us some reasonable assurance that they'll be able to hold it.

H.W.Jr: (On phone) Hello. - Thank you.

You know, I could just sit tight and say, "Well now, let's do nothing for another day."

Harrison: ~~By~~ Another what?

H.W.Jr: For another day. You see, the word I sent to them was, "We'll do business with you for Tuesday, but that doesn't commit us beyond Tuesday." I mean I'd say, "We'll do business for Wednesday and go along on a day-to-day basis." And then if, for instance, they should find it only costs them fifty to a hundred thousand pounds, maybe they can control this thing as is, but if they find they can't and then they run up this thing, say, X number of francs, then I can still grudgingly give in. I mean just as long as they're afraid of me, they're going to continue to fight. Now, when they feel that - the time they're going to stop fighting is when it gets very expensive; then the thing gets very expensive and they let the thing go - then they can say, "Mr. Morgenthau, what you going to do about it?" Well, then, I'll say, "I guess there's nothing I can do about it." O.K. I don't see why I'm not in a strong position just sitting tight, saying, "Well now, I'm very sorry, I've still got to think this thing over. I'll do business with you Wednesday." And maybe Wednesday it won't cost them anything.

Caston: You can't at this time agree that a deliberate decision to retreat to 175 is within the spirit of the tripartite agreement at this moment.

White: I think that is the position to take, with one qualification. I can't help but feel that there is something a little bit strange about the

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situation. I'd like to be assured that they know - the French know, not the British - that the French people who are now in control of the government know how you feel about exchange control. It's not that you're telling them, but merely that they should know your views. Maybe they do. I'm just a little unhappy over the thought that maybe they don't, that's all. If they know that, then I think you can sit tight from day to day just as you outlined.

- Oliphant: Sit tight if you knew they knew.
- White: The decision is theirs, after all.
- Docuhead: The first section of Cochran's cable just came in.
- H. A. Jr: I don't want to bother with it.
- Harrison: I fear that what your position is at the moment, in the light of present circumstances - that you would consider it contrary to the spirit of the tripartite agreement if they let the franc go to 175.
- Gaston: Deliberately.
- Harrison: Deliberately, without reason. And that you would not consider it contrary to the tripartite agreement if, in an effort to keep it about where it is, they used exchange control, or used the gold or anything else.
- Oliphant: If they used exchange control of abnormal capital movements.
- White: On non-commercial transactions.
- H. A. Jr: On non-commercial.
- Oliphant: Abnormal capital movements - non-commercial transactions.
- Harrison: But not put yourself in the position of saying that you think that exchange control will do the trick.
- White: No, we have never taken that position.

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- Gaston: You wouldn't think it a violation if they should seek a special means for the moment of controlling abnormal movements of capital.
- Harrison: That it would be contrary if they deliberately let the franc go to 175; that it would not be contrary if, in their effort to keep it where it is, they should resort to exchange control.
- Gaston: Special devices.
- White: That's exactly the way we framed one of the answers.
- H. H. Jr: Just to give you - I mean this, I think, is rather interesting. Oh, I got the wrong thing. You (Harrison) would love to see that. That's Eccles' - his latest recovery program. But it's not for sale.
- Harrison: I hope it hasn't been bought.
- H. H. Jr: This is the last page which I sent the President. I said this:

"On the receipt of this cable we conferred at my house with Mr. Bewley, British financial attache. I sent word to Sir John Simon via Mr. Bewley that the United States Treasury wished to delay answering the French until we had seen a full copy of the decrees which they are supposed to issue on May 3, and that furthermore I would need time to get the benefit of advice from the President of the United States.

Now, you see - "I furthermore asked the British whether they would not rather see the French put in a system of supervision over capital movements, rather than see the franc continue to fall. I asked Bewley to try to get an answer for me on this question promptly.

"In the Treasury we seriously question the wisdom of continuing to go along with the French in their proposed policy of permitting the franc to seek its own level.

"It would be most helpful if you would care to express your own opinion in regard to this matter."

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I mean, in other words, I haven't decided anything.

Harrison: I feel this, that the publication of these decrees ought to strengthen the franc, and I came to the Treasury early this morning and saw Wayne Taylor and said I wouldn't be surprised if the franc was strong today, and he said that was a poor guess. But I would think after these decrees are absorbed and understood, the French franc ought to absorb some strength, because they're going in the right direction.

Logan: They had the figure set for 175. They were going to step in and cover at 175.

Taylor: Everybody's brother knew that.

H. A. Jr: You see, that's the thing that doesn't click with what Governor Harrison says. The normal thing would be to get this thing and see the French franc strengthened. Instead of that, they announced these decrees, which ought to be good if they were carried out, and then they themselves pulled the plug. On one hand they say, "We're going to do something to strengthen our own internal economy, but we don't believe this and we're going to let the franc weaken and we're going to make the franc weaken."

Now, I'm playing a big gamble, and I think that - as I said to the boys last night, that we've got everything to gain and every day we have we throw more light on this picture.

And this isn't the answer that I exactly expected from the British, because after all the German Army and the German planes aren't hanging over our heads, thank God, but they are over the British. Then, if the British get sufficiently worried about this, they might even make a constructive suggestion, which they haven't. I mean when you get right down to it, they can say the tripartite agreement is my baby - thank you very much, I'm very proud of it! - but she's two and a half years' old, or whatever it is, and if this means so much to the peace of Europe, why doesn't England say something and do something?

White: Do something.

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- H.M.Jr: Now, furthermore, no one has said, "What about Belgium?" Poor Belgium - what does this mean to Belgium, 175 to 200?
- White: She's getting in steadily worse position.
- H.M.Jr: What does it mean to the poor Belgians? I mean I'm just not yet convinced that this thing is as serious as it is, unless this is just a continuation of England's attitude toward Ethiopia, England's attitude toward Spain, England's attitude toward the Far East - "Let things drift. We'll muddle through. Now, we'll just muddle through."
- Harrison: Well, isn't this your program, Mr. Secretary, in fact: you sit tight and get the French to sit tight on the theory that the more you stall the stronger your position will be either to prove that the franc is going to stay where it is or to justify your going along with the British and saying, "All right, if this means - if this is the only alternative left, we'll go along with you." As I see it today, I feel that to throw the French out of the tripartite would be the last thing you want to do, of those three.
- H.M.Jr: Well, I think I agree with you on that.
- White: There's no - been nobody asking for that now.
- H.M.Jr: I think White's made a good point, and that is that we've got the French financial attache here and why don't I tell him of this message we've sent to the British?
- Slighant: Any harm in reviewing the whole discussion with Blum and all the rest of it?
- White: I don't think it's necessary.
- Slighant: Gives him the background.
- Taylor: No, I don't think you can tell him that you've made the suggestion to anybody else.
- H.M.Jr: No, because Blum felt this; he said he didn't want me to

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wet my feet; that was his attitude on this thing. So he felt it was a mistake to let them know I made the suggestion. Therefore he told it to nobody. Then, if that is true, I should return the same courtesy and not tell anybody, because they might turn on Blum and say, "So, if you had only used this, so and so, everything would have been all right."

Harrison: What's the franc today actually?

Lochhead: 165 to the pound - \$.0302.

H.M.Jr: (On phone) Hello. - Thank you. (Conversation with Hull follows:)

Tuesday  
May 3, 1938  
10:25 a.m.

Cordell  
Hull's

Secretary: Oh, the Secretary's coming right on. Just a moment please.

HMJr: Hello. Hello.

Cordell  
Hull: Hello.

HMJr: Hello, Cordell.

H: How are you feeling?

HMJr: I'm pretty well. And you?

H: All right. Yes, I was over in Judge Moore's office. I didn't know you'd called.

HMJr: That's all right. How's Mrs. Hull?

H: Why, pretty fair. We had ten to twelve days ...

HMJr: Yes.

H: ... of solid rest.

HMJr: Cordell, this French thing is boiling.

H: Yes.

HMJr: And I've had a long talk - one at five o'clock this morning - your friend Mr. Kennedy called me.

H: I see.

HMJr: And he just called me again.

H: Yes.

HMJr: And I've talked also with Cochran and I'd like very much to have a chance to talk to you - just the two of us. Now, what would be a good time for you? I'd be glad to come over any time that suits you.

H: Yes. Well now, I've got John Bourse unfortunately coming in here on the Brand matter at eleven o'clock.

- 2 -

HMJr: Well.

H: Ah..

HMJr: How about - have you anything right after lunch?

H: No. I could get in here, say, at - three?

HMJr: Three?

H: Would three be all right?

HMJr: I'll make it all right.

H: Well, or we could make it a quarter before three.

HMJr: Whatever you say. Three o'clock?

H: Three o'clock.

HMJr: At your office?

H: Yes.

HMJr: I'll be there at three o'clock.

H: All right, then.

HMJr: And, in the meantime I'm just going to sit tight.

H: Yes. I see.

HMJr: Unfortunately, the thing is getting hotter - the Wall Street Journal man just got this message from his New York office that the French Premier announced that the stabilization of the franc rests with the decision with London and Washington.

H: I see. Yes. Well, I guess the thing is pretty lively over there.

HMJr: Yes.

H: Well, all right, Henry.

HMJr: I'll be over at your office at three o'clock.

H: Three o'clock.

HMJr: Thank you.

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- Question: Can't wonder about the franc not being strong in the light of that kind of stuff.
- W. J. Jr.: Well - I mean on account of the difference in time, it doesn't make much difference. I mean the day is over in Europe. I mean we might just as well ...
- Mr. Tolson: Take time.
- W. J. Jr.: (To Mrs Klotz) Tell Mr. Altmeayer that on account of the international situation that will have to be called off.
- Miss Gandy: Altogether? For today, you mean.
- W. J. Jr.: Yes. I can't see him.
- Mr. Tolson: You know, they're such babies, though. On the eve of announcing these internal acts which are designed to strengthen the franc and normally should strengthen it, to let it leak out that they're going to let it go to 175 - one hand is then playing against the other. Now, this franc would have been strong and it not been for all those deliberately inspired leaks.
- Miss Gandy: They're even talking of 200; that is, there has been mention of 200 already, and there is no assurance that that talk of 200 won't begin to grow again in another few weeks or a month.
- Mr. Tolson: Has it been official talk?
- Mr. Tolson: From Kennedy's talk, if you should send a message to them today that we can not now agree that to let the franc go is within the spirit of the tripartite agreement - that's the way you feel today, you may feel differently some other day - and that we feel, that being so, if they want to stay in the tripartite agreement they ought to use all means available, which means their gold or perhaps some kind of exchange control if they want to do it, in an effort to keep within the tripartite agreement, which would show that you would not rule them out if they used some kind of exchange control - that's what they want to know, and you just sit tight on that. And I think you could get a message like that

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off today or tomorrow, as you see fit. And that would make them then stall for time themselves, and it would at least carry them over this meeting in Rome which the British are so much worried about.

Lochhead: George, you know, the terrible thing from an operator's viewpoint is to look at this market, know the market is terribly short on francs, then see this program set, and they put out the decrees that should strengthen the franc and at the same time drop it to 175, then allow it to come back again. In other words, it's a perfect set-up for the man that's got the short position to cover in, wait for his position again. The whole thing is set up as a paradise for the speculators.

Harrison: And the speculators in francs are not just the professionals either.

Lochhead: Yes. Now, as I say - I didn't go as far as you went. I'm just saying that as an exchange man, without going any further.

White: Professionals are defined differently in France.

H.H.Jr: Well, look, let me just ask you this. In advance of seeing Mr. Hull, do you think I ought to talk to the French? I think I better hold everything, because the day is gone as far as Europe is concerned, isn't it?

Harrison: I don't know whether in your talk with Cochran he got the impression that he should tell the French that you're going to sit tight today.

H.H.Jr: Oh yes. Oh, in my message to him I say that very definitely.

Harrison: I see. I didn't know that.

H.H.Jr: Well, I mean in my message I say here:

"Please inform Marchandau that:

"1. I was very much shocked and surprised at the message which Marchandau sent me.

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"2. I did not consider that under the tripartite agreement we had been consulted, but that he had simply informed us.

"3. We will execute any orders on Tuesday that we receive from the French to buy or sell francs, but in doing so we in no way acquiesce in the new French proposal, and, while I agree to do this Tuesday, we are not committed beyond Tuesday."

Wheeler: but I was wondering now - it was late over there and they've got to make their plans and orders for tomorrow.

Wheeler: I think that further cable that came over merely strengthens your original decision, which was to go in this particular instance very slowly and before you take a move be sure that you've got a consensus of opinion.

Wheeler: I was wondering whether that cable should be renewed for tomorrow.

Wheeler: I think it will be done tonight.

Wheeler: And at the time you do that, get in this other idea of informing them, if you want, to the effect that you would not consider it contrary to the tripartite if, in their effort to maintain their present position, they should decide to put in exchange control.

Wheeler: In fact ....

Wheeler: Any time you can see him (French Ambassador) this morning?

Wheeler: Sure.

Wheeler: What time?

Wheeler: Cut that bank thing short - the bank thing. I want him to bring Beaulieu with him. How long do you think we ought to give him? I think the French Ambassador ...

Wheeler: Quarter of 12?

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H.L.Jr: quarter of 12. And will he bring Beaulieu with him?

Taylor: Yes.

H.L.Jr: I used this example to Mrs. Morgenthau in explaining this thing. I said, "It's like you've got a confidential clerk that you know is going to the cash drawer and helping himself, but you don't say so. But he's constantly taking a little more and little more, and the longer you wait to fire that fellow, the more difficult it is." Now, we know that they've been doing this thing. They've been going to the cash drawer, they've been stealing a little on the side, and the longer we sit there and acquiesce the more difficult it is for us suddenly to get noble and say, "You can't do that." I mean it's just - well, that cashier can say, "Well, Mr. Morgenthau, you knew I was going to the cash drawer; you stood by and watched me go to this cash drawer for two years. Now, suddenly overnight, you get up on your high horse and you get moral on me and say, 'I won't stand for it!'" I mean it's - you soon become a partner of the fellow who's going to the cash drawer.

So the French Ambassador is coming down.

Taylor: Bonnet called him from Paris and asked him to come down and express to you the great importance, et cetera, and explain the background and so on.

H.L.Jr: (On phone) Secretary Hull, please.

McNamee: apropos of your (Harrison) remarks, the Secretary said yesterday that we were working for the wrong government.

Harrison: Working for what?

McNamee: The Secretary said, after looking this all over, he had decided we were working for the wrong government.

H.L.Jr: Got John Lewis coming in at 11, so I can't move it up much.

(On phone) Hello. - Who's there? - Let me talk to ... - Hello, Renchard. Hello, Renchard. - Good morning. - Since talking to Mr. Hull, the

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French Ambassador has asked to come down. He's coming at a quarter of 12 with a direct message from Bonnet. I'd like Mr. Hull to have a representative here. - Well, that's up to Mr. Hull. Have Mr. Hull have somebody here at a quarter of 12. - Thank you.

Huh?

Harrison: Good stuff.

H.M.Jr: He said, "Do you want Dr. Feis?"

I said, ~~that's up to~~ to Mr. Hull."

Well, I tell you what I'd like you people to do, if you wouldn't mind. Think you (Harrison) will be available from half past three on?

Harrison: (Nods yes)

H.M.Jr: Will you come back, and after seeing Hull we can talk this thing over again. Suppose you drop in here at half past three. If I'm not here, just come in here and sit down.

Harrison: All right, sir.

## PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Paris, France

DATE: May 3, 1938, 10 a.m.

NO.: 688

RUSH

FROM COCHRAN.

After I had had a telephone call from Secretary Morgenthau, I saw Rueff at the Ministry of Finance shortly after twelve midnight.

I told Rueff that I had communicated Minister Marchandeu's message to Secretary Morgenthau. I said that the latter had instructed me by telephone to give the following message to the Minister of Finance -

First. The message had been a shock to him.

Second. Under the Tripartite Agreement the parties thereto are supposed to consult, but that such notice by Minister Marchandeu was not, in Secretary Morgenthau's view, consultation.

Third. In the circumstances Secretary Morgenthau had not yet had time to consider what position the United States Treasury would take.

Fourth. On Tuesday the American authorities would continue to buy or sell on orders received from the French authorities but that this should not be interpreted as meaning that the Treasury acquiesced.

Fifth. On Tuesday he would consult with the British.

Sixth. In due course he would advise the French as to what he had decided to do. END SECTION ONE.

WILSON.

Rec'd 10:54 a.m.

SECTION TWO, NO. 888 of May 3, 1938, from Paris

Rueff made a note of these points both in English and in French. I made reference to Marchandean's statement to me some days ago that 175 was only a speculators' rate, and said, furthermore, that since that time I had had no definite information from the Ministry of Finance. He insisted that until on Sunday he himself did not know of Marchandean's decision.

After this Rueff went into the private apartments of Marchandean, which are in the same building as the office of the Minister; the Minister was in bed by that time, but Rueff gave him the message from Secretary Morgenthau. When Rueff came back he said that the Minister had intended his decision upon the 175 rate to be more or less in principle and was not to be applied until he had had a reply from Secretary Morgenthau. He had issued no instructions to put this decision into effect.

Then I asked Rueff whether I could inform the Secretary of the Treasury immediately that Marchandean would not give instructions on Monday to push the rate to 175 pending word from Secretary Morgenthau. I brought to Rueff's attention the fact that he was present when the Minister had spoken with me in the afternoon, and that there had been no misunderstanding the Minister's statement that on Tuesday he would put the plan into effect. On this point I was so positive that Rueff before he answered went again to the Minister.

PARAPHRASE, SECTION THREE NO. 688 OF MAY 3, 1938 FROM PARIS

He told me when he came back that the Minister meant his approach to be a genuine consultation. He said he will take no steps to put his contemplated plan into operation before he has word from the Secretary of the Treasury; however, he asked that the latter assist him by making such reply as soon as he could. I said that they should expect no reply on Tuesday morning. A safeguarding statement was put in by the French that if unforeseen pressure made action imperative before they get the reply of the Secretary of the Treasury, they would communicate with me.

After I had this talk with Rueff I came to the Embassy and at 3:15 this morning reached the Secretary of the Treasury by telephone, and gave him the information set forth above. I also told Secretary Morgenthau that the decrees to be issued this morning - releases on which were being distributed while I was at the Ministry of Finance - would include an 8 percent increase on all of the federal taxes in France.

In accordance with the request of Secretary Morgenthau, I have this morning talked with Butterworth on the telephone and I gave him a summary of the foregoing. I mentioned to Butterworth that I had received the Department's telegram No. 247 of May 2, midnight, and learned that the same message had been sent to him.

END SECTION THREE.

EA: LWF

WILSON.

Cable #688, Paris, dated May 3, 1938: Sec. 4, 2d paragraph, line 5;  
insert in place of (omission) "and have expressed". Will then read  
"authorities, and have expressed my"

PARIS

I haven't as yet had time to study the news  
which appeared this morning, but I will give a summary  
later.

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Re the Department's 247, second paragraph. I venture to recall that the Daladier Government came into office on a platform in which control of capital movements was opposed. I have set forth in various messages the belief of French and other monetary authorities, (omission) my own personal opinion, that it would not be effective to have control of capital movements in France if only of a modified character, and that even if such control were made drastic the desired ends would not be achieved. There has been an exodus from the country of most of the liquid capital, and control methods would not induce it to return. It is hard to conceive of exchange control measures being efficiently and effectively administered in a country where currency speculators appear to enjoy close relations with officials of the Government and where fiscal evasion has reached a high state of expertness. In the industries and securities of France, there should be really good opportunities for investment. The Government which is now in power, or some other French Government, eventually will have to create the atmosphere necessary for revival of confidence and capital repatriation. It will be a tremendous responsibility, in my mind, to presume to suggest

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to the French Government that any system likely to end up  
in exchange control be introduced in France.

END MESSAGE.

WILSON.

EA: LWW

Tuesday  
May 3, 1938  
10:44 a.m.

HMJr: Hello.

Operator: Congressman Woodrum.

HMJr: Hello.

Congressman  
Woodrum: Mr. Secretary.

HMJr: How are you?

W: Fine. I'm sorry that there was a little mixup down here yesterday. Miss Lonigan came over without any notice to us and we were just loaded up to the hilt.

HMJr: Well, what happened anyway?

W: Sir?

HMJr: What happened?

W: Well, we didn't have a chance to get her in for a personal hearing, but I asked her - I asked Mr. Shields to arrange for her to come over and to let me talk with her and get a statement from her.

HMJr: Fine.

W: I'll bring it before the committee. Now, the situation is this; I looked into it...

HMJr: Yeah.

W: We already have the authority in the bill - we had it in this year and we'll have it in next year - for them to do this work.

HMJr: Fine.

W: WPA has the authority to make allocations for that self-help work if they wish to do so.

HMJr: I see.

W: So what we've got to do is to sell Harry Hopkins on the idea.

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HMJr: That's what it is.

W: You see what I mean?

HMJr: I get you.

W: But I'm going to have her come down. We didn't know she was coming and we had LaGuardia and John L. Lewis and William F. Green and all that bunch on our neck, you see?

HMJr: Well...

W: And a lot of congressman too. So we were just sweating blood.

HMJr: Well, I think that ...

W: I was sorry that she - ah - ...

HMJr: Well, Mr. Woodrum, may I say this?

W: Yeah.

HMJr: I talked to Aubrey Williams last night.

W: Yeah.

HMJr: And God knows, I've done enough for those fellows for their organization and I personally - nobody else - I personally called him either two or three times and made the arrangement. See?

W: Uh huh.

HMJr: And then he goes and I think - forgets about it.

W: He didn't follow through on it you say?

HMJr: He didn't do anything. He said he told Corrington Gill but Corrington Gill told Miss Lonigan he didn't know anything about it.

W: No, I don't he did.

HMJr: What?

W: I don't think he did know anything about it.

HMJr: And - ah - then they tried to imply that you weren't in favor of it, see?

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- W: Oh, well, I - I couldn't take her right when she came over without notice; we didn't have any idea she was coming until she showed up at the committee room and we had ...
- HMJr: Well....
- W: You know the situation when you've got people like ....
- HMJr: I know. I didn't for the minute because after all, while we don't see each other very often when we do it's always been very pleasant.
- W: Oh, you know it.
- HMJr: And right from the first day I came to town you've always treated me like a gentleman.
- W: Well, I'm here for that purpose.
- HMJr: And I've tried to reciprocate. But I did think there was - I agree with you I don't think that the Hopkins people want it.
- W: No, we didn't have any idea that Miss Lonigan was coming up until she showed up at the committee that morning and we had this schedule made up there just pressing us to report this bill, you know.
- HMJr: Yeah.
- W: And, as I told - but I'll tell you this, that there won't anything be lost over it...
- HMJr: No.
- W: ...because I'd rather talk with her personally about it...
- HMJr: Yeah.
- W: ...and get a little statement and I'll talk with the committee about it...
- HMJr: All right.
- W: But, after all, the thing is going to revert back to Hopkins and what his attitude on it is going to be because we have authority in the bill now that they can go ahead with those projects.

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HMJr: Fine. Well, may I just explain my position once more. This takes care of a group of people; the poor devils aren't being taken care of in any other way.

W: Yeah.

HMJr: And that's my only interest.

W: Well, I think - I quite agree with you and I think it's a very fine thing.

HMJr: And your people down in Richmond have got one of the finest demonstrations I ever since and I've been there.

W: Yes.

HMJr: And it's a wonderful demonstration, - and they're taking care of these people at a minimum cost.

W: Yes.

HMJr: And, right there in Richmond they've demonstrated it can be done.

W: Sure.

HMJr: Now that's my only interest.

W: Fine. All right. Well, I'm going to get in touch with Miss Lonigan and we'll look after it Mr. Secretary.

HMJr: I'm very much obliged.

W: You betcha. All right, sir.

HMJr: Thank you.

MAY 3, 1938

11:45 am

Present:

The French Ambassador  
Dr. Feis  
Mr. Taylor  
Mr. Lochhead  
Mrs. Klotz

HM, Jr: I thought your Financial Attache would be with you.

Ambassador: He is away from Washington. I expect him certainly this afternoon, but yet I did not succeed in getting him.

HM, Jr: I am at your service.

Ambassador: Well, sir, as I told you, I got a telephone message from Mons. Bonnet about 10 o'clock this morning in which he asked me to ask you for an audience in reference to a certain message, which I do not know the exact contents of, but which has been brought to your attention by your Financial Attache in Paris.

HM, Jr: Mr. Cochran.

Ambassador: The French Government gave him a message for you. The French Government thought that -- he did not tell me what it was -- it was indispensable and that he would like to know at the earliest date what you think about it and he asked me to telephone him back after I had seen you what your impression is, if you can tell me something, but the reason I do not know what it is about is that Mons. Bonnet was very discreet on the telephone, which was wise.

HM, Jr: Yesterday afternoon we got a message from Mr. Marchandau (Cable 683). I think if you (Mr. Lochhead) will let the Ambassador read that part of the message it would be helpful.

(Ambassador read Cable 683)

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HM, Jr: After receiving that, Mr. Ambassador, I phoned Mr. Cochran -- it must have been about 12 o'clock last night, Paris time -- and told him that I was -- what were the four things I told him?

Mr. Lochhead: (gave the Secretary Cable 688 from Cochran.)

HM, Jr: You (the Ambassador) might just as well see this (Cable 688) because this is Cochran repeating to me what his instructions were. That took place at midnight last night, French time.

(Ambassador read Cable 688)

HM, Jr: Mr. Cochran got that message to Mr. Marchandean between 12 and 1 o'clock last night and then telephoned me back in which he said as a result of that message that the orders had not yet gone out to put the franc down to 175.

Ambassador: Uhm.

HM, Jr: What they must have done, they must have withdrawn the orders, because in the earlier cable they said they were doing this and yesterday, last night at one o'clock, Mr. Marchandean must have withdrawn.

Well, today the franc has been around 164-165 and we just gets orders today to support the franc. It's roughly, today, between 163-164 to the pound and we have been told that the French are not having great difficulty to keep the franc at that rate.

Ambassador: Uhm.

HM, Jr: Now, of course we have tried, ever since the new Government has been in we have asked repeatedly what their plans were and repeatedly they told us that they did not know and every time 175 francs would come up they would say no; there is nothing to that. I don't think I need tell you that I have demonstrated a number of times that I want to do everything that I can, within the United States law, to help your Government.

Ambassador: Uhm.

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HM, Jr: These aren't just idle words. I have done it again and again. We have stretched this thing until the Tripartite -- until she almost broke.

Frankly, I was very much disturbed last night because I felt that if the French Government had this in mind they should have consulted with us, which I thought that they had not. I am simply telling you this. Now, right at this moment I have no message for Mr. Bonnet or for Mr. Marchandeu. We are studying this matter very, very carefully and we have not lost our interest in being helpful to your Government whenever possible. We are still just as anxious to be as helpful as we ever were. This has come so suddenly that we don't know just how to evaluate it. We have not yet had an opportunity to have an answer from the British.

Ambassador: Uhm.

HM, Jr: I doubt whether I get an answer before tonight or tomorrow because of the difference in time. I have not yet heard from them. We only heard from them late last evening, so in view of the sudden announcement and proposal, rather, of announcement, I just need a little time and certainly before I come to any final decision I will want to confer with your Government.

Ambassador: Yes.

HM, Jr: I will want to confer before I come to a decision.

Ambassador: Uhm.

HM, Jr: But I do that think in as important a decision as this, all three Governments should have ample time to study the proposal, particularly in view of these new decrees, which we still haven't got copies of. I mean, the papers carry brief notice and we have not had a chance to read them and if these proposals are what they seem, then I should think the French franc would strengthen. And it just doesn't make sense that coming out with these very strong financial decrees, you say on the one hand we are going to collect taxes, 8% more, and on the other hand you say 'but the franc should weaken' and I can't make the two things fit.

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Ambassador: From what I infer, I think we are now just at the limit and if you made us to take a higher one it might be over. They can't make a stand. Mons. Bonnet told me on the phone that he thought this thing was indispensable; that they had no choice between what he apparently said in his message, that is, establishing a control of exchange, or just let it drop to 175, which we hope that she should be able to lower her rate in effect of new decrees and if he should, what I think you call some Mal---- (French word) she might not be required to go into control of exchange.

HM, Jr: Is that marginal recovery?

Ambassador: We would say in fencing ....

Dr. Feig: Elbow room.

Ambassador: If you are fencing, you would say you may retreat when you step forward again.

HM, Jr: I think, Mr. Ambassador, I need more time, I have not had a chance to hear yet definitely from the English and I have not had a chance to hear from the President.

Ambassador: Uhm.

HM, Jr: And if I have anything in mind I will call you at the Embassy and ask you, if you don't mind, that you come back.

Ambassador: Oh, yes. Certainly.

HM, Jr: But please tell Mr. Bonnet that my interest in France is just as great as it ever was, but he is making it a little more difficult for me.

Ambassador: Yes. I understand that you want proper consultation. That the notice given was not consultation and that you have of course in the course of consultation first to know the point of view and second to study the French Government which may be repercussions of new decrees.

HM, Jr: The French Government may feel differently tonight if they go through today and let's say, either

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it does not cost them anything or they may gain a little francs. They may feel different tonight about this matter than they did last night before the decrees were out. Now Mr. Lochhead, who has charge of our Stabilization Fund, up to this moment we have had no request to buy or sell francs. Absolutely dead. And if we went through that way today, let's say it did not cost you anything at the end of the day, your Government might feel differently.

Ambassador: Yes.

HM, Jr: I appreciate it has been costing them an enormous sum and naturally I am sympathetic.

Ambassador: Yes.

HM, Jr: But I can't help but question the efficacy of permitting the franc to continue to fall. If that is going to give you stability.....

Ambassador: I was under the impression that the Stabilization Fund has exchanged some resources. Our Exchange Fund is not exhausted.

Mr. Lochhead: No, they should not be exhausted. I think they still even have a little on balance since the time the new Government came in besides their previous resources.

HM, Jr: We have quite a lot of gold here belonging to the French.

Mr. Lochhead: I don't know over there whether they would call it Stabilization or General Fund. They use it for stabilization, but I can't say whether it is Bank of France gold or not.

HM, Jr: Supposing President Roosevelt comes out with a new program and we think it is going to be very helpful and immediately on the morning of the announcement we start to push the Government bond market down! It seems to me that you would be wanting to do just the opposite. You would want to show a strong franc to show that this is the reception that the world is giving to these new decrees. Well received and you have a strong franc. Instead of that the Government wants to automatically push it down. I can't understand it. I just can't understand it.

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Ambassador: Just from what I understand, he wanted more or less to step backwards to be able to step forwards afterward. But of course what Mr. Poincare did in 1926, don't you think at first he lowered the exchange more certainly considerably below the point that he got eventually afterwards?

HM, Jr: That was a long time ago. A lot of things have happened. You see, this has been going on for three years and you have lost 2½ billions gold. But, as I say, what might have looked very black at midnight last night, maybe this afternoon it may have a little silver lining.

A mbassador: Yes.

HM, Jr: So, if you would permit me and if I have some message, I will get in touch with you after four o'clock.

Ambassador: Please, certainly.

HM, Jr: I can reach you through the Embassy?

Ambassador: Oh, yes. I will be at the Embassy. As soon as Leroy-Beaulieu will be in Washington, of course he will come to see me and I will send him to you.

HM, Jr: If he just would stay at the Embassy because we phoned him yesterday and asked him to be here today.

Mr. Lochhead: He had already left. Apparently he was coming down by motor and the weather was none too good.

HM, Jr: I see. All right, sir.

Ambassador: Yes, I think he is motoring and the landscape is more congenial than the landscape on the international sea of exchange.

I am very grateful to you for your welcome and I will send back your message. I will tell Mr. Bonnet.

HM, Jr: Thank you very much and my personal regards.

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(The Ambassador left.)

HM, Jr: What's this story about the Financial Attache?

Mr. Lochhead: We telephoned yesterday morning. His office said he was already on his way back to Washington because he wanted an appointment tomorrow afternoon. Then we got hold of the Embassy this morning. They said he's motoring down.

HM, Jr: At least, I am going to sit tight. Mr. Sewley will undoubtedly have a formal answer for me. It will not, undoubtedly, come in until late tonight. After I see Mr. Hull tonight, I will say to them 'I need another 24 hours to think it over and we will continue to do business with you on Wednesday, but I need another 24 hours to think it over.' Now, if during the next 24 hours these fellows -- and the franc stays where it is and it does not cost them very much or if they should be lucky and gain a little bit, may be they will change their mind and I need so much elbow room, but you fellows (State Department) need not worry over there. Certainly I will not take the move of putting them out without giving you people all the chance in the world to talk. I will not do it without first cabling the President, which I have not, and I am more than willing to play the Democracies to the end. I realize the terrific stakes. I wish I trusted Bonnet, which I don't. I wish they would not give out statements like they did, that they are waiting on the English and ourselves, which they gave out; came over from Paris. And that does not help matters any.

Now the amusing thing, in view of the worst news domestically -- we have had steel off again this week, automobiles down, everything the worst -- our market is up  $1\frac{1}{2}$  points. Now if that makes sense, I would like to know it. Isn't this worth while gambling with another day, just to sit tight?

Dr. Feis: Yes. I don't think you are gambling. I can't see that you are injuring the situation by proceeding as you have proceeded.

HM, Jr: And I did not in any way tip my hand; let them know I was disturbed. I want to think it over; still feel kindly disposed and still want to do it, but.....

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Dr. Feis: The only conceivable way in which that method of procedure might have an adverse effect is if these fellows had in mind a ---- (French word) technique, moving way down, devaluing, strengthening there with the hope of stimulating considerable inflow of capital at that point in covering. I suppose that technical manouever is past. But that's secondary and whether it would have worked or not, I don't pretend to say. Just speaking not as State Department, but as an economist, I think the only fact that is not getting enough attention is that one fact that Monick cited in his cable -- national income of 200 milliards, total obligation of 110-115 milliards and largely, I think, influenced by American thought, these fellows as part of their program had in mind something that would further move up prices and the total flow of income while leaving costs where they were except for the new decess and they may have decided on cutting the franc as one element in the general economic program. That's the one technical consideration and against that I can see ....

HM,Jr: If they had that in mind yesterday was one day they must have known it. They could have gotten this thing Saturday. This is what we want to put over. We will put our cards on the table.

Dr. Feis: The only excuse is the terrific confusion in the Cabinet. But I wholly agree that from their own point of view, perfect misery, and there is no damage being done by this.

HM,Jr: Is France today the France of Poincare? Is the strength there?

Dr. Feis: The job of trying to bring capital back to France and getting French production operating is infinitely more difficult than in Poincare's times. I don't know whether any Government can pull it off. I fear not.

HM,Jr: Well, all I can say is as of 12:15, I think we are all right so far and when I go over to see Mr. Hull, by three, we will know more about this situation. Maybe there will be a note in from the English. There may be a telegram in from the President. Now it's too early to tell whether it's good or bad, but from our standpoint it certainly wasn't bad.

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Mr. Lochhead: And I don't think it has cost them anything to do it today. If it had cost them to keep the rate at 165, it would have been different.

Dr. Feis: That's the exchange point of view.

HM, Jr: Our market is up 1.87. Certainly there are no leaks.

Dr. Feis: They have finally decided that recovery has begun.

HM, Jr: Are you going out moderately cheerful?

Dr. Feis: I do plead for a little more attention to the economic possibility alongside the exchange aspect.

HM, Jr: And don't forget economics at home too.

This is the way I feel. These fellows have been going to the till so long and we have been kind of closing our eye, but if we keep letting them go to the till, after a while if I suddenly get moral and say, 'You can't keep going to that drawer' he will say, 'You have been letting me do it for a year. Why do you suddenly get on your high-horse?' The longer I wait, the more difficult it is to keep them from going to that drawer and after a while I become a partner in that drime.

Mr. Taylor: You have been that for a long time.

HM, Jr: No. They have played pretty well within the rules.

Dr. Feis: And I think one of the ironical aspects of it is I can make a far better case for their action in going down to 175 than they have ever made to you.

HM, Jr: That's what burns me up. And what burns me up is they are so blankety-blank stupid that they don't take the method of really controlling this thing by going after these people who send their money out and send it just to escape.

Mr. Lochhead: Exchange control in the general market was well expressed by -- that it took 2500

-10-

honest Germans to run an honest exchange in Germany and he did not think there were 300 honest Frenchmen.

HM, Jr: And on that basis, I should go along and trust them.

Mr. Lockheed: My point is you can't bar it out because you are afraid of their honesty.

Dr. Feis: If this arms race continues to mount, they must control capital movements. There is no alternative.

HM, Jr: All right. Let's say that they should do it.

Dr. Feis: I right along have said that they should do it.

HM, Jr: Well, in the meantime, you can buy a franc at 3.03 instead of -- what would it be at 175?

Mr. Lockheed: About 2.88.

HM, Jr: 3.03 is the Morgenthau franc!

oOo-oOo

This was 178  
followed by  
Call for Benter

May 3, 1938

Present:

Mr. Taylor  
Mr. Lochhead  
Dr. White

(After Mr. Bewley had departed.)

HM, Jr: Well, we had a long palaver with the French and they said, What do you want to know? I said, I want to know why you are doing this. The only superficial reason you are doing this is for trade advantage. 'Oh, my God; no!' Then, Why are you?

They are going to telephone back and maybe we will get a reason. Bewley saw reason and I said, At least we have gained a day and a day gained is a day gained. Tomorrow, I don't know.

In view of that cable which came in from Wilson, which says that the Communists and Extreme Radical Socialists are the only people who want exchange control (Feis let me ready it, but he did not have copies -- Wilson sends a cable that the only people who will go along on exchange control are the Communists and Extreme Radical Socialists, and that you can't get that out of this Government. What's the use of saying -- it would be like saying to Mr. Roosevelt, Unless you give up your trade treaty, we won't do so and so. While Cordell Hull and President Roosevelt are here, we won't give up the trade treaty.

Mr. Taylor: They have political commitments so it's impossible for them to do it.

HM, Jr: I don't see, Harry, I think the last 24 hours, if I say so myself, I don't think we have lost a lot.

Dr. White: No. I think up to now, I am willing to concede a chance. You are in a more difficult situation by view of the fact that everybody else is taking a different attitude.

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Mr. Taylor: I think you have done just right. I think tomorrow you have got to get around to saying a little more, because you scared hell out of them, which is fine. That's exactly right. Now, after they know and tell you what they will tell you, which is not going to add anything to your own knowledge, they are going to say, This is <sup>the</sup> same technical type of move that you made when you felt it was good to de-sterilize gold to give a fli-up to other measures. That's what I am guessing.

Dr. White: There is this possibility: that in attempting to answer your question they may find that their answers are not so good. They themselves may find difficulty ....

Mr. Taylor: It does not make any difference.

Dr. White: I agree the delay has been all to the good. There is a slight possibility that today they did not lose much, with every reason why they should. They can't say 'tremendous pressure'. Then why did you lose only 60 or 70,000 pounds?

Mr. Taylor: 700,000 pounds.

HM, Jr: That is not an awful lot.

Dr. White: But they can't keep that up steadily. They still can't say that there is tremendous pressure on the franc. Therefore, they must give some other reason, and that would be difficult.

Mr. Taylor: As I said before, you scared hell out of them, and that's fine. That's just what they need.

Dr. White: Do you expect anything more tonight?

HM, Jr: I am expecting a call from Butterworth.

oOo-oOo

Pages 181 through 184

May 5, 1938, now in Book 123, pp. 348 A-D

## PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Paris, France

DATE: May 3, 1938, noon

NO.: 688

STRICTLY CONFIDENTIAL FOR THE SECRETARY AND  
UNDERSECRETARY.

I refer to the suggestion made in telegram No. 247 from the Department, paragraph two, and also to the last paragraph of telegram No. 688 of May 3, 10 a.m., from Cochran. I venture to submit the following for your consideration.

Any measure for exchange control has been consistently opposed by the Radical Socialist Party, which forms the backbone of the present Government as well as the Center parties which are supporting the Government. Support for the exchange control idea is found only among the Socialists and to a lesser degree among the Communists. I personally believe that a large majority of French opinion is convinced that to begin exchange control would be but to begin measures of restraint which would lead to an economic and financial dictatorship; the latter in turn would inevitably lead to a dictatorship in the political field. Whether or not I am right in this opinion is not the question; what is important is that this opinion is widely and sincerely held, and it accounts for the deep-rooted hostility towards anything along the exchange control idea.

If I judge rightly, what the present Government wants

- 2 -

to do is to create conditions which would restore confidence. Thus there would be attraction for essential capital to return to France from abroad. Such measures as would create psychological obstacles to the repatriation of funds, as for example the appearance of a beginning of exchange control, would obviously be contrary to the policy of creating confidence.

WILSON.

## PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Paris, France

DATE: May 3, 1938, noon

NO.: 690

RUSH FROM COCHRAN

At a rate of 163 1/2 to the pound exchange trading opened at Paris banks. I was told by two traders that the series of decrees which was published this morning had been disappointing to the market, and that there had developed a nervous condition on the market.

At twelve noon I visited at the Bank of France. The control by that hour had given 54,000 pounds. The rate had moved to 165 and there was an apparently growing demand for sterling. While I was at the Bank of France the Bank of England telephoned and reported that in London a rumor was circulating that there was imminent an important change in French monetary policy. In an effort to hold the rate to 165, the French control instructed the British control to sell 100,000 pounds.

While I was at the Bank of France the Governor, Fournier, came in. He was quite nervous and asked when they could expect Washington's reply. Officials of the Bank of France realized that the decrees had received a poor reception.

WILSON.

EA:LWW

10

GRAY

London

Dated May 3, 1938,

Rec'd 12:25 p.m.

Secretary of State,  
Washington.

RUSH

306, May 3, 5 p.m.

FOR TREASURY FROM BUTTERWORTH.

For purposes of record there is briefly set forth below the main points of the Ambassador's telephone report of his conversations with the Chancellor of the Exchequer and the Prime Minister:

(One) The British Government is definitely against the imposition of an exchange control by France, that they are opposed to it not only because it cuts across basic liberal principles but because they do not believe the French can work such a system. In their view it would mean the worst of both worlds, for despite exchange control the franc in their opinion would be depreciated any way.

(Two) The British maintain that they are just as annoyed as we are about the French action, but they are prepared

Page 2, #366 from London

prepared to overlook it because they are profoundly convinced that it would be a grave mistake for political as well as financial reasons to break up the Tripartite Agreement, particularly on the occasion of Hitler's visit to Mussolini. They point out that British trade will be much more adversely affected than American trade and that "it won't cost us any money" to acquiesce in the French action.

(Three) At the same time the British state that they will not do anything unless we agree and they expressed the hope that in our reply to the French we would urge France to take steps to put her house in order.

The British want very much our answer by this afternoon or tonight.

KENNEDY

CSB

JR

GRAY

London

Dated May 3, 1938

Rec'd 1:30 p.m.

Secretary of State,  
Washington.

RUSH.

367, May 3, 7 p.m.

FOR TREASURY FROM BUTTERWORTH.

British Treasury states that French are pushing them for an answer and that they in turn while not desirous of pushing us would like to know whether our reply can be expected this evening.

KENNEDY

DDM:CSB

12-1001-17

FEDERAL RESERVE BANK  
OF NEW YORK

191

OFFICE CORRESPONDENCE

DATE May 3, 1938.

CONFIDENTIAL FILES

SUBJECT: TELEPHONE CONVERSATION WITH  
BANK OF FRANCE

FROM D. J. Cameron

Mr. Cariguel called me at 1:40 p.m. and asked what was doing in the market. I told him that at the moment 500,000 francs were offered at 302 3/4 and that sterling was 498 13/16. He asked what the London-Paris cross-rate would be at those rates and I told him about 164.75. He then asked me to hold the wire for a minute and then came in again and asked me to alter his order to buy francs for today from the basis of 165.13 to the pound net to him, to 165.12 net to him for up to 10,000,000 francs and 165.88 net to him for an unlimited amount. I told him that we would be glad to comply with his wishes. He then asked that we call him at his home (Carnot 4338) if anything of importance should happen.

SEARCHED  
SERIALIZED  
INDEXED  
MAY 10 1938  
FEDERAL RESERVE BANK  
NEW YORK

RE FRENCH MONETARY SITUATION

May 3, 1938.  
3:30 p.m.

Present: Mr. Taylor  
Mr. Lochhead  
Mrs Klotz  
Mr. White  
Mr. Harrison  
Jr. Knoke  
Mr. Gaston  
Mr. Oliphant

H. W. Jr: I saw Mr. Hull, and Mr. Hull had just seen Feis, who brought him up to date, and he said, after talking to Feis and thinking it over himself - he said he'd continue on a short-time basis in a manner in which I protect all my rights and wait and see what would happen. And we discussed the thing - whether we should say, "Good until cancelled" or simply say, "We'll do business with you on Wednesday." And he thought that was a very good way, to notify that we'd do business on Wednesday. But we need more time. And pray and hope something will happen which will give us a little light. And he thinks we've got nothing to lose by waiting and we may get a lucky break. Very quiet - and that's the way he feels about it. Perfectly satisfied, and complimented me on what I've done up to date, and felt that so far what we had done was to hold them up close with a tight rein, and that till three o'clock this afternoon it was good.

So I thought what I would do - I would call up Cochran and Butterworth and tell them that we'll do business for them till Wednesday and I haven't heard from the President yet and I'm just waiting to see what happens, need more time. Then, in order to be courteous all around, we'll let the French Ambassador know. If he wants to come down, it's all right.

Lochhead: Beaulieu was outside.

H. W. Jr: Would you (Kieley) call up the French Ambassador and say if he could come right down I'd be pleased to see him, and the same for Mr. Bewley of the British Embassy, please.

(Gaston and Oliphant come in)

H.M.Jr: I was saying, Mr. Hull simply said the thing to do was to sit tight, do business for another 24 hours, and hope that we get a lucky break.

Oliphant: Been no additional information since we met this morning, has there?

H.M.Jr: No.

I think I'd take a message like this for the President. "President of the United States. ..." - is there any covering message which would make it easier?

Taylor: You've got that summary from ....

H.M.Jr: Yes, Butterworth.

Taylor: ... Butterworth.

H.M.Jr: All right.

"For the President of the United States." Send cable number 366.

"The following cable from Cochran gives you a brief summary of what the French - the Bank of France did today." That's 693.

"After discussing this whole situation with Cordell Hull, we have decided to notify the British and the French that we will continue for another 24 hours.

"Hull and I feel that we have everything to gain by going along another day without coming to any decision, and that by doing so possibly we may get a lucky break.

"I would be pleased to receive any suggestions that you have to help guide me in this extremely difficult situation."

(Copy of message in final form is attached)

Harrison: May I make a suggestion?

H.M.Jr: Sure.

Harrison: Has he got, or has he got any way of getting, the impression that you got from Kennedy today about the

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attitude of the British?

H.M.Jr: Yes, that's in the cable. That gives a summary - that the British Government is against the imposition of exchange control.

Harrison: That cable goes to him.

H.M.Jr: Oh, I'm giving him everything.

Harrison: Because I thought that was important, what they said about Rome.

I have one thing in mind that I've been thinking over during lunch, especially in view of that pressure they have brought to bear - that the French action on whether the franc should be lowered or not would depend on British and American decisions. And that is that you, in protection of yourself and the whole international situation - that you want to be sure not to be maneuvered into the position of being the one fellow to break it up.

Now, the British, while they are just as sore as you are, have shown an inclination - "Well, let's go ahead with them this time anyway," and they've pointed out to you as forcefully as they can through Kennedy the implications of what might happen if the tripartite is broken up now. And I should think you want to be careful not to be maneuvered, either by the French or the British, into the position of being the one to break up the tripartite, after all the patience you have shown all these years, just at this ticklish time.

H.M.Jr: I agree again.

Harrison: But I was wondering whether that slant in any message you give to the President might not let him know the line along which you are thinking. I think it is the nub of the question at the moment - more political than it is financial. That's just a thought. I ...

Knoke: I don't think reference to Rome appears in Butterworth's cable, does it?

Lochhead: Yes, I think he speaks about it.

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H.M.Jr: "... agreement, particularly on the occasion of Hitler's visit to Mussolini. They point out that British trade will be much more adversely affected...."

Harrison: Kennedy was pretty vigorous on that this morning; made all his emphasis on that.

White: That was on the assumption they might be dropped. No such action is being taken. Everything is being frozen just as it is. Therefore, I don't quite see the danger that you speak of. That is, there is no action being taken here. By not answering that letter, that does not indicate that they're being dropped; so that you can take any action tomorrow that the occasion warrants in the light of that tomorrow, but failure to take such action today does not make that danger more imminent.

Harrison: I agree with you, but I'm wondering whether the French might not say that "we decided on our own account, and studying our own situation, that it was necessary for us to let the franc go; we put it up to the British .." and the British have probably indicated in their own way that they wouldn't mind their doing so, and that they wouldn't think that was cause for breaking up of the tripartite. Now, a failure to answer even for 24 hours might be construed by the French as judgment on our part that we're not going to allow them to do what they think is necessary, and that the cost of their going ahead without our approval is withdrawal from the tripartite.

White: I suspect that they're so eager to have the Secretary's good wishes and cooperation and to remain in, that they'll give notice of any such intention, and they'd hesitate to do it.

Harrison: I'm inclined to agree with you, but that's the only possible risk.

Oliphant: The fact that the Secretary suggested an alternative to the British which the French might follow tended to put the ball - the hot potato back on the English lap. Now, is your point that, since no suggestion of an alternative had been made to the French, we haven't put the hot potato back on the French?

Harrison: Back on the French at all.

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- H.M.Jr: Well - I mean if ....
- Harrison: I don't know about what you said to the French Ambassador.
- H.M.Jr: Nothing, nothing. I had the lovely job of having him come in here, and he had gotten a telephone message from Bonnet, who said, "For Heaven's sake go down and see Morgenthau, tell him I think he's a nice fellow." And he said, "I'm awful sorry, Mr. Secretary, I don't know what it's all about." So we fished out one cable after another and he did his home work here. I'm not exaggerating. "I don't know a thing - what it's about, except I was to come down and see you and express Mr. Bonnet's ... " so forth and so on. So I let him read it and I said, "Mr. Ambassador, we're thinking this over and if we come to a decision or have anything we'll let you know. But I'm giving the matter very serious consideration."
- Now, if I put in at the end there, "Mr. President, I'm watching my step to see that I don't get tagged with the blame" - well, the President knows me by now. I think I'll go one better. That very last paragraph - I'll cut it out entirely, because in the first telegram - cut it all out.
- Gaston: I had the same objections that Harry didn't express to the last half of that sentence.
- H.M.Jr: What?
- Gaston: It seems to indicate that you had no plan of your own.
- White: This morning you said you might consider the possibility of indicating to the French financial attache a postponement .....
- H.M.Jr: Oh, I kind of think that in view of all the opposition all the way around, that is unnecessarily putting my neck out.
- White: It does increase the risk.
- H.M.Jr: I mean taking what - then there's the chance of these

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people - now, if you're going to think about who's going to be blamed, I have made the suggestion to the British, the British have turned me down. Now, I made the suggestion to Mr. Blum as a matter of record. If Mr. Blum didn't want to leave that record in the Treasury ..... but I think that may be, under circumstances, going a little bit too far.

White: Would it change the matter any if you could put it in somewhat the same terms as you put the French - instead of recommending, suggest.

H.M.Jr: It's too late. We'd have had to start that way. Furthermore, the British don't want to go along.

White: Of course, they make it difficult, if they don't want it to work.

H.M.Jr: Not only they don't think it will work, but the American Ambassador in London is vehemently opposed to it. And I haven't read it, but Mr. Cochran, they tell me, has filed a cable here that he's vehemently opposed to it.

Taylor: Everybody's turned us down on it.

White: O.K., I just wanted to make sure that I understand your position.

H.M.Jr: You're right, and if I had started de novo, it might .... Put it this way: if the French had given me a chance to catch my breath, instead of notifying me five, six o'clock Monday afternoon, they were going to do this thing Tuesday morning, then I could have started out; but they didn't give me a chance, and they can't turn themselves. Since then has come in this cable from Wilson over there, saying that on a parity basis they can't do it.

May 3, 1938.

FOR THE PRESIDENT OF THE UNITED STATES  
STRICTLY CONFIDENTIAL

RECEIVED AT 12:25 P.M. FOLLOWING CABLE FROM BUTTERWORTH,  
LONDON:

"FOR TREASURY FROM BUTTERWORTH.

"FOR PURPOSES OF RECORD THERE IS BRIEFLY SET FORTH  
BELOW THE MAIN POINTS OF THE AMBASSADOR'S TELEPHONE  
REPORT OF HIS CONVERSATIONS WITH THE CHANCELLOR OF  
THE EXCHEQUER AND THE PRIME MINISTER:

"(ONE) THE BRITISH GOVERNMENT IS DEFINITELY AGAINST  
THE IMPOSITION OF AN EXCHANGE CONTROL BY FRANCE, THAT  
THEY ARE OPPOSED TO IT NOT ONLY BECAUSE IT CUTS ACROSS  
BASIC LIBERAL PRINCIPLES BUT BECAUSE THEY DO NOT  
BELIEVE THE FRENCH CAN WORK SUCH A SYSTEM. IN THEIR  
VIEW IT WOULD MEAN THE WORST OF BOTH WORLDS, FOR  
DESPITE EXCHANGE CONTROL THE FRANC IN THEIR OPINION  
WOULD BE DEPRECIATED ANY WAY.

"(TWO) THE BRITISH MAINTAIN THAT THEY ARE JUST AS  
ANNOYED AS WE ARE ABOUT THE FRENCH ACTION, BUT THEY  
ARE PREPARED TO OVERLOOK IT BECAUSE THEY ARE PROFOUNDLY  
CONVINCED THAT IT WOULD BE A GRAVE MISTAKE FOR  
POLITICAL AS WELL AS FINANCIAL REASONS TO BREAK UP  
THE TRIPARTITE AGREEMENT, PARTICULARLY ON THE OCCASION  
OF HITLER'S VISIT TO MUSSOLINI. THEY POINT OUT THAT  
BRITISH TRADE WILL BE MUCH MORE ADVERSELY AFFECTED  
THAN AMERICAN TRADE AND THAT 'IT WON'T COST US ANY  
MONEY' TO ACQUIESCE IN THE FRENCH ACTION.

"(THREE) AT THE SAME TIME THE BRITISH STATE THAT THEY  
WILL NOT DO ANYTHING UNLESS WE AGREE AND THEY EXPRESSED  
THE HOPE THAT IN OUR REPLY TO THE FRENCH WE WOULD URGE  
FRANCE TO TAKE STEPS TO PUT HER HOUSE IN ORDER.

"THE BRITISH WANT VERY MUCH OUR ANSWER BY THIS  
AFTERNOON OR TONIGHT."

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THE FOLLOWING CABLE FROM COCHRAN GIVES YOU A BRIEF SUMMARY OF WHAT THE BANK OF FRANCE DID TODAY:

"AT HALF-PAST FIVE I HAD A TALK WITH THE BANK OF FRANCE. CONTROL'S INTERVENTION FOR THE DAY UP TO THAT HOUR HAD COST BETWEEN 600,000 AND 700,000. THE RATE RANGE HAD BEEN BETWEEN 164 1/2 AND 165 FOR THE MOST PART. AFTER THREE O'CLOCK THE DEMAND FOR STERLING HAD QUIETED DOWN. CAUSE OF FRANC SALES WAS PARTLY FROM DISAPPOINTMENT OVER THE INEFFECTIVE CHARACTER OF THE DECREES, AND PARTLY BY FEAR OF OPERATORS THAT THERE WILL BE CONTINUED DECLINE IN THE FRANC EXCHANGE RATE.

"BESIDES THE OPERATIONS DESCRIBED ABOVE, THE CONTROL BOUGHT BELGAS IMPORTANTLY FOR MATURITIES OF FRENCH RAILWAY LOANS."

AFTER DISCUSSING THIS WHOLE SITUATION WITH CORDELL HULL WE HAVE DECIDED TO NOTIFY THE BRITISH AND THE FRENCH THAT WE WILL CONTINUE FOR ANOTHER 24 HOURS.

HENRY MORGENTHAU JR.

Mr. Secretary:

200

We know that the French franc is to be devalued depending upon U.S. <sup>and British</sup> approval and that the French and British Ambassadors were here this afternoon. Will there be an announcement or will you talk to us for background?

N.Y. Times  
N.Y. Herald-Tribune  
Associated Press  
Central News

Tuesday  
May 3, 1938  
3:57 p.m.

HMJr: Hello.

H. Merle  
Cochran: Hello, Mr. Secretary.

HMJr: How are you? Cochran.

C: Yes, sir.

HMJr: Will you notify the French Treasury that we will ...

C: I don't hear you.

HMJr: Will you notify the French Treasury...?

C: Yes.

HMJr: ...that we will continue to do business with them  
on Wednesday and - in their behalf - under the  
Tri-partite Agreement? Hello.

C: ...with them on their behalf?

HMJr: Yes. I mean we'll continue to operate under the  
Tri-partite Agreement in their behalf on Wednesday.

C: Yes.

HMJr: And that I am giving this whole matter very serious  
consideration but I need at least another day to  
think it over.

C: I see.

HMJr: See? Hello.

C: Yes.

HMJr: And for your own information I've come to this  
decision after a personal conference with Mr. Hull.  
Hello.

C: Hello.

HMJr: I mean this is the combined view taken by both Mr.  
Hull and myself after he and I had a conference by  
ourselves for a half an hour.

C: I see.

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HMJr: See?

C: Yes.

HMJr: Now, would you mind repeating what the message is please?

C: I am to inform the French Treasury that you will continue to do business with them on their behalf on Wednesday.

HMJr: I'm sorry. We've got a bad connection. Will you repeat please?

C: I am to inform the French Treasury here that you will continue to do business with them on their behalf on Wednesday.

HMJr: Yes.

C: That you are giving the whole matter very serious consideration...

HMJr: Yes.

C: And that you will require one more day.

HMJr: At least one more day.

C: At least?

HMJr: Hello.

C: Yes.

HMJr: I need at least another day.

C: Require one more day to reach your decision. Right.

HMJr: Hello.

C: Hello.

HMJr: I say I need at least another day.

C: At least another day.

HMJr: Yes. I mean I may not reach a decision by Wednesday night. See?

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C: But you need at least another day?

HMJr: Yes. Now, another thing. Hello. Hello.

C: Yes.

HMJr: Cochran.

C: Yes.

HMJr: Please caution them to be very careful in their statement - ah - not to try to throw the blame one place or another - ah - outside of France.

C: I didn't get that. to please caution ...

HMJr: The French Treasury.

C: Yes.

HMJr: To be very careful in their publicity - I mean - there was a statement that came across on the ticker ...

C: Yes.

HMJr: ... that the French Treasury was waiting for England and the United States to make up their minds.

C: That's on the ticker, is it?

HMJr: Yes.

C: Is that so?

HMJr: Now I want to caution them to be careful....

C: Yes, sir.

HMJr: ... as to the official leaks - do you get me?

C: Yes, yes.

HMJr: I want them to be careful. Now, I mean, we're doing the very best we can but I don't want them to try to put out stories which will try to place the blame on either England or the United States.

C: Surely not, no.

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HMJr: And I can play that game also.

C: Right.

HMJr: But I don't want to. See?

C: Well I'll get in touch with them yet tonight. I haven't talked with them today.

HMJr: Yes.

C: They did not call me so I thought it better to wait until I had some word from you.

HMJr: Well now, you've got the message.

C: Yes. Yes, I have it.

HMJr: And we'll see what happens tomorrow.

C: All right, sir.

HMJr: And - now just wait one minute.

C: Yes.

(Short pause)

HMJr: Hello.

C: Yes, sir.

HMJr: Up to this time, which is four o'clock, we've only had to buy one million and a quarter of francs all day.

C: One million and a quarter?

HMJr: That's all.

C: Yes.

HMJr: Which you might say is nothing.

C: Yes. Well, at six o'clock I sent you a wire giving you the latest figures which I had ....

HMJr: Yes.

C: That it had cost them at least six or seven hundred thousand pounds.

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HMJr: Yes. We got that.

C: You have that?

HMJr: Yeah.

C: That is the right figure.

HMJr: Yeah.

C: And I sent you a cable on the decree summarizing that. You probably saw it in the press too.

HMJr: Uh huh.

C: They're not letting anyone talk much in this press group.

HMJr: Uh huh.

C: They're fairly current but they're not startling enough; they're not important enough to make anything swing in the trend.

HMJr: Uh huh. Well, we'll hope for the best for tomorrow.

C: All right, sir. And I'll get this message to him tonight and that's all.

HMJr: Thank you.

C: All right. Good night.

HMJr: Good night.

May 3, 1938

4:05 p.m.

Present:

French Ambassador  
Mr. Leroy-Beaulieu (Financial Attache)  
Mr. Taylor  
Mr. Lochhead  
Mrs. Klotz

HM,Jr: Did you (Mr. Leroy-Beaulieu) have a nice drive down?

Mr. L-B: A little hot.

HM,Jr: Mr. Ambassador, we have been thinking about this all day and I went over and talked to Mr. Hull about the matter and we need at least another 24 hours. That's after thinking about it all day. We need at least another 24 hours. So if you would convey that message to them, I would appreciate it.

Ambassador: Yes. I will phone. May I add anything or ask anything that you want to be more completely informed on.

HM,Jr: No. They evidently took adequate means to take care of the franc today and I just would like to -- after all, they took at least two weeks to study this, so I think if we take several days that isn't asking too much time on as important a matter as this. I mean, I have dropped everything today to devote myself to this.

Ambassador: Uhm.

HM,Jr: And it's so important that I can't just decide.

Ambassador: Uhm.

HM,Jr: And with the President away, I have not heard from him. I have had no communication from him. And so I hope they will continue tomorrow as they did.

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today. I mean, your Government to support the franc.

Ambassador: Of course, that may be somewhat more difficult for them tomorrow if something has leaked out.

HM, Jr: Unfortunately, of course I don't know where, but the news service carried the report that France was waiting on Great Britain and the United States to make up their mind.

Mr. L-B: When did you see it?

HM, Jr: Mr. Lochhead can look it up and get you the exact time.

Mr. Taylor: Around noon.

Mr. Lochhead: It was in the news report of the Dow Jones, Wall Street Journal, that the French Treasury had stated that they were waiting for the British and American Treasuries to make up their mind as to a lower franc. They mentioned "lower level".

Mr. L-B: The news came from Paris?

Mr. Lochhead: Came from Paris.

Ambassador: When?

Mr. Lochhead: This morning.

Ambassador: Since or before I saw you?

Mr. Lochhead: Probably just at the same time.

HM, Jr: You (Mr. Lochhead) can find a copy of it and give it to the Ambassador.

Mr. Taylor: I think it was before you were here because when I came out of the office one of the boys came and showed it to me.

Ambassador: Uhr.

Mr. L-B: There is no special point on which you would like to have further information?

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HM, Jr: No. They have just tonight cabled us copies of the decrees. We will see those tomorrow. We have not seen those yet, but they tell me they are on their way and will be here tomorrow morning.

Mr. L-B: I see.

Ambassador: This morning I wonder whether I was wrong. I asked you first there were several things you wanted to make clear. One of them of course is the decrees, the economy of the new decrees. The second thing was what exactly was the state of the Stabilization Fund and which you hope the French Government can reasonably hope to keep the franc at its actual level taking into account the effect of the new decrees .....

HM, Jr: Pardon me. I did not ask about the Stabilization Fund. You asked us did we know how much Fund was left in the Stabilization Fund.

Ambassador: No. Exactly that is the certain matter I was perhaps wrong. I was under the impression that you were not quite sure that the French Government was obliged to bring the franc to a level, to a lower level.

HM, Jr: That's perfectly true. I question the necessity.

Ambassador: Yes.

HM, Jr: I questioned the necessity of simultaneously with the announcement of these decrees of forcing the franc down to 175. I still question it.

Mr. L-B: You mean to say, Mr. Secretary, that you doubt, or question, that the Fund has not got enough money to support the franc at its present level?

HM, Jr: Please get this straight. I am not questioning how much money is in the fund; not questioning what they can do with the fund, or anything about the fund. Now I did not raise the question about the fund. That's -- I mean, if I want to know how much money is in the fund I could ask, if I thought I had the right to. I did not ask how much money or what the fund will do

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or anything about the fund. What I do say is I do want to study that by forcing the franc down to 175, are you putting in the practice of competitive devaluation. I mean, are you doing it for a competitive advantage which, under the Tripartite Agreement, we agreed not to do. In other words, are you putting it down to 175 in order to get trade advantage?

Mr. L-B: Oh, no, I don't think so.

Ambassador: Oh, no. I don't believe that, but from what Mons. Bonnet said he did it because they really had to choose between continuation of devaluation ....

Mr. L-B: I think, Mr. Secretary, they did it -- of course, they are trying to do it and they are asking you what you think, because nothing is done, only because there has been so much talk about it and if they do it there will be return of capital, but no talk about trade advantage.

Hill, Jr.: Talking as Governments and not as individuals, the fact -- I can say this, as one Government and not as one individual -- the fact that that does not make sense to me as a Governmental action is what bothers me. I am not talking as an individual, but as a Governmental action it does not make sense. And that's what is bothering me and, therefore, I am questioning what is the reason for forcing the franc down to 175. After all, we have other members. Belgium. What does this do to Belgium? What does this do to Holland? And the agreement -- after all, the spirit of the Tripartite Agreement was to stop this competitive devaluation for trade advantage. That was the spirit and that was the idea. Now on three hours' notice the French Government proposes to drop it from 160 to 175 and I, who may be affected the least by it and who could stand it the most, ask why and I still have not been able to answer it to myself. Now, the fact that you are suddenly going to drop it and let it come back, again talking as myself, just does not make sense and I can't convince myself. Maybe after I have 24 hours to think about it, maybe we will decide it's all right, but in the meantime I have not had a chance to hear from him and we simply -- normally if you are going to do a thing like this on Monday, they

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usually notify us on Friday and we get a couple of days to think this over, but to give you two or three hours on a move as unusual as this is, the Government just does not have time to think. If the French Government can throw any new light on this thing, it will be most helpful.

Mr. L-B: Yes.

H.M.Jr: It will be most helpful.

Ambassador: The reason I mentioned stabilization fund has perhaps nothing to do with the question which I was raising. It was if the French Government had not at the present time the means of keeping the franc so high. I don't know what our rates might be from a technical point of view.

H.M.Jr: I don't want to raise that question.

Ambassador: But if it is a question of general policy, is it a question of being practical or is it impossible.

H.M.Jr: If the French Government says this is a carefully thought out plan which we can put through and I can become convinced of it, far be it from me to tell the French Government how to administer their affairs, but that's just what I am trying to weigh and trying to think over and it's a very unusual action and, as I say, we can afford to be unselfish about it because the franc going to 175 to the pound would not have an important effect on our economy, but it's just the example that it sets to other countries. And whatever the period is -- two or three years now -- all currencies have been more or less stabilized, due to the Tripartite Agreement, and as soon as one Government breaks away there is no telling how many will follow suit because they will say 'If the French Government can do it, why can't we?' Then we start all over again, each country lowering its currency until we have complete financial chaos and to say you are going to drop to 175 and catch the speculators and push it back to something else -- the unfortunate part is for two weeks the speculators have been saying it is going to 175. Not 174 or 176, but 175. For two weeks Marchandean has been denying that. But the speculators

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have been consistently saying 175. And 175 it is. Now these speculators knew what it was going to be and for two weeks they have said 175 and for two weeks Mr. Marchandean has vehemently denied it, but it turns out to be 175.

Mr. L-B: I see your point.

HM,Jr: One of the things we all agreed upon was we wanted to do away with the international speculator in foreign exchange and I can't help but think this plays right in his hand, and that's why I need more time.

Mr. L-B: Yes.

HM,Jr: As I say, in our country here, up to a minutes ago, we dealt in 1,250,000 francs. That's all the francs that have been done today, which is nothing. And there is no speculation on this side and I wish you would tell that to Mr. Bonnet. 1½ millions. That's nothing. So whatever speculation is taking place is not in the United States.

Mr. Lochhead: And 1,000,000 of that 1½ millions was French order.

HM,Jr: The French Government.

Mr. Lochhead: Well, came from French sources.

Ambassador: That's one million dollars?

Mr. Lochhead: No; 1½ millions francs.

HM,Jr: Of which, Mr. Lochhead said, 1,000,000 came from France, so you might say there was practically no dealing here. So the speculation was not on this side. We are watching it very closely to see that they do not take advantage.

Mr. L-H: Mr. Secretary, I have not got anything official to tell you, but I should like you to have in mind that we are not doing that for trade purposes because I know it is not the aim of the French Government. You know there has been much talk in financial circles

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all over the place telling us to the pound 200 francs, so we have let it drop unwillingly from 130 to the present level. From 130 to 165. So perhaps the French Government thought if it could hold it more closely on the new basis, on a new level, from financial point of view ....

Mr. Lochhead: I don't think you can pick out 175 as being a good figure. They are already talking 200.

HM, Jr.: They are talking 200. And please, Mr. Ambassador, don't go away with the thought that any particular figure, whether it be 175 or 165 or 185 or 200, we are not interested in any one figure. We are interested in mutual stability. We are not going to pick a number.

Mr. L-B: I see.

HM, Jr.: We are only interested in getting financial stability, including Belgium, Holland and Switzerland, and I wish I could convince myself that by letting it drop you people can snap it back again. Because we started this thing around 125. It's gotten steadily worse. Steadily worse. And from the figures and estimates that we have, you people to do business don't need 175 francs.

Mr. L-B: You think the franc is already undervalued more or less?

HM, Jr.: We can't make any estimates to show that you need 175 to do business outside of France. I mean, that at a lower franc that you would not have favorable foreign exchange. Do you think you need 175?

Mr. L-B: Well, I think it is not <sup>the</sup> external point of view believing the franc is at present overvalued at its present value, but I don't know. If from internal point of view, of debts of the country and roads, it may be.

HM, Jr.: That's the situation. We need at least another 24 hours to think about it.

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Ambassador: Of course we are going to telephone Bonnet. I am a bit concerned. I don't know I can tell Bonnet what more of explanation or information he could give you to help you making your minds up.

HM, Jr: He might give me an explanation why he wants to force the franc down. What is the reason for wanting to force the franc down.

Ambassador: You have not got sufficient explanation about it.

HM, Jr: No.

Mr. L-B: I shall telephone him.

Ambassador: We will telephone both and ask for detailed information, because I think about the general policy certainly I assume that the French Government is not trying to win advantage for its trade.

HM, Jr: The question is why, Mr. Ambassador, why are they doing it? If it is not for trade advantage, then why?

Mr. L-B: I will tell you, Mr. Secretary, only from the point of view of the balance of payments for the time being ....

HM, Jr: Pardon me, but you say they are talking 200. I know they are talking 200. They say 175. I am in the foreign exchange business. I say, 'Well, I guess I will wait. I guess it's going to 200.' And it goes to 200 and maybe it will go to 300. Where is this thing going to stop?

Ambassador: I think it will stop eventually. We have an economy program. For example, our salaries of all officials in the country have been reduced by half. Since one year we did not get any increase. So I think it is general economy, because we have enormous debt, armament expenses. It is not a rosy situation, but I think we can face it.

Mr. L-B: And I think, Mr. Secretary, that they are doing it more from technical point of view. You

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mentioned, very justly, before what happened to the franc within the last year. Gradually it went down. And every Minister of Finance when he came into power said he would try to keep the franc at its present level and meanwhile he could not check speculation and the franc went down and down. I think the acting Minister wants to keep it now to a level and perhaps they think there is more chance of keeping it at this level now if they have a little margin to fluctuate.

HM, Jr: Mr. Ambassador, maybe it will be helpful if you will talk to Mr. Bonnet and Mr. Marchandeu and get it first hand. But what's bothering me -- and possibly if you will explain that to them, they will give you further explanation. And, as I told you this morning, my attitude is one of wanting to be helpful. I have been helpful. I want to continue to be helpful. But this is something which was sprung on me so hastily that we have not had time and I have not had time to hear from the President and so, therefore, I am asking that we be given another 24 hours or 48 hours to think this thing over.

Ambassador: And that you should like to be more informed of the general plan, of the economy plan, and also more or less I think your reservation is that it is not sliding and the speculator will force our Government on to 180 or 200 and so on. I certainly will appeal to Mr. Bonnet that he should explain.

HM, Jr: With all our troubles in the Far East, they have been very careful not to let their currencies slide and if this continues in France, some of the countries in the Far East will say 'The United States does not say anything about the French. Why can't we start.' And they are in much worse shape than some of the European countries. But, I mean, since the Tripartite, no country has tried competitive devaluation and that's something to keep. I have gone all through this. I have every reason to want to continue to be helpful and there is nothing which would make me -- the last thing I want to see is this thing break up. Everything that I have, official and personal, is to see this continue. So if you people can only give me a reasonable explanation.

Ambassador: What was the date of the Tripartite?

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Mr. Lochhead: September 1936.

Ambassador: Yes. I wonder if it was made as a political experiment since. I don't think it has proved a financial success.

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(The Ambassador and the Financial Attache left and were immediately followed by Mr. Bewley. Transcript of conversation between HM, Jr and Bewley, is separate from this and follows immediately.)

May 3, 1938

Present:

Mr. Bewley  
Mr. Taylor  
Mr. Lochhead  
Mrs. Klotz

HM, Jr.: I am sorry to have kept you (Bewley) waiting.

Mr. Bewley: Not at all.

HM, Jr.: But unfortunately the French don't advise their Ambassador here what's going on and he is told to come to see me and I have to go to school with him. Really!

Mr. Bewley: Yes.

HM, Jr.: You have heard nothing?

Mr. Bewley: I sent off a long telegram last night, but I have had no reply.

HM, Jr.: All right. I will be very brief. I can boil down in 30 seconds what I have been taking 30 minutes to say.

After going over this matter very carefully, we want at least another 24 hours to think this over. No. 1: we have not heard from the President of the United States. No. 2: I have not heard directly from your Government, although Mr. Kennedy called me after he had seen Sir John Simon and had lunch with Mr. Chamberlain. And you might tell your Government that we think there is everything to be gained by taking another 24 hours to think this over. We don't see that we have anything to lose.

Mr. Bewley: Yes.

HM, Jr.: And they told Mr. Kennedy that they don't like this idea about exchange control.

Mr. Bewley: They told him that?

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HM, Jr: Yes. I am not going to press it. On the other hand, they did maintain the franc today.

Mr. Bewley: I see. It was 166.

HM, Jr: 165. And it cost them 5-800,000 pounds, which is not excessive, is it?

Mr. Bewley: No.

HM, Jr: And they did the large sum in our market of 1½ million francs, of which 1 million came from France, so on our side we actually did 350,000 francs and that's the total business we have done today, so whatever is going on is not over here and, as I say, I have asked these gentlemen 'Can they give me an explanation of why they want to force it down?' and I said, talking as one Government to another, it does not make sense. Now, they are going back and telephone Bonnet and Marchandau and maybe we will get something tomorrow, but we feel here we want another 24 hours and, as I say, possibly your people will have something or not. But that's the whole story.

Mr. Bewley: Yes. All right.

HM, Jr: And, as I say, in the meantime they have played the game.

Mr. Bewley: Yes. Oh, yes.

HM, Jr: And they have kept the franc around 164-165 and I don't think it was too expensive.

Now, also for your information, I told them that I did not like the message which came out over the ticker at noon, supposedly from the French Minister of Finance, that they were waiting to hear from the British and ourselves. Now, I told them I don't like it. Although we don't play the game that way, if they push us too hard we can make a few statements too, but please try to refrain trying to tag anybody. And I sent that to them.

Mr. Bewley: Yes.

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HM, Jr.: Isn't that the whole story?

Mr. Taylor: Yes.

Mr. Bewley: You are awaiting replies from all three: from the President, from us and also from the French?

HM, Jr.: That's right. They had nothing but 'please go down and see Mr. Morgenthau and say he's a nice fellow, but I don't know what it's all about.' So we had to let them read the cables. So they said, 'What bothers you?' I said, 'not being personal, it does not make sense. Are you doing it for trade advantage?' 'Oh, no. Oh, no. That's not it.' 'Then why are you doing it if it is not for competitive trade advantage? What's the reason?' Well, of course, they could not answer because they did not know and that's a perfectly fair question.

Mr. Bewley: Yes.

HM, Jr.: I said, the spirit of the Tripartite will prevent the world from continuing in a race of competitive currencies. That has been stopped and, I said, in all the troubles in the Far East they have not depreciated their currency. Which is true.

Mr. Bewley: Oh, yes.

HM, Jr.: And I said if they see that the French get away with it, why wouldn't they start it.

So we simply feel here that we can't see that we are losing anything either for you or for ourselves by sitting tight and in the meantime by having a stiff upper lip they did hold it.

Mr. Bewley: Yes.

HM, Jr.: They did hold it. Now, maybe if we are again stiff with them, they will hold it again tomorrow and the first thing tomorrow maybe they will like it.

Mr. Bewley: They may if the figure of 175 is not already too widely known.

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HM, Jr: I went so far as to say that another thing, I said, I don't like, for two weeks the international speculator has known it is to be 175. Not 174. Not 176, but 175, and, I said, for two weeks Mr. Marchandean has vehemently denied it is going to be 175, but, I said, it is 175. Now, I said, we all agreed it was the international speculator in foreign exchange that we wanted to put out of business and to show he's not operating on this side, we did 1½ million francs today of which 1 million was French sources. He's not operating on this side. And, I said, I don't like it.

So I would say, to use the American venacular, I got plenty off my chest. And up until half past four the thing has worked.

Mr. Bewley: Yes.

HM, Jr: Now, maybe tomorrow when we wake up, we will find it is 175, but as some of our people came in with these decrees, you would normally expect the franc to strengthen. That would be the normal thing.

Mr. Bewley: That would be the normal thing.

HM, Jr: But "we wanted elbow room; we wanted 175 and then have it bound back like Poincare did." I said, 'Well, this is not the France today as it was at that time.' We had a friendly chat. I aired my views.

May I ask you, do you see that we have anything to lose in what has happened up to today?

Mr. Bewley: No.

HM, Jr: That we gained a day?

Mr. Bewley: We certainly have gained a day. I feel dubious at the end because I think when you want 175 you eventually get to 175.

HM, Jr: I agree with you, but getting to 175 is there any assurance we will not go to 200?

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Mr. Bewley: Not at all.

HM, Jr: And if we had given in easily?

Mr. Bewley: Of, if we had not made a fight.

HM, Jr: But as I say, as of tonight I did get get action for your Government and ours. Tomorrow I may look silly.

Mr. Bewley: I wouldn't say you would look silly.

HM, Jr: And it's in both our interests.

Mr. Bewley: I think so.

HM, Jr: And if the message had gone grudgingly agreeing to this, -- it may go that way anyway!

Mr. Bewley: I will try to get you an answer tomorrow.

HM, Jr: We don't enjoy this. It worries me sick. I have done nothing else today, all day long. I realize the full importance of trying to keep the French above water, terrifically important, and as I told them I am doing everything I can to help.

By the way, Bewley, I am going to the French Embassy tonight for dinner. I am leaving at about a quarter of eight. If you get anything will you let me know. It will be helpful because unquestionably they will do business there.

Mr. Bewley: If I have anything, I will certainly pass it on to you.

oGo-oGo

After the departure of Mr. Bewley, Dr. White came in, and the following conversation took place:

HM, Jr: Well, we had a long palaver with the French and they said, What do you want to know? I said, I want to know why you are doing this? The only superficial reason you are doing this is for trade advantage.

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"Oh, my God! No!" Then why are you? They are going to telephone back and maybe we will get a reason. Bewley was in and I said, At least we have gained a day and a day gained is a day gained. Tomorrow, I don't know.

In view of that cable which came in from Wilson which says that the Communists and Extreme Radical Socialists are the only people who want exchange control (Feis let me read it, but he did not have copies) -- Wilson sends a cable that the only people who will go along on exchange control are the Communists and Extreme Radical Socialists and that you can't get that out of this Government. What's the use of saying -- it would be like saying to Mr. Roosevelt, Unless you give up your trade treaty we won't do so and so. While Cordell Hull and President Roosevelt are here, we won't give up the trade treaty.

Mr. Taylor: They have political commitments so it is impossible for them to do it.

HM, Jr: I don't see, Harry, I think the last 24 hours, if I do say so myself, I don't think we have missed a lot.

Dr. White: No. I think up to now I am willing to concede a chance. You are in a more difficult situation by view of the fact that everybody else is taking a different attitude.

Mr. Taylor: I think you have done just right. I think tomorrow you have got to get around to saying a little more because you scared hell out of them, which is fine. That's exactly right. Now after they come and tell you what they will tell you, which is not going to add anything to human knowledge, there are going to say, This is the same technical type of move that you made when you felt it was good to desterilize gold to give a fli-up to other measures. That's what I am guessing.

Dr. White: There is this possibility: that in attempting to answer that question they may find that their answers are not so good. They themselves may find difficulty ...

Mr. Taylor: It does not make any difference.

Dr. White: But if in a couple of days it still

-7-

remains at that, I agree they will most likely go down and I agree the delay has been all to the good. Slight possibility that today they did not lose much with every reason why they should. They can't say tremendous pressure. Then why did you lose only 60 or 70,000 pounds?

Mr. Taylor: 700,000 pounds.

HM, Jr: That is not an awful lot.

Dr. White: But they can't keep that up steadily. They still can't say that there is tremendous pressure on the franc. Therefore they must give some other reason and that would be difficult.

Mr. Taylor: As I said before, you scared hell out of them and that's fine. That's just what they need.

Dr. White: Do you expect anything more tonight?

HM, Jr: I am expecting a telephone call from Butterworth.

oOo-oOo

Tuesday  
May 3, 1938  
5:09 p.m.

HMJr: Hello.

Operator: I have Mr. Butterworth.

HMJr: Thank heavens.

O: All right. Go ahead.

HMJr: Hello.  
Wm. Walton  
Butterworth: Hello.

HMJr: I hope I didn't get you out of bed.

W: No, you haven't, sir.

HMJr: Ah - but if I did I'd only be getting even with the Ambassador for what he did to me this morning.

W: (Laughs)

HMJr: But there's no reason to take it out on you.

W: Well, that's all right, sir.

HMJr: Butterworth, after spending all day practically on this French matter and after having a long talk with Mr. Hull ...

W: Yes.

HMJr: ... we feel we need at least another twenty-four hours.

W: Uh huh.

HMJr: You see?

W: Yes.

HMJr: And that - in the first place we haven't heard directly from the English, I mean - although we did hear through the Ambassador and we've got - we have no word from the President, see?

W: Yes.

- 2 -

- HMJr: And the French did defend the franc today and it did stay around a hundred and sixty-five although it cost them six or seven hundred thousand pounds to do it.
- B: Yes.
- HMJr: But the interesting thing was there was practically no business in the French franc on this side over here.
- B: Yes.
- HMJr: They actually transacted - did a million and a quarter francs.
- B: Yes.
- HMJr: With - the one million order came from France. Now that was all the business that was over here.
- B: Yeah.
- HMJr: We feel that as of tonight we think what's happened is worth while. I mean, in other words, that the French have gone back and have defended the franc at not too great a cost to them.
- B: Yes.
- HMJr: And we feel that we've got everything to gain by waiting another day.
- B: Uh huh.
- HMJr: And the message I'd like you to give the British Treasury is that we want at least another twenty-four hours to think it over.
- B: Uh huh.
- HMJr: See?
- B: Yeah.
- HMJr: And that we think that - well, that's that, anyway.
- B: Uh huh. All right. I'll pass that on to them.

- 3 -

HMJr: Any suggestion you want to volunteer?

B: No, sir. You've gotten that confirmatory telegram that I sent?

HMJr: Yes we've gotten all of your telegrams now.

B: I just wanted it to be - I thought you would rather like to have it confirmed ...

HMJr: Yes...

B: ..that way.

HMJr: That's right.

B: And now I told them that we're most anxious to get that word ----- and I take it that we will consult with them before either of us send a message to Paris.

HMJr: Ah - consult with them?

B: Yeah.

HMJr: Oh yes.

B: I should like to tell them that.

HMJr: Before we do anything definite.

B: Let's see, his telephone number for tonight would be - you see, the French

HMJr: Who gave you his tele- - what is his telephone number?

B: Phillips.

HMJr: Yes.

B: And so I am to telephone him as soon as I hear from you.

HMJr: Yes. Well that's the message. And if...

B: All right, I'll tell him.

HMJr: Now, wait a minute. The French Ambassador called on me...

- 4 -

B: Yes.

HMJr: And he wanted to know why we were waiting.

B: That's right.

HMJr: And I said because we did not have any information which satisfied me as to why they had to depress the franc. Hello.

B: Yes.

HMJr: I said, "There's nothing which you've given me which makes sense and you've given me no reason why you should push the franc down to a hundred and seventy-five. Now, if you can give me a good reason I'd like to have it." And Bonnet called him and told him to call on me. Do you see? Hello.

B: Yes.

HMJr: And now he's gone back to telephone Bonnet that that's the way I feel.

B: Right.

HMJr: Now, maybe out of that we'll get something and maybe they'll realize that they can't give us any good reason.

B: Yeah.

HMJr: I said that - "Is your reason that you want a competitive trade advantage?" He said, "Oh, no, no, no! - no such idea." I said, "Well, then what is your reason?" I said, "Frankly it just doesn't make sense."

B: Yeah.

HMJr: And I said nothing about that suggestion which I made -- you know ...

B: Yeah.

HMJr: .... about exchange control.

B: Yeah.

HMJr: I said nothing to them about that.

- 5 -

B: Good.

HMJr: But I said, "I want a good reason".

B: Yeah.

HMJr: So that's that. And also, you might tell Mr. Phillips that I told them I was not pleased with the fact that a statement was made to the press by the French Treasury that they were waiting to hear some word from Great Britain and ourselves.

B: Uh huh.

HMJr: And I cautioned them not to start a newspaper barrage on us.

B: Yeah.

HMJr: That I didn't like it.

B: Uh huh.

HMJr: So that's that. And I've made no statement to the press and will make none.

B: Good. Good.  
And consider twenty-four hours - can you make it slightly less than that in the sense taking into consideration the time element here?

HMJr: Well, I can't do that, Butterworth, because I've already told the French that we wanted at least another twenty-four hours.

B: Uh huh. All right.

HMJr: I'm sorry there's six hours difference but I can't help it.

B: All right. That's perfectly all right.

HMJr: All right.

B: I just asked you the question that they put to me.

HMJr: I know. Well, you'll have to take it like a man.  
(Laughs)

- 6 -

B: (Laughs) That's right.  
HMJr: All right. (Laughingly)  
B: And allow for the implication shall we say.  
HMJr: (Laughingly) All right.  
B: Goodbye, sir.  
HMJr: Goodbye.

## PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Paris, France

DATE: May 3, 1938, 6 p.m.

NO.: 693

RUSH FROM COCHRAN.

At half-past five I had a talk with the Bank of France. Control's intervention for the day up to that hour had cost between 600,000 and 700,000. The rate range had been between 164 1/2 and 165 for the most part. After three o'clock the demand for sterling had quieted down. Cause of franc sales was partly from disappointment over the ineffective character of the decess, and partly by fear of operators that there will be continued decline in the franc exchange rate.

Besides the operations described above, the control bought belgas importantly for maturities of French railway loans.

WILSON.

EA:LWW

REB

GRAY

Paris

Dated May 3, 1938

Rec'd 8 p. m.

Secretary of State,  
Washington.

692, May 3, 4 p. m. (SECTION ONE)  
FROM COCHRAN.

Journal Officiel this morning published text of seven decrees relating respectively to the budget, production, credit, opening of credits for a special program of national defense, control of foreigners, integration of credits into the general budget, and the delivery of a tourist card for foreign visitors. Journal Officiel also published decree closing loan issue of March 9 for the pension fund and a decree providing for the opening of subscriptions to six month and one year Treasury bonds bearing interest at the rate of 3.25% and 3.50% respectively.

Memorandum accompanying these decrees explains necessity to reintegrate into the general budget expenses of a permanent character which are embodied in the special armament and public works budget and in the  
Treasury

RES

2-#692, From Paris, May 3, 4 p. m.

Treasury accounts. Emphasizing the necessity to administer public funds with prudence it is pointed out that the service of the public debt and national defense alone represent 67% of appropriation of the ordinary budget.

To meet the existing special situation it is considered that special methods must be adopted notably a uniform increase of 8% of all taxes and revenue assessed payable to the state with the exception of customs duties (it is indicated that later on a revision of the customs tariff may be decreed). The Government considers this special contribution should immediately provide resources required by the Treasury. It is expected that the measure will produce 3,200,000,000 francs.

(END SECTION ONE)

WILSON

NPL

EMB

LMS

GRAY

Paris

Dated May 3, 1938

Rec'd 9:50 p. m.

Secretary of State,  
Washington.

692, May 3, 4 p. m. (SECTION TWO)

Memorandum then explains machinery under which more strict control and examination will be made of the administration of budgetary appropriations and of the execution of the budget.

Considerable space is devoted to decrees relating to production. It is stated that fiscal charges absorb forty per cent of the national revenue. Therefore production must be increased and decrees to this end provide for the spending up of certain branches, measures favoring the industry, for construction of dwellings chiefly through providing for low interest rates, for adjustment of the forty-hour law, and certain fiscal reductions for those employing capital in industrial improvements, social constructions, et cetera.

Regarding credit the Government recognizes that no important progress towards increased production is possible unless funds are made available to this end.

Therefore

No. 692, May 3, 4 p. m., Sec. 2, from Paris. -2-

Therefore the relevant decree embodies measures to facilitate advances to the ensemble of French economy, including enterprises working for the state. Acceptance of drafts is rendered obligatory. Present measures enabling state contractors to mobilize their credits are reinforced.

It is explained that decrees providing for opening of credits for special program of national defense relate to measure proposed by the Blue Government but which was never approved by Parliament. The credit authorized totals 4,712,000,000 francs.

WILSON

EMB:NPL

EDA

GRAY

PARIS

Dated May 3, 1938

Received 10 p.m.

Secretary of State

Washington

692, May 3, 4 p.m. (SECTION THREE).

Regarding decree for controlling ~~foreigners~~ in France, it is stressed that measures decided upon are necessary for the security of the country, the general economy of France and the safeguarding of public order. It is stressed, however, that decree in no way modifies regular conditions of access into France, nor modifies the traditional regulations of hospitality. Measure provides notably that all foreigners staying in France more than two months must obtain either an identity or tourist card. Penalties in the way of fines or imprisonment are provided for fraud practiced in securing entry or for failing to procure necessary card. All foreigners now in France must comply with new law before May 31 next.

The decree providing for the Reinteg ratios of credits into general budget involves about 8,000,000,000 francs.

The

ETA - 2 - #692, May 3, 4 p.m. from Paris Section three.

The final decree fixes the conditions under which foreign tourists may obtain special cards entitling them to reduced prices for gasoline. The reduction is 60 centimes per liter limit 20 liters daily and maximum quantity of 600 liters.

According to the press the second series of decrees of the Daladier Government will be issued next week and will principally concern strike statutes.

(END OF MESSAGE).

WILSON

NPL:EMB

COPIED TO

DATE

CLASSIFIED BY

DATE

JR

GRAY

London

Dated May 4, 1938

Rec'd 6 a.m.

Secretary of State,  
Washington.

RUSH.

3GB, May 4, 11 a.m.

FOR TREASURY FROM BUTTERWORTH.

As instructed by telephone I conveyed to Phillips late last night the message that no decision could be expected for at least another twenty-four hours.

This morning's London press contains reports from Washington of the conferences at the Treasury and of the comings and goings of the British and French representatives. This has contributed to an increased pressure on the franc which has all the earmarks of the beginning of a movement that will carry it towards the 175 mark anyway.

As of possible interest there is quoted below an excerpt from an editorial in today's TIMES: "Most of the financial problems would be solved if the French capital which has fled the country could be induced to return and be put to fruitful work in France. As

was

-2- #368, May 4, 11 a.m., from London.

was shown in Monsieur Blum's memorandum no less than 80,000,000,000 francs has been sent abroad during the past three years leaving a gap which could not be filled by the creation of new money since this was spirited away as fast as it was created. There is thus a vicious circle to break; capital is not likely to return until business in France improves to the point of providing opportunities for profitable -- and safe-- investment while business revival demands the investment of capital. What is needed is an act of faith and this can only be expected as the response to bold and comprehensive measures restoring confidence in the future. The decrees now issued are no more than the first step of the Government's programme. They seem a most useful installment but it would be premature to attempt to estimate their effect until the whole plan is disclosed".

KENNEDY

DDM

## MEMORANDUM OF THE DAY'S ACTIVITIES

May 3, 1936

To: The Secretary  
 From: Mr. Magill

1. Extension of Los Angeles Experiment

After my conference with you I called Mr. Graves and asked him to outline plans for a New York Settlement Unit similar to the one which has been operating in Los Angeles. Mr. Graves said he would have his plans ready in a few days. He will prepare a similar outline for a unit at Chicago. He thinks, however, that the two additional units ought not to be announced simultaneously.

2. Chairman Arundell of the Board of Tax Appeals

I gave Mr. Arundell the substance of your suggestion that he see the President regarding the reappointment of members of the Board whose terms are about to expire. Arundell is doubtful about the desirability of speaking to the President in view of the fact that he himself is one of the four men whose terms expire. I made it clear to him that since the Board was an independent agency and he is Chairman of it, he should consider whether he does not owe an obligation to his fellow members to present the matter of reappointments to the President.

3. Mr. William S. Dana

I have a twelve page opinion from Mr. Oliphant on the subject of Mr. Dana's tax case, about which Mrs. Roosevelt wrote to you in February and again on April 13th. Mr. Oliphant concludes that the action of the Internal Revenue Agent at Brooklyn, N.Y., was correct in proposing additional income taxes on account of the income and capital gains of a certain trust. The facts are quite involved and so is the law applicable to them. Do you want them summarized for Mrs. Roosevelt; or do you think that a general letter is enough, indicating that Mr. Oliphant has gone into the case and assures you that it has been correctly handled.

*Am*

MEMORANDUM OF THE DAY'S ACTIVITIES

May 4, 1938

239

To: The Secretary

From: Mr. Magill

1. Legislative work

Mr. Oliphant and I discussed the reorganization of the tax legislative work occasioned by Mr. Kent's resignation. I should like to discuss the proposed set-up with you at your convenience. Our thought is that Mr. Tarleau should head a small group of men to work on the major questions of tax legislation, and that the routine and detailed questions should continue to be handled by the Legislative Division in the General Counsel's office. Mr. Tarleau and his group will work under my immediate supervision. The Treasury tax regulations will continue to be prepared by the Legislative Division, but will pass through Mr. Tarleau for his approval before they are presented for signature to you or myself.

2. Economic research and taxation

Mr. Blough has spent the greater part of the day with Mr. Shoup reviewing plans for the reorganization of the tax research work. I spent some time with the two men also, suggesting some major problems to be considered. Mr. Blough will be here tomorrow morning if you could find time to see him.

3. Other callers

Mr. Basil O'Connor called to ascertain the present state of the cosmetics tax and proposes to submit additional memoranda this summer. Mr. Joseph Burns, who successfully prosecuted the tax fraud case against the attorney and accountants for Ringling Brothers Circus, came in to discuss the problems he ran into. Mr. James M. Nicely, Vice President of the Guaranty Trust Company, believes that consumption is now out-running production in a number of industries and that there is a reasonably good chance of an upturn in three or four months from now. He had had lunch with Tom Corcoran who told him that he had managed the successful campaign of Senator Pepper in Florida; and that he did not think the spending program would materially assist in promoting business recovery.

*fm*

## MEMORANDUM OF THE DAY'S ACTIVITIES

May 5, 1938

To:               The Secretary  
From:             Mr. Magill

1.     The Tax Bill

The Conference Committee this morning ~~went over~~  
the more troublesome amendments of the tax bill. One amend-  
ment, a very difficult one affecting inventories, remains  
to be drawn. The Conference Committee will meet again  
Saturday morning to conclude its work. Senator Harrison hopes  
to take up the Conference Report in the Senate on Monday.

RM

MAY 3 1938

My dear Mr. Attorney General:

Receipt is acknowledged of your letter of April 29, 1938, enclosing draft of a proposed bill in equity against the City of New York for the specific performance of an agreement with the City in connection with the acquirement of the new post office site in New York City and the vacating of the old post office building, together with a copy of the proposed stipulation in such suit.

I desire to advise you in behalf of the Director of Procurement and myself, that the stipulation submitted is satisfactory to us and that we will carry out its terms as to the sale of the old building if the stipulation is entered into.

Very truly yours,

(Signed) H. Morganthau, Jr.

Secretary of the Treasury.

The Honorable,

The Attorney General of the United States.

TAN:vis - 5-3-38

May 3, 1938

SMALL HOME MORTGAGE INSURANCE

During the week ending April 30, Mortgages Selected for Appraisal with one small office not reporting, numbered 4,879 amounting to \$22,349,695. For the corresponding week of 1937, 3,613 Mortgages were Selected for Appraisal amounting to \$15,224,773. For the past week approximately 52 per cent, or 2,518 mortgages covered new homes to be constructed, and during the week construction was started on 1,601 new small homes.

LARGE SCALE HOUSING PROJECTS

The attached table gives the status of insurance of Large Scale Housing Projects as of April 30, showing 18 projects valued at approximately \$19,000,000 in operation; 20 projects valued at \$16,500,000 with loans closed and under construction; and 22 projects valued at approximately \$25,000,000 with financing arranged as of that date. Two of this latter group are under construction at the present time.

PROPERTY IMPROVEMENT LOANS

As of April 30, more than 2,100 lending institutions were reporting notes for insurance covering advances made for improvement to existing properties or for new construction, and during the week ending April 30, 8,047 notes for \$3,918,790 were accepted for insurance. For the month of April, 28,117 notes for \$13,578,533 were reported and accepted for insurance.

FEDERAL HOUSING ADMINISTRATION  
WASHINGTON, D.C.

WEEKLY VOLUME OF INSURING OPERATIONS

For 1938 and corresponding Period of 1937

HOME MORTGAGES SELECTED FOR APPRAISAL

| Week Ending | 1938  |              | 1937  |              |
|-------------|-------|--------------|-------|--------------|
|             | No.   | Am.          | No.   | Am.          |
| Jan. 8      | 1,266 | \$ 5,483,184 | 1,967 | \$ 8,565,690 |
| " 15        | 1,504 | 6,531,200    | 2,286 | 9,566,860    |
| " 22        | 1,711 | 7,299,975    | 2,167 | 9,447,127    |
| " 29        | 1,882 | 8,160,640    | 2,272 | 10,091,713   |
| Feb. 5      | 1,982 | 8,671,895    | 2,306 | 9,721,165    |
| " 12        | 1,988 | 8,787,105    | 2,701 | 11,068,008   |
| " 19        | 2,219 | 10,025,800   | 2,755 | 11,784,099   |
| " 26        | 2,775 | 13,160,250   | 2,835 | 11,747,964   |
| Mar. 5      | 3,899 | 17,613,402   | 3,244 | 15,685,600   |
| " 12        | 4,470 | 20,386,711   | 3,405 | 14,176,560   |
| " 19        | 4,697 | 21,293,051   | 4,085 | 16,679,710   |
| " 26        | 4,863 | 22,566,219   | 3,475 | 14,970,848   |
| Apr. 2      | 4,713 | 21,414,849   | 3,617 | 15,266,435   |
| " 9         | 5,037 | 23,242,102   | 3,516 | 15,414,023   |
| " 16        | 4,453 | 20,386,480   | 3,451 | 15,294,425   |
| " 23        | 5,076 | 22,994,647   | 3,796 | 14,627,136   |
| " 30*       | 4,679 | 22,349,695   | 3,613 | 15,224,772   |

\* One insuring office report not received.

FEDERAL HOUSING ADMINISTRATION  
WASHINGTON, D.C.

WEEKLY VOLUME OF INSURING OPERATIONS

For 1938 and corresponding Period of 1937

MORTGAGES ACCEPTED FOR INSURANCE

| Week Ending: | 1938  |              | 1937  |              |
|--------------|-------|--------------|-------|--------------|
|              | No.   | Am.          | No.   | Am.          |
| Jan. 8       | 943   | \$ 4,035,500 | 1,443 | \$ 5,821,375 |
| " 15         | 1,101 | 4,542,900    | 1,786 | 7,341,615    |
| " 22         | 1,058 | 4,445,500    | 1,767 | 7,435,500    |
| " 29         | 1,329 | 5,501,500    | 1,880 | 7,660,250    |
| Feb. 5       | 1,099 | 4,451,000    | 1,811 | 7,434,160    |
| " 12         | 1,172 | 4,649,900    | 1,778 | 7,410,850    |
| " 19         | 1,194 | 4,837,100    | 1,869 | 7,702,650    |
| " 26         | 1,033 | 4,350,200    | 1,897 | 7,824,500    |
| Mar. 5       | 1,589 | 6,905,400    | 2,291 | 9,092,500    |
| " 12         | 1,705 | 7,601,400    | 2,135 | 8,947,600    |
| " 19         | 1,883 | 8,388,400    | 2,358 | 9,781,500    |
| " 26         | 2,290 | 9,995,900    | 2,497 | 10,295,380   |
| Apr. 3       | 2,642 | 11,601,700   | 2,602 | 10,855,280   |
| " 9          | 2,947 | 12,703,400   | 2,898 | 10,651,685   |
| " 16         | 3,284 | 14,230,625   | 2,660 | 10,919,110   |
| " 23         | 3,781 | 16,514,000   | 2,922 | 12,069,160   |
| " 30*        | 3,497 | 15,635,300   | 2,841 | 11,800,100   |

\* One insuring office report not received.

## FEDERAL HOUSING MORTGAGE COMMISSION

Commissions through April 30, 1955

| STATUS                                    | NAME OF PROJECT              | LOCATION OF PROJECT | NO. OF FAMILY UNITS | CAPITALIZATION | AMOUNT OF MORTGAGE |
|---|------------------------------|---------------------|---------------------|----------------|--------------------|
| <b>In Operation - Projects Completed</b>  |                              |                     |                     |                |                    |
|   |                              | <u>City</u>         | <u>State</u>        |                |                    |
| 000-00001                                 | Colonial Village, Inc.       | Arlington           | Va.                 | 278            | \$ 1,158,600       |
| 000-00002                                 | Colonial Village, Inc.       | Arlington           | Va.                 | 462            | 1,460,800          |
| 000-00003                                 | Falkland Properties, Inc.    | Silver Spring       | Md.                 | 178            | 1,100,000          |
| 000-00004                                 | Colonial Village Addition    | Arlington           | Va.                 | 256            | 904,800            |
| 000-00005                                 | Brentwood Village            | Washington          | D.C.                | 628            | 2,090,000          |
| 000-00006                                 | Falkland Addition            | Silver Spring       | Md.                 | 501            | 1,619,000          |
| 000-00007                                 | Second Buckingham Community  | Arlington           | Va.                 | 190            | 648,828            |
| 000-00008                                 | First Buckingham Community   | Arlington           | Va.                 | 810            | 2,230,000          |
| 002-00001                                 | Housing Co. of Dundalk       | Baltimore           | Md.                 | 272            | 1,034,488          |
| 003-00001                                 | Chippewa Falls Housing Corp. | Chippewa Falls      | Mass.               | 184            | 277,000            |
| 100-00001                                 | Cherter Crest                | Pleasanton          | S.T.                | 279            | 1,402,340          |
| 034-00001                                 | Elm Terrace                  | York                | Pa.                 | 43             | 185,344            |
| 035-00001                                 | Meadville Housing            | Meadville           | Pa.                 | 302            | 1,002,000          |
| 043-00001                                 | Country Club Apartments      | Greensboro          | N.C.                | 86             | 271,000            |
| 053-00002                                 | University Apartments        | Durham              | N.C.                | 114            | 435,000            |
| 073-00001                                 | Linwood Colonial             | Indianapolis        | Ind.                | 39             | 200,000            |
| 083-00001                                 | Green Tree Manor             | Louisville          | Ky.                 | 265            | 1,287,000          |
| 083-00001                                 | Crosssett Housing            | Crosssett           | Ark.                | 192            | 640,124            |
| 18  |                              |                     |                     | 2,224          | \$18,222,931       |
| <b>Loans Closed - *Under Construction</b> |                              |                     |                     |                |                    |
| 000-00010                                 | Third Buckingham Community   | Arlington           | Va.                 | 200            | \$ 841,500         |
| 002-00002                                 | Drexels Landing              | Annapolis           | Md.                 | 68             | 580,000            |
| 002-00003                                 | Northwood                    | Baltimore           | Md.                 | 308            | 1,497,800          |
| 001-00001                                 | Madway Court                 | Newark              | N.J.                | 270            | 1,315,000          |
| 100-00003                                 | Scarsdale Limited Div.       | Scarsdale           | N.Y.                | 168            | 1,010,000          |
| 100-00004                                 | Greggook Limited Div.        | Scarsdale           | N.Y.                | 152            | 797,000            |
| 018-00001                                 | Second Garden Bay            | Jackson Heights     | N.Y.                | 210            | 1,041,000          |
| 034-00002                                 | Harberth Apartments          | Brookline           | Pa.                 | 114            | 548,000            |
| 061-00001                                 | Limited Divided Housing      | Atlanta             | Ga.                 | 174            | 806,000            |
| 069-00003                                 | Myrtle Apartments            | Charlotte           | N.C.                | 72             | 405,000            |
| 069-00004                                 | Twin Castles                 | Winston-Salem       | N.C.                | 124            | 580,000            |
| 069-00007                                 | Raleigh Apartments           | Raleigh             | N.C.                | 114            | 728,740            |
| 069-00008                                 | Common Courts                | Raleigh             | N.C.                | 147            | 704,000            |
| 081-00001                                 | Olisour Courts               | Richmond            | Va.                 | 138            | 850,000            |
| 071-00001                                 | Granville-Bryne              | Chicago             | Ill.                | 198            | 977,700            |
| 073-00002                                 | New Albany Housing           | New Albany          | Ind.                | 40             | 180,000            |
| 073-00003                                 | South Linwood Colonial       | Indianapolis        | Ind.                | 64             | 224,200            |
| 085-00001                                 | Massachusetts Village        | St. Louis           | Mo.                 | 54             | 214,000            |
| 112-00001                                 | Cole's Manor                 | Dallas              | Tex.                | 94             | 431,771            |
| 114-00001                                 | Silver Oaks                  | Houston             | Tex.                | 134            | 720,000            |
| 20  |                              |                     |                     | 1,811          | \$16,945,771       |
| TOTAL FRESHLY PAYING MORTGAGES            |                              |                     |                     | 32 Projects    | \$21,144,702       |
| <b>Financing Arranged</b>                 |                              |                     |                     |                |                    |
| 017-00001                                 | Forest Corporation           | Bartford            | Conn.               | 31             | \$ 170,300         |
| *000-00009                                | *Arboretum Homes             | Greenbelt           | Md.                 | 10             | 49,780             |
| 001-00002                                 | General Kearney              | Crown Point         | N.J.                | 169            | 648,000            |
| 001-00003                                 | English Village              | Linden              | N.J.                | 66             | 329,000            |
| 001-00004                                 | Linden Housing               | Atlantic City       | N.J.                | 264            | 1,300,000          |
| 001-00006                                 | Waleigh Corp.                | Atlantic City       | N.J.                | 80             | 389,000            |
| 014-00001                                 | Grandale Village             | Buffalo             | N.Y.                | 249            | 1,074,000          |
| 015-00002                                 | Third Garden Bay             | Jackson Heights     | N.Y.                | 270            | 1,305,000          |
| 018-00003                                 | Queens Boulevard             | Long Island         | N.Y.                | 540            | 2,992,000          |
| *100-00002                                | *Glenwood Apartments         | Long Beach          | N.Y.                | 307            | 1,788,000          |
| 100-00003                                 | Larchmont Gardens            | Larchmont           | N.Y.                | 384            | 2,175,000          |
| 034-00003                                 | 69th Street Corporation      | Upper Darby         | Pa.                 | 488            | 1,900,000          |
| 034-00004                                 | Park Plaza                   | Harrisburg          | Pa.                 | 117            | 495,000            |
| 034-00005                                 | Small Home Buyers Corp.      | Philadelphia        | Pa.                 | 113            | 526,000            |
| 034-00006                                 | Margate Housing              | Upper Darby         | Pa.                 | 30             | 194,975            |
| 035-00009                                 | Warrywood                    | High Point          | N.C.                | 60             | 305,000            |
| 050-00002                                 | Larchmont                    | Sarfolk             | Va.                 | 172            | 816,000            |
| 051-00003                                 | Seawagon Court               | Richmond            | Va.                 | 52             | 411,000            |
| 051-00004                                 | Seawagon Court               | Portsmouth          | Va.                 | 70             | 305,800            |
| 043-00001                                 | Loveway Apartments           | Columbus            | Ohio                | 380            | 1,429,000          |
| 113-00001                                 | Glens Gardens                | Los Angeles         | Calif.              | 1,040          | 3,400,000          |
| 117-00001                                 | Madison Park Housing         | Seattle             | Wash.               | 304            | 1,380,000          |
| 21  |                              |                     |                     | 2,756          | \$24,802,773       |
| Additional Commitments Outstanding        |                              |                     |                     |                | \$10,196,000       |
| TOTAL COMMITMENTS ISSUED                  |                              |                     |                     |                | \$38,848,180       |

\* Construction now in process.  
 1/ Includes 1 project for \$1,180,000 refinanced.  
 2/ Includes 1 project under construction

Division of Economic and Statistics  
 Operating Statistics Section



RE: BANK EXAMINATION POLICY

May 3, 1938.  
11:00 A. M.

Present: Mr. Taylor  
 Mr. Gaston  
 Mr. Upham  
 Mr. Davis (Federal Reserve Board)  
 Mr. McKee " " "  
 Mr. Paulger " " "  
 Mr. Crowley (F. D. I. C.)  
 Mr. Smythe "  
 Mr. Nichols "  
 Mr. Folger (Comptroller's Office)  
 Mr. Diggs " "

Upham:

We have three major things that we discussed every afternoon last week trying to get an agreement on. The first one was with respect to the treatment of the slow column which now appears in bank examination reports, in which certain loans in the bank are placed and classified; and the problem there was whether to eliminate the column altogether, whether to change the name, or what to do with it; and we got a majority and a minority report on that, which are the first two documents that you have. I think, perhaps, to place the two positions before you, I might as well read those.

"The majority agreement with respect to the classification of loans is that the three columns in the examination report now known as slow, doubtful, and loss will be continued. Their present form, and that of the instructions to examiners as to the type of loan to be included in each of the three columns, will remain the same as at present. It is proposed to label these three columns by the roman numerals I, II and III. At the top of each page upon which this tabulation occurs, there will appear the roman numeral I and following it a definition of the type of loan which is included in the column; there will also appear roman numeral II followed by the single word 'doubtful'; and there will also appear the roman numeral III followed by the single word 'loss'.

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"Where there is a recapitulation of the columns now known as slow, doubtful and loss, the same device will be used, i.e., the use of the three roman numerals as symbols with the accompanying explanation of what is included under each. As now, on the recapitulation page only the totals in columns II and III will be included in figuring the net sound capital of banks."

There's been a good deal of criticism of that word "slow." In 1934, as a result of an examining conference, instructions were sent out to examiners that "slow" doesn't mean slow. Since then I think there's been some change in the type of loan.

Davis: May I ask a question, Mr. Secretary?

H.M.Jr: Please.

Davis: What do you mean by "a definition of the type", after roman numeral I?

Upham: That will - Mr. Folger and Mr. Nichols, who constitute the majority in that case, are working on a definition of just the type of loans to be included in that column, and it conforms, substantially, to instructions sent to examiners in 1934, following this conference. That is, the principal distinction being that they are not slow loans. They are not to be put in there because of their maturity - because they have been renewed. They are loans that are subject to criticism, - the quality of loans rather than the maturity of them.

Now, the minority position on this slow column:

"The minority position with respect to the classification of loans in the examination report is that the column now known as 'slow' should be eliminated from the pages upon which it now appears and that provision be made elsewhere in the report, under a heading 'Loans Listed for Information or Comment,' or other suitable heading, for listing, with appropriate comment, not totaled and not included in any recapitulation, such loans as the examiner feels

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should be set out for the information of the directors and proper officers of the bank, with the clear understanding that such loans are not being classified as doubtful or loss and are not necessarily to be regarded as criticized assets."

The majority had a feeling that generally speaking, the majority of bank examiners put too few rather than too many loans in the column now known as slow. They believe that there are a good many loans in banks which are not properly classified as doubtful or loss, but which should, nevertheless, be criticized. They felt that bankers expect and want the opinion of the examiner on this type of loan and that the bankers expect and want a recapitulation of the loans now included in the slow column. They don't believe that good bankers object to this classification practice except the use of the word "slow" and they don't feel that bankers are deterred from making good loans by this classification.

The minority, on the other hand, felt that bankers are deterred from making many acceptable loans by reason of the practice of bank examiners in classifying them as slow. They feel that totally, this classification, in recapitulating it, alarms bank directors unduly, and they make the point that since all the assets of the bank are rediscountable with the Federal Reserve, that no loans other than those that are definitely doubtful or loss should be criticized, and they feel the inclusion of this slow column is deflationary.

The third page gives you a little history of the slow column in 1934, so far as national banks are concerned. Twenty-seven per cent of the loans were included in the slow column, and then we had that bank examination conference in which new instructions were sent out to examiners, and you can see that the percentage of loans in the slow column has declined materially from twenty-seven to less than ten, while at the same time the doubtful and loss have gone down.

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- McKee: Does that indicate to you that that's brought about by the different classifications and not liquidation?
- Upham: Well, I .....
- McKee: Can any of you answer?
- Folger: Largely, I would say. Largely by the classification, change in the .....
- McKee: ..... the approach?
- Folger: Due in part to both, some liquidation, and the change in the classification.
- McKee: All you've got to look at, Gus, is the total of your loans outstanding.
- Folger: There were more in 1934. The total loans were larger in 1934. I mean larger now than in 1934.
- McKee: You're comparing seven billion, seven hundred forty million against eight billion, nine hundred thirty-three million.
- Davis: Don't you think lots of loans were slow in 1934 than what was meant by slow in 1936? I mean, don't you have to make some allowance - these figures aren't as significant when you get in the comparisons of the country, as they appear to be prima facie.
- McKee: The thing we're talking about is more prevalent in the smaller bank, and I do know that a lot of those assets were refinanced by the Home Owners' Loan Corporation, and a lot of other Government financing, that eliminated those assets from the portfolio, so your slow classification has come - the shrinkage in it is as much from liquidation and refinancing as anything else, if a proper analysis is made of it.
- Crowley: I don't think it makes any difference whether it was twenty-seven per cent in '34 or twenty-seven per cent now. I think, in general, that your recapitulation program and your improvement in assets did move into a better position, lots

of loans marked slow, and there's been a lot of liquidation, but the thing that you're getting at here is essential. Your old "slow" column, presumably, was sort of a dumping ground for slow assets and assets of an unsatisfactory nature. Now what they are trying to do is disregard the criticism of the so-called slow item, but yet that's a good item, as it can be paid, and that's what they've tried to arrive at, and that's the reason they are getting away from the word "slow" and the definition will work out so that the items included in item one will no longer be a slow item - will be an item - not a bankable item. That's what you're getting at, isn't it, Gus?

Folger: One that requires attention.

Crowley: So that this analysis doesn't particularly get at what we want.

McKee: No, I'm not paying any attention to analysis.

Upham: The tentative definition for that column.

H.M.Jr: I'm acting as impartial Chairman. I mean, is the Comptroller's Office going to sit there and take that?

Folger: I've just said that the instructions that went out have cause a great many - since that time a great many loans that were ultimately collectible and had been classed as slow, they have since been left out of the report of a great many such loans.

McKee: But your analysis wouldn't prove to you whether the assets were still in the bank or not, because if they are considered good you don't list them.

Folger: As long as they are collectible.

Diggs: But before '34 they were in the slow column.

McKee: That's right.

Diggs: But they are not in the slow column today.

- McKee: You don't know whether they are in the bank today.
- Davis: That doesn't mean that is due solely - as this table makes it appear.
- Diggs: Except that we don't know whether they are listed today. We do know that we're two-thirds less than we were in '34 on this slow column.
- Davis: We want to point out that that might be due to something else, but we don't know.
- McKee: I just like to know where all the Government credit has gone then, if it hasn't gone to help some of these banks out.
- Diggs: It's gone into some of it, yes, but not all of it.
- Crowley: I don't know if this argument has anything to do with what we're trying to do anyhow. We all know there is reason for amounts to be charged off, and things like that; we know there's been a recovery in certain types of collateral loans that have put those loans in better shape, but that's got nothing to do with what we're trying to arrive at here.
- Folger: This work was done in '34 after the crash and after the reorganization program was completed.
- Upham: If I may say a word, without taking sides, John, the reason I put that in was not to prove that the change that came in 1934 brought about that reduction, but to indicate that now, at the end of 1937, there isn't a tremendous percentage of the banks' loans classified as slow, and not so much validity, perhaps, to the criticism of that column as in 1934. That was my point.
- McKee: May I add, before you lose your chain of thought that the figures that you are predicating your nine-point-something percentage on, today are reports of examinations. A lot were made prior to this recession, see, so you don't know what

the new classification is going to look like.

Davis: Mr. Chairman, may I make one point, without extensive discussion, just in the form of a question? Now if we don't question the statement that was made, supporting the majority position, that good bankers don't object to the slow column and don't consider it retarding their making sound loans - if we don't question that, it won't be considered that there isn't anything to be said on the other side, will there, because I think in the Treasury - my attention has been called to one study made in the fourth district - the Cleveland district - which shows that more than half of the national bank reports indicated they did feel they're still cramped by the use of the 'slow' bank examination policy. I just want to make that statement.

Diggs: What is the report in the district in Chicago? Did - what did it show? Did you study that also?

Davis: My attention was not called to that, but if you wish to go into that you can easily get those figures.

Upham: What it shows has been a matter of some disagreement in the meetings that we have had.

McKee: It seems to me there are three differences - shall we keep the column or eliminate it entirely?

H.M.Jr: Is that the only thing you have?

Upham: Oh no! We have two other things. The fourth page is the majority agreement with respect to the appraisal of bonds. (2)

"1. That depreciation in stock and defaulted bonds be classified as loss and that securities in these groups (III and IV) be listed and priced in the report of examination." (The minority does not disagree on that so far as defaulted and stocks are concerned.

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"2. That depreciation on securities in group II and in the fourth grade of general market obligations in group I be deducted in the report in computing the net sound capital of the bank, and that securities in these classifications be listed and priced in the report of examination.

"3. That depreciation in all group I securities except the fourth grade of general market obligations be disregarded and that these securities not be priced in the report of examination."

List them but give no market price.

"4. That unrealized appreciation be not allowed.

"5. That a premium on bonds purchased at a premium be amortized."

Now, the minority position with respect to the appraisal of bonds is:

"1. That only depreciation in stocks and defaulted bonds be classified as estimated loss, and that securities in these groups be listed and priced in the report of examination."

That is in accordance with the views of the majority with the exception of the word "only."

"2. That securities in groups I and II be not priced, and preferably be not listed, in the report of examination. A complete list of all securities, however, should be attached to the report of examination sent to the Supervisory authorities.

"3. That depreciation, other than in stocks and defaulted bonds, should not be taken into consideration in computing 'net sound capital.' On the other hand, it can not be affirmatively stated that depreciation in any securities constitutes sound capital. Therefore, the minority feels that the schedule showing a computation of net sound capital be eliminated from the reports of examination."

The fourth and fifth are the same as the majority.

H.M.Jr: In both cases are the minority the same?

Upham: In both of those cases the minority are the same - the Federal Reserve. In both of those cases the F. D. I. C. and the Comptroller's Office are the majority.

Crowley: Cy, will you explain just what the difference is between the minority and majority, in your own way.

H.M.Jr: A good point.

McKee: Can't we go through this report and come to that?

Upham: And the third thing we took up is the matter of taking profits from certain securities and impounding them in a special account where they are unavailable for dividends. "The majority agreement ...." and in this case the majority is the Federal Reserve and the F. D. I. C.:

"The majority agreement with respect to the treatment of net profits from the sale of securities is that until adequate reserves against the securities account have been built up, all such profits should be impounded and be unavailable for any purpose other than to take care of losses resulting from the sale of securities."

H.M.Jr: Who is the minority?

Upham: The minority is Mr. Folger - Comptroller of the Currency.

"The minority position with respect to the treatment of profits from the sale of securities is that:

1. Estimated losses should be charged off.
2. Banks should be required to establish and maintain adequate reserves, including reserves against the securities account.

3. Banks should not be required to earmark individual items of profit, regardless of source.
4. Speculation should be severely criticized and penalized."

- H.M.Jr: Before we get into the thing, may I thank the gentlemen for the many afternoons' hard work they put in, - and now, if you'll answer Mr. Crowley's question.
- Crowley: In the first place, Cy, as I see this thing, there is very little difference in the spirit of what these three men have tried to agree on. It's just a difference of how far we should go. For instance, in the loss item, or the slow item, there's no difference of opinion, as I get it, as to what kind of an item ought to be so-called "criticized" item.
- What the Federal Reserve disagree with us on is that they do not wish to carry that to the final analysis of the condition of the bank. They want to put that in the examination for supervisory purposes, but not send that to the Board of Directors.
- Paulger: That wasn't my position. We did expect to put in the report another page which would include these items. They were not to be totaled because they would include other things besides criticized items, but that would be in the report of examination.
- Crowley: I would - do you mean .....
- Paulger: Special items, or special comments.
- McKee: Criticized, not as to value maybe, but criticized as to overloads.
- Crowley: But that is a criticized item, though, John.
- McKee: It is mentioned, to be brought to the attention of the Boards for their consideration and disposal.
- Davis: Not necessarily criticized.

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Crowley: As far as we are concerned, you can't have a bank examination and not call this damned thing as you see it. We're perfectly willing to cooperate in and eliminate this slow item. That's good. You can't hold a Board of Directors responsible for the operation of a bank and sue them for negligence and things of that character unless you give them the complete picture of the institution. We're perfectly willing, and we are in accord, of sitting down and working out a definition, but we do feel that whatever criticized items are shown by the examination, they should go to the Board of Directors of the bank, that they may know the situation.

Davis: There's no difference on our part, of that position. I think Mr. Paulger made that clear.

Crowley: Then we're all clear on that.

Folger: There seems that there is a difference there to me - quite a difference. Mr. Paulger doesn't agree to show any total of that class of paper.

Paulger: That's right.

Folger: - didn't want the report to show how much of that classification of paper there is in the bank.

Paulger: May I say a few words on that?

H.M.Jr: Please.

Paulger: In the list of criticized assets are three columns, slow, doubtful, and loss, and in the recapitulation of criticized items are three columns, the totals of slow, doubtful, and loss, and the doubtful and loss columns are the only ones that are used in applying, as a deduction to the net sound capital position. In other words, the slow column is included with the slow assets, but is not used for any particular purpose, other than to list them.

The bankers complained about this - having this slow column included in the criticized assets in the recapitulation, and to get away from

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this criticism that - we think that these loans can be listed on another page, not totaled and not included. The objective would be the same; there is nothing lost; the loans are all called to the attention of the bank just as they were before, but it gets away from the criticism that has been made for years of including this slow classification, and we feel that the change could be advantageously made to meet the criticism and still the objective would be reached.

- Folger: Where has this criticism come from that you speak about?
- McKee: You (Folger) haven't heard of it?
- Folger: Very little of it.
- McKee: You find it mostly, Mr. Comptroller, from the smaller banks throughout the country.
- Folger: You don't have many of them.
- McKee: I think I knew a little about banking before I went on the Federal Reserve Board.
- Folger: The Federal Reserve doesn't have so many of them.
- Paulger: Of course, that's been criticized for years. It hasn't been just for the last two or three years.
- Crowley: We're all agreed, then, that we're going to eliminate .....
- McKee: No, we don't agree. Don't fool yourself, and don't try to fool me - you're talking one thing and writing something else, Leo.
- Crowley: But John, if you can't believe your examiners are going to carry out the spirit in which you agree here - they won't carry out the thing you agree to .....
- McKee: You can't rely on the spirit of the examiner. You've got to be more specific than in the past in giving instructions to the examiners.

Mr. Paulger, please - that the word 'slow' - changing the word 'slow', if the column is to stay in, is advantageous, and what the majority agreed upon, he'd go along with, if the column is to remain. As the majority sees it, to eliminate the slow column, put in an extra page, simply means that the examiner would use that page then as a catch-all; instead of having twenty-seven per cent of the loans listed in the report of examination as in 1934, you have a gradual build-up of a great many of the loans in the bank which we are trying to eliminate now as presumably criticized items. The whole thought .....

McKee: - You're trying to eliminate them, did you say? You want to get them out of the bank?

Nichols: We feel there are errors on both sides; that a great many examiners are not putting in the slow column what they should, and, on the other hand, a great many examiners are putting in the slow column items they are not supposed to - that are not slow and shouldn't go in that.

McKee: John, don't you think, then, you're not putting what you should in the doubtful column. Is that what you're trying to get at?

Nichols: No. Instructions are, when you have an examiner and he can't make up his mind as to whether or not there is a loss, it is doubtful. If he's a lazy examiner and is going to use the doubtful column just to hurry the examination along, and not give the right values to it - the doubtful column is never used except in case of estates, litigation, certain technical matters to the loan that he can't really determine - rarely used except where the examiner can not possibly determine the per cent or the proportion of loss. Now, by the same token, proposed by keeping this - keeping this in, with the nomenclature changed, that we will eliminate a great many items of the banks that now have that word "slow," which leaves the examiner and the banker to misunderstand what the loans are in that column. We feel that for the examiner to sum up his findings of the bank for the Board of Directors he

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must tell him of the loans bordering on "doubtful," of elements obtained in them, and unless something is accomplished - done - it's going to pass from that slow column which we propose to name number one (I), into the doubtful, and it must be maintained in order for the examiner to really show the picture of the bank he's examined, and the conscientious examiner is going to do it anyway. And it certainly should be summarized.

H.M.Jr: All right .....

Nichols: Have I stated our position?

Folger: Yes, you have. We know from experience, that the banks that become insolvent - ninety per cent, or more, of such insolvency is caused by an accumulation of poor assets.

McKee: You could start back one step further.

Folger: It could become solvent over night and the examiner could classify it as doubtful or loss. The bank - hardly any banker would make that kind of a loan. But when you get a report showing nothing in the report except what the examiner considers doubtful or loss, you can't tell anything about that bank; you can't determine the policies; you can't tell whether it's a good bank, a poor bank, or one whose policies are right or wrong.

McKee: Outside of the confidence you have in the examiner, you can't tell about the other assets he doesn't list.

Folger: If you don't know the examiner you can't tell about that.

H.M.Jr: What I'd like to do, gentlemen is this: I've got this report Mr. Upham prepared - he said it is not unanimous. I've asked certain people to come in and study it, in the banking business, and I'm going to get their advice tomorrow. If it's agreeable to you people, I wonder if you'd care to come back Friday morning at eleven o'clock, and see if I'd be able to travel the road and make up my mind -

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my mind is still open. These people are coming in tomorrow; I'm going to put this thing up to them and see what they think, and try to get it across to them, and after they have seen it, I thought that we'd report back to you, what their advice is to me. Then we can go over it again. Does that seem fair? Huh? Now as I understand it, these rules and regulations, as far as they go, really gets down to the Comptroller's Office and the F. D. I. C. I mean, they make the rules and regulations. Is that right?

Folger: (Nods "Yes.")

H.M.Jr: And the Federal Reserve hasn't any rules and regulations.

McKee: As to what?

H.M.Jr: As to bank examinations.

McKee: Yes.

H.M.Jr: Have you?

McKee: Member state banks.

Upham: Binding upon both national banks and state member banks?

Davis: That's as an investment - not as a procedure.

H.M.Jr: Well, with that exception - I mean, if these two people could get together - carrying out - with the exception of state members, what two - with the exception of the examinations, of which the Federal Reserve is possible .....

Crowley: Mr. Secretary, let me say, I know you're anxious to get to your appointment. I think that there is very little difference between the Federal Reserve concurring with us here; if we could sit down with them and let us iron this thing out in our own way. We may have to have a battle royal here but there's not very much difference of opinion here that I think eventually we can get together. And on the securities end of the thing there is practically

no difference between the three of us; we are practically in accord on that, Gus, with the exception that we say - that Gus says he doesn't want to earmark individual items of profit, but he's for the adequate reserves, and that is, practically speaking, what we're all trying to get at, Mr. Secretary.

Folger: There's very little difference there, with the so-called profit on bond sales, but there is a great difference, Mr. Crowley,.....

H.M.Jr: May I interrupt just a moment. If you gentlemen are so inclined to adjourn to Mr. Taylor's room, I know that he'd be delighted to offer you the services of his room, but I'm just going to tell you, as far as I'm concerned, I won't come to any decision until I have a chance to talk to you gentlemen again, see? And if it would be agreeable to come back ..... And if you fellows want to go into Taylor's room and take your coats off, why, God bless you.

The majority agreement with respect to the classification of loans is that the three columns in the examination report now known as slow, doubtful, and loss will be continued. Their present form, and that of the instructions to examiners as to the type of loan to be included in each of the three columns, will remain the same as at present. It is proposed to label these three columns by the roman numerals I, II and III. At the top of each page upon which this tabulation occurs, there will appear the roman numeral I and following it a definition of the type of loan which is included in the column; there will also appear roman numeral II followed by the single word "doubtful"; and there will also appear the roman numeral III followed by the single word "loss".

Where there is a recapitulation of the columns now known as slow, doubtful and loss, the same device will be used, i.e., the use of the three roman numerals as symbols with the accompanying explanation of what is included under <sup>each</sup> that. As now, on the recapitulation page only the totals in columns II and III will be included in figuring the net sound capital of banks.

(It should be noted that this agreement would result in the complete elimination of the word "slow" from loan classifications.)

May 2, 1938

The minority position with respect to the classification of loans in the examination report is that the column now known as "slow" should be eliminated from the pages upon which it now appears and that provision be made elsewhere in the report, under a heading "Loans Listed for Information or Comment", or other suitable heading, for listing, with appropriate comment, not totaled and not included in any recapitulation, such loans as the examiner feels should be set out for the information of the directors and proper officers of the bank, with the clear understanding that such loans are not being classified as doubtful or loss and are not necessarily to be regarded as criticized assets.

May 8, 1938

April 28, 1958

In 1954 with total loans in 5,275 national banks of \$7,740,896,000, national bank examiners classified 27 per cent in the slow column.

In the last half of 1957 with total loans in 5,267 national banks of \$8,953,216,400, national bank examiners classified only 9.61 per cent in the slow column.

| <u>Year</u>        | <u>Slow</u> | <u>Doubtful</u> | <u>Loss</u> |
|--------------------|-------------|-----------------|-------------|
| 1954               | 27%         | 4%              | 2.9%        |
| 1955               | 16%         | 3%              | .8%         |
| First half of 1957 | 10.68%      | 1.14%           | .68%        |
| Last half of 1957  | 9.61%       | 1.06%           | .49         |

The majority agreement with respect to the appraisal of bonds is

1. That depreciation in stock and defaulted bonds be classified as loss and that securities in these groups (III and IV) be listed and priced in the report of examination. (The minority does not disagree on this point.)
2. That depreciation on securities in group II and in the fourth grade of general market obligations in group I be deducted in the report in computing the net sound capital of the bank, and that securities in these classifications be listed and priced in the report of examination.
3. That depreciation in all group I securities except the fourth grade of general market obligations be disregarded and that these securities not be priced in the report of examination.
4. That unrealized appreciation be not allowed.
5. That a premium on bonds purchased at a premium be amortized.

The minority position with respect to the appraisal of bonds is

1. That only depreciation in stocks and defaulted bonds be classified as estimated loss, and that securities in these groups be listed and priced in the report of examination. (This is in accordance with the views of the majority.)
2. That securities in groups I and II be not priced, and preferably be not listed, in the report of examination. A complete list of all securities, however, should be attached to the report of examination sent to the Supervisory authorities.
3. That depreciation, other than in stocks and defaulted bonds, should not be taken into consideration in computing "net sound capital." On the other hand, it can not be affirmatively stated that depreciation in any securities constitutes sound capital. Therefore, the minority feels that the schedule showing a computation of net sound capital be eliminated from the reports of examination.
4. That unrealized appreciation be not allowed.
5. That a premium on bonds purchased at a premium be amortized.

May 2, 1928

The majority agreement with respect to the treatment of net profits from the sale of securities is that until adequate reserves against the securities account have been built up, all such profits should be impounded and be unavailable for any purpose other than to take care of losses resulting from the sale of securities.

May 2, 1938

The minority position with respect to the treatment of profits from the sale of securities is that

1. Estimated losses should be charged off.
2. Banks should be required to establish and maintain adequate reserves, including reserves against the securities account.
3. Banks should not be required to earmark individual items of profit, regardless of source.
4. Speculation should be severely criticized and penalized.

May 2, 1938

May 3, 1938.

Mr. Taylor

Mr. White

Subject: Poland

Summary1. Economic Situation

Area and population. The area of Poland is 150,000 square miles, or almost that of California.

The population of Poland continues to increase rapidly. It is now 34 million and is increasing at the rate of one-half million a year.

Over two-thirds of the population is engaged in agriculture. One-third of the population consists of minorities — Ukrainians, Jews, Russians, Germans — and sustained attempts to Polonize them have not been very successful.

Poland is fairly rich in natural resources but the national productivity is extremely low. Fifty percent of the land is arable; 22 percent is under forests and 18 percent is pasture land. She is predominantly an agricultural country. The land is fertile and rich in timber. Poland is also fairly rich in mineral resources, being a large producer of coal, lead, zinc, salt and potash, having sizable reserves of oil and iron ore. She produces no gold and little silver. She has to import cotton, wool, hides, copper, rubber and other tropical products. Lack of capital retards her industrial development and the exploitation of her natural resources. The social and economic organization of agriculture is extremely backward, and the standard of living is extremely low, her national income in 1929 being under \$3 billion.

Recovery was slow in coming to Poland; the depression lasted for six years and was intensified by the pursuit of a deflationary policy.

There are no signs of a recession yet. Industrial production and the volume of foreign trade continue to rise and unless the world economic situation deteriorates in the near future there is no reason to expect any change for the worse.

Report prepared chiefly by S. Adler  
 Edited by H. D. White and E. Glasser

5/3/38 - Original to Mr. Taylor.

Mr. Taylor - 2

Why did not Poland devalue during or before 1936? Poland is the only member of the gold bloc which had not devalued at the end of 1936. In spite of the heavy drain of gold, considerable social unrest and the importance of her foreign trade to her, Poland refused to devalue, largely because

- (a) She had already taken steps which were partially effective substitutes for devaluation such as introduction of exchange control, suspension of foreign debt service, export subsidies and clearing agreements;
- (b) Poland had already carried through a sharp and painful process of deflation, the advantages of which it did not want to forego;
- (c) The disastrous experience of previous inflations — in 1919 and 1923-1924 — enhanced the fear of devaluation and made it politically difficult;
- (d) The world recovery in agricultural prices was rapidly diminishing the strain on the Polish economy.

Poland's gold and foreign exchange holdings fell by 70 percent from the end of 1929 to July 1936, when they reached a low point of 374 million sloties. This decline is due to the withdrawal of foreign and domestic capital and a series of unfavorable balances of payments. Since then the Bank of Poland's position has improved and it now has 456 million sloties (\$86,200,000) of gold and foreign exchange. In addition there is reason to believe that the Government has concealed gold resources held at the disposal of the army.

The sloty exchange rate is stable with narrow limits at 18.9 cents. Prior to our devaluation the sloty was worth 11.2 cents. Notes in circulation and bank deposits have both risen steadily in the last three or four years, but are not unduly expanded.

Poland, despite a curtailment of expenditure of over 25 percent and its rigidly deflationary policy, only succeeded in balancing its budget in 1936. Budgetary expenditures for 1936 and 1937 averaged about 2.3 billion sloties per annum. Almost half these expenditures were on armaments.

Poland's foreign trade declined by 66 percent from 1929 to 1934, but has since experienced a considerable revival. Poland's balance of trade, which was customarily favorable, is tending to become less and less so as the progressive industrialization of the country and the development of the armament industry in the "triangle" involve heavy importations of capital goods and machinery.

Mr. Taylor - 3

United States trade with Poland is of negligible significance to us but constitutes almost 10 percent of Poland's foreign trade. Preliminary conversations for a trade agreement are continuing, though serious obstacles exist.

Poland's balance of payments is characteristic of that of a debtor country and her net adverse balance for 1934 and 1935 was over 100 million zloties which was met by transfers of gold and currency. Owing to the strain on her economic position, Poland adopted exchange control in April 1936 and suspended foreign debt payments in June 1936.

United States-Polish balance of payments for 1937 was unfavorable to Poland by about \$2 million. Poland is not meeting its full interest obligations to the United States. (American holdings of Polish dollar bonds are estimated at \$68,000,000.)

What are Poland's economic prospects? Poland's economic welfare is largely tied up with the course of world agricultural prices and the possibilities of war in Europe. As long as world agricultural prices are maintained, Poland's economic position is comparatively secure. But the long run prospects are not encouraging. Poland needs foreign capital but will have increasing difficulty in obtaining it because of (a) the general political uncertainty, (b) Poland's bad record in meeting debt obligations, and, (c) her policy of nationalizing or turning over to her nationals foreign investments in Poland.

## 2. Political Situation

The Polish political system is a dictatorship, tempered by mild and innocuous doses of democracy. The President's powers are as broad as those of the Sejm but the most powerful single person in Poland is not the President but Smigly-Rydz, the Inspector-General of the Army.

Is the internal political position stable? Not very. The existence of a large body of unemployed in the city and of land-hungry, impoverished and indebted peasants in the country is not conducive to political stability, but there is no reason to expect any rapid change for the worse. Last year the National Unity Movement, which was then pro-Fascist in character, was launched in order to concentrate all political activity within one pro-Government party. But it failed to obtain popular support and has since been reorganized, on a more moderate basis. The two chief parties of the opposition, the Peasants' Party and the Socialist Party, function under a large number of legal restrictions.

Poland is in an extremely vulnerable position from a military point of view. It lies across the great eastern European plain between Germany and Russia. Of its 3,500 miles of land frontier, 1,000 miles border Germany and 800 miles, Russia. Its heavy industries are especially exposed to attack in case of war, being concentrated in Upper Silesia on the German frontier. She is surrounded on all sides by countries which are potential enemies and at best lukewarm friends.

Mr. Taylor - 4

What are Poland's relations with France? From 1921 the Franco-Polish Alliance was the mainstay of Poland's foreign policy. But the vacillations of French foreign policy in the last few years and the increasing strength of Germany have weakened Poland's ties with France. Poland obtained a loan of \$121 million from France in 1936 to be expended on rearmaments. Nonetheless, future developments may compel her to abandon the political conditions probably attached to the loan.

Poland now has non-aggression pacts with its two most powerful neighbors, Germany and Russia. The pact with Germany was concluded in 1934 and the one with Russia, in 1932. Prior to the consummation of these pacts her relations with both countries had frequently been strained. One of the terms of the Versailles Treaty, which it had particularly objected to, was the creation of the Polish corridor and the subsequent treatment of the German minority in Poland had only served to exacerbate German susceptibilities. Relations with Russia had been even more distant. Poland had only averted defeat in its war with Russia in 1921 as a result of last minute French assistance, and the activities of the Communist International constituted a permanent threat to Poland's internal stability.

But circumstances are such that it is becoming extremely difficult for her to develop and maintain cordial relations with both countries.

Poland has been steadily drawing closer to Germany since 1934. The conclusion of the non-aggression pact marked a turning point in Polish foreign policy. Poland, like Germany, has refused to participate in multilateral agreements, because it is opposed to the freezing of the status quo. It has settled many of its outstanding issues with Germany. Its present Foreign Minister, Colonel Josef Beck, is notoriously anti-Russian and anti-French and pro-Nazi. In recent years Poland has been pursuing a policy parallel to that of Germany with respect to Czecho-slovakia, with which country its relations have become increasingly embittered.

Yet there is also evidence pointing in the opposite direction. It is hardly likely that Poland would have received so large a loan from France (1936) without a pledge that it would not be used against France's allies, though the pressure of events may obviously vitiate the pledge's effectiveness. Danzig, the minority question, and certain economic issues are still outstanding points of difference between Germany and Poland. Above all, the expansion of Germany is a threat to Poland's very national existence.

Mr. Taylor - 5

Why did Poland force the resumption of diplomatic relations with Lithuania this March? Since the Polish seizure of Vilna in 1920 there have been no diplomatic relations between Poland and Lithuania. The most obvious explanation of this Polish action vis-a-vis in Lithuania is that she was exploiting the general political uncertainty in Europe arising from the German invasion of Austria. None of the great powers were willing to assert enough pressure to deter Poland. Whether this action was carried out with or without Germany's tacit consent cannot be known for certain, though the former appears plausible.

What is Poland's foreign policy likely to be in the near future? From every point of view it is to the interest of Poland that peace be preserved. But as the possibility of war between Germany and Russia increases, Poland must decide what her policy will be in the event of such war. If, as appears almost certain, England makes no commitment with respect to Eastern Europe and the Franco-Soviet pact is weakened, then Poland will be on the side of Germany.

Can Poland pursue an independent policy? Probably not, especially if she is to continue an aggressive policy, which requires the support or at least the tolerance of Germany and/or Russia. As Russia is for the present interested in the preservation of the status quo, an aggressive policy on the part of Poland therefore involves greater cooperation with Germany.

The choice which confronts Poland is extraordinarily difficult. It is not sufficiently powerful to keep the peace between its two neighbors and will inevitably be involved in any conflict between them. Whichever side she chooses, or whoever is the victor in a Russo-German war, her independence will be threatened.

Its decision as to which side she will support on the coming conflict, therefore, will be dictated first and foremost by the final alignment of forces on each side.

POLAND 1/I. Economic Situation

Area and Population: The area of Poland is 150,000 square miles, or almost that of California.

Its population is 34 millions, with the enormous rate of increase of half a million per annum, or 14 per thousand. Its birth rate is one of the highest in Europe. In 1936 it was 26.2 per 1,000 and the death rate 14.2. Both rates have fallen significantly in the last ten years. The death rate, however, fell by only 15 percent as compared with a decline of almost 20 percent in the birth rate. Almost 70 percent of the population is engaged in agriculture and 25 percent, in mining, manufacturing and the distributive industries.

Not more than two-thirds of the population is Polish. The leading minorities are Ukrainians, Jews, Russians and Germans. Though serious attempts have been made to Polishize the minority groups, so far their attempts have had small success. These groups were not originally enthusiastic about their incorporation in Poland when Poland was revived as a political entity, and the subsequent policy and practice of the Polish Government have scarcely tended to strengthen their allegiances. Should war break out some of the minority groups — though by no means all — could not be depended upon to remain loyal to the present Polish Government.

Poland is fairly rich in natural resources. Fifty percent of its land is arable, 22 percent is under forest, and 18 percent is pasture land. The land is fertile and rich in timber. Poland is also fairly rich in mineral resources, being a large producer of coal, lead, zinc, salt and potash, and having sizeable reserves of oil and iron ore. She has to import cotton, wool, hides, copper, rubber and other tropical products. Poland produces no gold. Silver production, which amounted to over half a million ounces in 1930 and 365,000 ounces in 1931 has not exceeded 100,000 ounces since, being only 25,000 ounces according to the Director of the Mint's estimates in 1936. This drop is explained by the severe fall in the production of lead and zinc, of the mining of which silver is a by-product, which is still way behind 1929 levels.

But owing to a lack of capital its natural productivity is extremely low. The standard of living is miserably low. Its peak national income was reached in 1929, when it was 26 million sloties, which at the then prevailing rate of exchange was scarcely \$3 billions. (According to the estimate of the German Wirtschaftsdienst, however, it was only 17.4 billions.) In 1932 it fell to 14 billion sloties, and while there has been considerable recovery in the last two or three years, 1929 levels have

1/ Report prepared chiefly by S. Adler  
 Edited by H. D. White and H. Glasser

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not yet been regained. The lack of capital seriously retards her industrial development and the exploitation of her natural resources.

It is predominantly an agricultural country. Poland is a large producer of wheat, rye, barley, oats, potatoes, beets, flax and meat products. The vast majority of the farms are small and the distribution of land is extremely unequal. Almost two-thirds of the total number of farms are under 13 acres and almost 90 percent under 25 acres. Forty-five percent of the land is owned by .6 percent of the farmers and only 15 percent of the land by 65 percent. Though some attempts to bring about a more equitable distribution of the land and to raise farming standards have been made, the social and economic organization of agriculture remains extremely backward. The large landowners still constitute one of the dominant political influences in the country.

Poland's leading industries are timber, textiles, steel and the mining of coal, iron ore, potash, lead, zinc and petroleum. Poland has 19.8 million acres of forest, and produces 760 million cubic feet of timber per year. She is a large exporter of timber, paper and furniture. The textile industry, employing over 130,000 workers, is the largest single employer of labor. Poland produces about 30 million tons of coal a year, about a third of which is exported. With an annual zinc production of about 100,000 tons, it produces 10 percent of total world output. Steel production is about one million tons per annum and crude oil output 500,000 tons per annum.

The most important recent development in Polish industry was the passing of the National Development Bill in February 1937, authorizing the Government to spend 2.4 billion zloties in the next four years on military, industrial and economic schemes. The most spectacular feature of this plan is the contemplated transference, for strategic reasons, of large segments of important national industries to the so-called "triangle". (See map.) The center of this area is to be Sandomierz at the confluence of the San and the Vistula.

Poland's foreign trade declined by 66 percent from 1929 to 1934, but has since experienced a considerable revival, despite its failure to devalue. Exports for the first two months of 1938 show a slight decline and imports an increase of nearly 25 percent on the first two months of 1937.

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**Polish Foreign Trade**  
(In millions of zloties)

|                | <u>Exports</u> | <u>Imports</u> | <u>Export Surplus</u> |
|----------------|----------------|----------------|-----------------------|
| 1929           | 2,813          | 3,111          | - 298                 |
| 1930           | 2,433          | 2,246          | + 187                 |
| 1931           | 1,879          | 1,468          | + 411                 |
| 1932           | 1,084          | 862            | + 222                 |
| 1933           | 960            | 827            | + 133                 |
| 1934           | 975            | 799            | + 176                 |
| 1935           | 925            | 861            | + 64                  |
| 1936           | 1,026          | 1,003          | + 23                  |
| 1937           | 1,196          | 1,254          | - 58                  |
| Jan.-Feb. 1937 | 191            | 172            | - 19                  |
| Jan.-Feb. 1938 | 176            | 213            | - 36                  |

The tendency for Poland's trade balance to become increasingly unfavorable was maintained in the first two months of 1938, when the excess of imports was 36.3 million zloties as compared with an excess of exports of 18.2 million zloties for the same period in 1937. The progressive industrialization of the country has entailed an increasingly large importation of capital goods, which has absorbed most of the favorable trade balance of previous years.

Poland's exports consist chiefly of raw materials, and to a much lesser extent of manufactured goods. Her most important exports are: Mineral products, chiefly coal, zinc, rye, barley, bacon, timber and metals. Recovery in exports has been most substantial in the case of foodstuffs, animal products and textile products.

**Poland - Exports by Selected Commodities, 1934, 1936 and 1937**

(In thousands of zloties)

|                                       | 1934    | 1936      | 1937      |
|---------------------------------------|---------|-----------|-----------|
| Total exports                         | 975,342 | 1,026,246 | 1,195,551 |
| Mineral products                      | 210,397 | 171,598   | 233,463   |
| Wood, cork, and mfr., and basket work | 179,624 | 165,312   | 201,584   |
| Vegetable products                    | 168,459 | 209,291   | 139,803   |
| Common metals and mfr.                | 115,504 | 96,985    | 138,252   |
| Animals and animal prods.             | 139,181 | 178,362   | 204,244   |
| Textiles and mfr.                     | 54,317  | 71,760    | 89,400    |
| Prepared foodstuffs and tobacco       | 33,453  | 56,046    | 90,771    |

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Imports consist largely of textile raw materials, machinery, manufactures and vegetable products. Its chief imports are cotton, wool, hides, machinery and vehicles, scrap iron, fruit and tobacco. Imports of machinery and metals and manufactures have more than doubled since 1934.

**Poland - Imports by Selected Commodities, 1932, 1936 and 1937**

(In thousands of zloties)

|   | 1932    | 1936      | 1937      |
|---|---------|-----------|-----------|
| Total imports                               | 798,760 | 1,003,445 | 1,254,298 |
| Machinery and vehicles                      | 68,326  | 122,421   | 160,651   |
| Common metals and mfrs.                     | 83,800  | 129,249   | 202,805   |
| Textile raw materials and mfrs.             | 256,505 | 312,594   | 347,791   |
| Vegetable products                          | 95,174  | 90,582    | 107,643   |
| Chemicals and pharmaceuticals and dyestuffs | 51,843  | 63,868    | 67,303    |
| Hides, skins, furs and leather mfrs.        | 69,647  | 84,907    | 96,844    |

Poland's chief customers are England and Germany. Then come the United States, Sweden, Belgium, Netherlands, Austria and Italy. The United Kingdom, Germany and the United States account for between 40 and 50 percent of Poland's total exports.

**Poland - Exports by Principal Countries, 1934, 1936 and 1937**  
(1,000 zloties)

|                | 1934    | 1936      | 1937      |
|----------------|---------|-----------|-----------|
| Total          | 975,342 | 1,026,246 | 1,195,544 |
| United Kingdom | 191,922 | 221,601   | 219,261   |
| Germany        | 161,596 | 145,333   | 173,019   |
| United States  | 22,842  | 67,272    | 100,922   |
| Sweden         | 45,087  | 59,556    | 75,155    |
| Belgium        | 58,284  | 84,347    | 68,989    |
| Netherlands    | 40,076  | 45,989    | 61,175    |
| Austria        | 57,216  | 58,840    | 58,667    |
| Italy          | 37,034  | 22,019    | 54,153    |
| Czechoslovakia | 50,430  | 49,184    | 51,949    |
| France         | 40,709  | 43,670    | 49,213    |

Poland's chief sources of supply are Germany, the United Kingdom, and the United States, which together account for 40 percent of total imports.

Imports by Principal Countries  
(Thousands of slotes)

|                | 1934    | 1936      | 1937      |
|----------------|---------|-----------|-----------|
| Total          | 798,760 | 1,009,445 | 1,254,298 |
| Germany        | 108,471 | 142,886   | 182,166   |
| United Kingdom | 86,208  | 141,637   | 149,204   |
| United States  | 121,065 | 119,298   | 149,145   |
| Austria        | 36,663  | 44,867    | 57,838    |
| Netherlands    | 29,426  | 37,267    | 57,663    |
| Belgium        | 25,348  | 43,448    | 56,320    |

Poland during the depression extended governmental control over foreign trade. It developed a system of clearing and compensation agreements, import licenses, and export subsidies very much in the manner of Germany, though, of course, on a smaller scale. Tariffs were raised in October 1933. Clearing agreements have been made with the chief European countries with which it trades, and compensation trade agreements have been entered into with South and Central American countries, and Palestine; commercial treaties have also been concluded with several British dominions in the last year.

Since 1933 the system of import licenses was gradually extended until in May 1936 licenses were required for all imports. For a time export subsidies were granted to a large number of agricultural products. They totalled 23 million slotes in 1935-1936, but were reduced to 10 million slotes in 1936-1937.

U.S. Trade with Poland

United States trade with Poland is insignificant from our point of view. Our foreign trade with Poland is less than 1 percent of total foreign trade. Net Polish imports from the United States constitute 12 - 15 percent of total Polish imports, and exports to the United States, between 5 and 7 percent of total Polish exports.

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## United States - Polish Trade in 1936 and 1937

(In thousands of dollars)

|                       | 1936   | 1937   |
|-----------------------|--------|--------|
| United States exports | 20,278 | 26,290 |
| United States imports | 12,138 | 19,568 |

Raw cotton constitutes a third of United States exports to Poland. The chief single import in 1936 was ham and bacon, which accounted for almost half our total imports.

Poland receives most-favored nation treatment from the United States. The prospects for a trade agreement with Poland do not appear to be too bright. In the preliminary conversations several serious obstacles have been encountered:

- (a) Poland has asked us to promise that we shall never impose countervailing duties on any of her imports.
- (b) She has asked for the retention of preferences with respect to adjacent Baltic and Danubian countries.

However, these preliminary discussions are still continuing.

Poland's balance of payments is characteristic of that of a debtor country. Until 1937 it usually has had a sizeable favorable balance of trade. Because of the large number of Polish immigrants in the United States and other countries, it also has a sizeable balance of immigrant remittances. As Germany has to pay Poland for railroad services through the Polish corridor, it usually has a surplus on the communications item in its service account. But it has had to pay over 150 million zloties a year in interest and is a net importer of capital. The rates of interest it has had to pay on its foreign borrowings have been as high as 7 and 8 percent.

As a result of the decline in the favorable balance of trade and the increasingly unfavorable balance of payments, Poland, which had already adopted a system of clearing agreements with some countries, formally adopted exchange control in April 1936 and suspended payments on its debt service in June 1937. Since then Poland has come to an agreement with British and some United States bondholders and has reduced the rate of interest payable to Poles holding dollar and sterling bonds of the Polish Government to  $4\frac{1}{2}$  percent.

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U.S. - Polish balance of payments

For the first six months of 1937 Poland had a net favorable balance of payments of \$3½ million.

First Half Year - 1937

(In millions of dollars)

|              | Trade   | Services | Interest | Capital | Total   |
|--------------|---------|----------|----------|---------|---------|
| Receipts     | 10.560  | 8.051    | -        | .38     | 18,649  |
| Expenditures | 12.587  | .775     | .931     | .828    | 15,121  |
| Net          | - 2.027 | +7.275   | - .931   | - .790  | + 3,528 |

Polish obligations to the United States

Poland is not meeting its full interest obligations to the United States. With the suspension of debt payments in June 1936 there was a partial default on the interest due to the United States bondholders. Prolonged negotiations with United States bondholders ensued and a Polish mission to settle outstanding issues was sent to the United States at the end of 1936. According to a consular report of January 18, 1938, \$68 million of Polish obligations are now held in the United States. Of this, about one-third in the hands of three principal creditors, the Silesian-American Corporation, Ulen & Company, and the Mellon-owned Standard Car Finance Company, is serviced satisfactorily.

The outstanding \$45 millions worth of dollar bonds are widely held in the United States and have not yet been funded. Poland wishes to convert them to a 4½ percent interest basis, but United States bondholders do not want to go below 5 percent, especially as the British bondholders are holding out for 5½ percent. British bondholders are in a more favorable bargaining position, because:

- (a) Sterling bonds are not as widely held as the outstanding dollar bonds. British bondholders are, therefore, better organized, and their protective council works in close conjunction with the British Government and the London banks.
- (b) The Anglo-Polish trade balance makes possible the application of the British-enforced clearing law.
- (c) The London money market is now indispensable to Poland as a source of both long- and short-term credits, whereas there is little hope of raising any loans in New York.

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Throughout the depression Poland pursued a deflationary policy and prices continued to fall until 1935. The price of food and drink fell even more than the general wholesale price level. From 74 in 1929 it fell to 49 in 1935 and was still only 57 in December 1937. The effects of the Government's deflationary policy were aggravated by the precipitous decline in agricultural prices since 1929, which still further impoverished the country and reduced the people's already low standard of living.

|   | 1929  | 1932  | 1934  | 1935  | 1936 | 1937 | Jan.<br>1938 |
|---|-------|-------|-------|-------|------|------|--------------|
| General wholesale price level                     | 100   | 68    | 58    | 55.1  | 56.1 | 61.7 | 60.3         |
| Cost of living                                    | 100   | 87.7  | 65.6  | 63    | 60.1 | 63.9 | 63.4         |
| Industrial production                             | 100   | 53.9  | 63    | 66.4  | 72.2 | 85.3 | 89.6         |
| Number of unemployed (thousands)<br>December 31st | 185.3 | 220.2 | 413.7 | 402.8 | 466  | 470  | 549          |

In common with other gold bloc countries Poland was late in experiencing recovery. Prices did not begin to rise until 1936, foreign trade continued to fall till 1935 and unemployment increased steadily until the end of 1934. The increase in industrial production from 1932-1934 which occurred even though the depression was continuing, was largely due to a large scale Government public works program. Recovery could not be substantial until a significant increase in agricultural prices had occurred. The increase in the number of unemployed since 1935, simultaneously with an increase in the number employed, is due to the fact that: (a) The Government has made registration a condition for obtaining employment on public works; and (b) recovery has not been substantial enough to take care of the natural increase in the number of people coming on to the labor market.

The present recovery does not show any immediate signs of coming to an end. Most of the economic indices continue to register slight but steady improvements. The index of industrial production for January 1938 is higher than for any month since 1930, and the volume of foreign trade continues to rise.

Poland is one of the few countries which have not devalued their currency. As a result of its refusal to devalue, it was compelled to adopt a system of import licenses and quotas in 1933, and finally thorough-going exchange control in April 1936 after a heavy run on

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the Bank of Poland. The Government has not only refused to depreciate the value of its currency; it has also attempted to force through a policy of compulsory price reduction on the part of the leading cartels and syndicates. It is the pursuit of her deflationary program and its attendant hardships which has been largely responsible for a considerable amount of agrarian discontent.

Why did Poland not devalue during or before 1936?

Poland is the only member of the gold bloc which had not devalued at the end of September 1936. Contrary to the expectations of our legation, Poland did not value in spite of:

- (a) A considerable diminution in gold and foreign exchange reserves from the end of December 1934 to the beginning of July 1936.
- (b) The social unrest created by the fall in agricultural prices and the deflationary policy of the Government.
- (c) The handicap to Polish exports as a result of devaluation by all competing countries.

In an official statement on monetary policy on December 1, 1936, M. Kwiatkowski, Vice-Premier and Minister of Finance gave the following reasons for the Government's decisions:

- (a) Poland had already carried through a sharp process of deflation and did not wish at such a late stage to forego the advantages of this policy, the imposition of which had involved heavy sacrifices.
  - (b) It wished to avoid a depreciation in the value of Government paper and private savings and a decline in the real value of earnings.
  - (c) The Government wished to avoid increasing the spread between the prices of goods the farmer bought and goods the farmer sold.
  - (c) After painfully balancing its budget it did not wish to do anything which might increase the possibilities of a deficit.
- Of these reasons only (a) and (b) would seem to have any validity.

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In addition

- (a) The disastrous experiences of the inflations of 1919 and 1923-1924 made the introduction of devaluation politically difficult.
- (b) Poland had already introduced a system of exchange control and import licensing in April 1936, though the other gold bloc currencies were still attached to the gold standard.
- (c) A temporary suspension of transfers on foreign debt service was announced on June 27th, 1936.
- (d) The world recovery in agricultural prices was enhancing the value of Polish exports.
- (e) Poland had adopted a policy of export subsidies and was forcing the export of mineral products by selling them below world prices.
- (f) Poland had already adopted a far-reaching scheme of clearing agreements with some of the most important of the countries with which it traded.
- (g) A noticeable rise in prices occurred in Poland immediately after the adoption of devaluation by the other gold bloc countries.
- (h) The size of its foreign debt in terms of the zloty was diminished by its maintenance of the zloty. The size of the foreign debt fell from 3,282 million zloties on January 1, 1936 to 2,921 million zloties on October 1, 1936, largely as a result of the devaluation of the franc and other gold bloc currencies.

The Bank of Poland's gold and foreign exchange holdings fell heavily from 1929 right down to July 1936 when they reached the low point of 874 million zloties.

|                | 1929 | 1932 | 1933 | 1934              | 1935 | 1936 | 1937 | March<br>1938 |
|----------------|------|------|------|-------------------|------|------|------|---------------|
|                |      |      |      | (Million zloties) |      |      |      |               |
| Gold           | 701  | 502  | 476  | 503               | 444  | 393  | 435  | 438           |
| Foreign Assets | 526  | 137  | 88   | 28                | 27   | 30   | 36   | 18            |

The explanation for the decline in the gold and foreign exchange assets of the Bank of Poland is to be sought:

- (a) In the withdrawal of foreign capital. The withdrawal of foreign capital was stimulated by the Polish Government's action in taking over and encouraging the taking over of certain foreign enterprises.

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(b) In the flight of domestic capital, which reached considerable dimensions just before exchange control was introduced.

(c) In the fact that Poland's customarily favorable balance of trade did not suffice to meet foreign debt obligations.

Since 1936 the Bank of Poland's position has improved. Moreover, there is reason to believe that Poland's gold holdings in the first quarter of 1937 increased by more than the 42 million zloties which the official figures indicate. According to a consular report of May 7, 1937, the excess of 30 million zloties in the import of gold over the increase of 13 million zloties in the gold holdings of the Bank of Poland in the first three months of 1937 was probably being held at the disposal of the Polish Army instead of being entered into the gold reserves of the Bank of Poland.

This increase in the gold holdings of the Polish Government was apparently due to sales by the Government and private factories of war materials and equipment to the Spanish Government and to General Franco's forces. In addition, Polish textile mills were executing large orders on account of the Spanish Government, so that there is reason to believe that concealed increases in Polish Government gold holdings continued throughout 1937.

The zloty exchange rate is stable within narrow limits at 18.9 cents. Prior to our devaluation the zloty was worth 11.2 cents.

Notes and coins in circulation and bank deposits have risen steadily since 1933, but are not now unduly expanded.

Since December 31st, 1929, when the total note and metal currency in circulation was 1,600 million zloties, with a gold and foreign currency cover of 61.9 percent, there was a steady decline until the end of 1932 when circulation was 1,325 million zloties and the statutory cover 45 percent.

In March 1933 a law was passed eliminating foreign assets from the statutory cover, and the statutory minimum reserve was reduced from 40 percent to 30 percent of all sight liabilities above 100 million zloties. Since then notes and coin in circulation have risen steadily to 1,531 million zloties in March 1938, the statutory cover being about 35 percent.

Total bank deposits have risen considerably from a low of 850 million zloties in 1933 to 1,048 millions in 1936 and 1,349 millions in 1937. Current and sight accounts increased from 456 millions in 1933 to 897 millions in 1936 and 749 millions in 1937. The discount rate was reduced from the 5 percent which had prevailed since 1934 to 4.5 percent in December 1937, but the average private bank rate on 4 - 5 months' bills is still as high as 11.5 percent.

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### Budgetary situation

In spite of its rigid deflationary policy, until the year 1936-1937, the Polish Government had accumulated a budgetary deficit of almost 1½ billion zloties, since when it has succeeded in keeping its budget in balance. Expenditures in 1936-1937 totalled 2.2 billion zloties and in 1937, 2.3 billions. Almost half these expenditures were on armaments. The size of the national debt is about 5 billion zloties, internal debt being approximately 2 billions and foreign debt, 3 billions.

What are Poland's economic prospects? Poland's economic welfare is largely tied up with the course of world agricultural prices and the prospects of her attracting foreign capital. As long as world agricultural prices are maintained, Poland's economic position is comparatively secure. But the prospects of any substantial increase in her national income are not encouraging. The political situation is extremely unstable. Poland needs foreign capital but will have increasing difficulty in obtaining it because of (a) the general political uncertainty, (b) Poland's bad record in meeting debt obligations, and (c) her policy of nationalizing or turning over to her nationals foreign investments in Poland.

## 2. Political Situation

The Polish political system is a dictatorship tempered by mild and innocuous doses of democracy. The President of the Republic is elected for a term of 7 years, chosen from two candidates, one nominated by the retiring President, and the other, by the Assembly of electors, consisting of 50 members of the Sejm and 25 members of the Senate. The President himself nominates a third of the Senate and elections to the Sejm are carried on in conditions which allow the dominant political machine to obtain its desired result.

The President's powers are extremely broad but the most powerful single person in Poland is not the President but the Inspector-General of the Army, the post originally occupied by Pilsudski, and now by Smigly-Rydz, who is the leader of the ruling junta. This junta is largely composed of members of the famous band of 300 legionnaires, organized by Pilsudski during the war. Original members of this band still occupy almost all the strategic positions in the Polish army and politics.

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Is the internal political situation stable? Not very. The danger of social and political discontent is always present as long as unemployment exists in the towns and the social and economic organization of agriculture remains so backward.

The expression of political opposition to the Government is hedged around with numerous restrictions. Last year a decree promulgating the dissolution of political parties was issued, and while it does not appear to have been enforced, the legal status of the political parties is highly insecure. Under Government sponsorship Colonel Adam Koc - another of Pilsudski's 300 legionnaires and ex-President of the Bank of Poland (he resigned from the governorship of the bank in April 1936 as a result of his persistent opposition to the inevitable introduction of exchange control) - launched the National Unity Movement in order to concentrate all political activity within one pro-Government party. This movement, which was Fascist in character, failed to obtain popular support. His failure did not contribute to the enhancement of the present regime.

Though there is not yet outright dictatorship in Poland, there are several powerful reactionary, if not pro-Fascist, groups, both within the political parties, such as the extremely nationalistic Endeks, and within the ruling junta. Colonel Koc, the leader of the pro-Fascist groups, was removed from leadership of the National Unity Movement in January - as a result of strong opposition by the war veterans to increasing Fascist tendencies. Only very recently the Union of Young Poland, which he organized to serve as a nucleus among college students, was purged of its too openly Fascist leaders.

The new leader of the National Unity Movement, General Skwarczynski, is trying to broaden its base by excluding the extreme nationalists and by making its policy only moderately nationalist and anti-Semitic and non-totalitarian and turning it into a conservative pro-Government party. He is carrying its appeal away from the nationalist youth and city middle class to the peasants.

The strongest party among the peasants, however, is the anti-Government Peasants' Party, which probably has the largest following in the country and whose leader, Witos, is now in exile. The Congress of the Peasants' Party held in Cracow in February showed unmistakably that there was a growing gulf between the Government and the people. Together with the Peasants' Party, the Socialist Party constitutes the basis of the opposition. It is opposed to the Government's rapprochement with Germany and to the extreme manifestations of Polish nationalism. In the last year its activities have increased; for the first time in many years it sent a deputation to the President to protest against the present direction of Government policy.

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As yet the Government has been able to resist the pressure for Pitos' recall and for democratic concessions to both of these parties, but the political situation is endemicly unstable. According to our consular reports large-scale riots occurred in 1936 due to prolonged unemployment and agrarian distress. The existence of a large body of unemployed in the city and of land-hungry, impoverished and indebted peasants in the country is not conducive to political stability, but there is no reason to expect any rapid change for the worse.

Poland is in an extremely vulnerable position from a military point of view. It lies across the great eastern European plain between Germany and Russia. Poland has a land frontier of about 3,500 miles and adjoins Germany, Russia, Czechoslovakia, Rumania, Lithuania and Latvia. It has a common frontier of 1,000 miles with Germany and 800 miles with Russia. Its heavy industries are especially exposed to attack in case of war, as they are concentrated in Upper Silesia on the German border, and it will take some time before they can be affectively transferred to the strategically safer "triangle". It has a strip of 80 miles on the Baltic Coast with the port of Gdynia, and two other outlets on the Baltic — Danzig on the mouth of the Vistula and now Memel at the mouth of the Niemen.

Surrounded on all sides by countries which are potential enemies and at best but lukewarm friends — with perhaps the exception of Rumania — the mainstay of her foreign policy before Hitler's coming to power was her alliance with France. France undoubtedly mainly was responsible for saving Poland from Russia in 1921 and had in the course of years extended considerable credits to her. Her two most powerful neighbors, Germany and Russia, have both been historically enemies of an independent Poland, and in the event of a clash between the two Poland would most probably be the battleground. Her relations with Czechoslovakia are embittered by the presence of a Polish minority on the Czechoslovakian frontier at Teschen; she had no official relations with Lithuania for over 17 years until last month.

What are Poland's relations with France? Since 1921 the backbone of Poland's foreign policy was its alliance with France, but events since 1933 have served to weaken this alliance. It has been claimed by many responsible writers that Pilsudski in 1933 invited the French to wage a punitive war against Germany before it was too late. The Nazis had so often indicated that the Polish corridor, not to mention the highly industrial area of Upper Silesia which had been granted to Poland as a result of the "plebiscite" of 1921, must be restored to Germany that the Poles wanted to wage war against Germany before it was too late.

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The French refusal and Hitler's obvious desire for a rapprochement with Poland hastened the emergence of the Polish-German pact of non-aggression in January 1934, which runs for 10 years. The cooperative inactivity of French foreign policy since the assassination of Barthou in 1934 in the face of German aggression has served to weaken Poland's relations with France. Even Poland's economic ties with France are weaker than they used to be. The Franco-Polish commercial treaty of 1924 was denounced by Poland in 1935, and there have been some disputes over Polish treatment of French capital invested in Poland. However, the 2.6 billion francs loan made by France to Poland for expenditure on armaments went a long way towards redressing the balance, both economically and politically. Nonetheless, future developments may compel her to abandon the political conditions which were probably attached to the loan.

What are Poland's relations with Russia?

Since the conclusion of peace in 1921 relations with Russia have never been amicable. Poland had only averted defeat in 1921 as a result of last minute French assistance and the activities of the Communist International constituted a permanent threat to her internal stability. But owing to the rapid rise of the Nazis after 1930, Poland agreed to a non-aggression pact with Russia in 1932, subsequently renewed in 1934 for 10 years.

Poland thus has non-aggression pacts with its two most powerful and most dangerous neighbors. But circumstances are such that it is very difficult to maintain both consistently.

Poland has been steadily drawing closer to Germany.

The conclusion of the non-aggression pact in January 1934 marked a turning point in Polish foreign policy. Prior to its conclusion Polish-German relations had usually been strained. One of the terms of the Versailles Treaty which Germany had particularly objected to, was the creation of the Polish corridor and the subsequent treatment of the German minority in Poland had only served to exacerbate German susceptibilities.

In 1934 and 1935 France and Russia pushed hard for an eastern Locarno to be joined by all the Eastern Powers in order to guarantee the status quo in eastern Europe, and when Germany turned it down flatly, Poland was only too glad to follow in her footsteps. Poland has indicated that, like Germany, it prefers bilateral to multilateral non-aggression pacts. The conclusion of the non-aggression pact of 1934 has been followed by renewed press agreements by which each power promises to control press and radio references to the other.

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The present Foreign Minister is Col. Josef Beck, notoriously anti-Russian and anti-French (in 1923 when he was a member of the Polish Embassy in Paris he was expelled from France under humiliating circumstances — he was accused of violation of diplomatic privileges) and would appear to be inclined in the direction of sympathy for Nazism.

Poland's very strong antipathy to Czechoslovakia is another factor which serves to draw Poland closer to the Germans. Though in the last few years Czechoslovakia has made overt attempts to improve its relations with Poland, Poland has not only rejected these offers but has manifested a more hostile attitude to her southern neighbor. It has been claimed by the usually well-informed Manchester Guardian Central European correspondent that one secret item in the non-aggression pact with Germany of 1934 was that Poland was not to oppose German ambitions in Czechoslovakia. Whether in return the corridor was to be allowed to remain in the hands of the Poles or whether, in addition to this concession, Germany was to allow Poland to take over Teschen, is not known. Poland is now claiming that there are 250,000 Poles in Czechoslovakia, although the number has usually been estimated at not more than 100,000 to 125,000; this claim is being made to support the rights of Poland to interfere in Czechoslovakia. Another recent move paralleling those of Germany and laying the ground for joint action with Germany is the Polish complaint that anti-Polish communist propaganda is emanating from Czechoslovakia.

In addition, several other factors point in the direction of a closer intimacy with Germany than with the U.S.S.R.

(a) Poland has consistently opposed any attempts to freeze the status quo in Eastern Europe. Russia is strongly in favor of such attempts, while Germany is as strongly opposed.

(b) "Incidents" between Poland and Russia are continually occurring. There have been a number of frontier clashes and since 1935 neither country has permitted entry to journalists from the other.

(c) In the final choice between Germany and Russia the decisive voice of the land-owning nobility would prefer Germany as the lesser of two evils.

Yet, there is also evidence pointing in the opposite direction

(a) The alliance with France has never been abrogated. In 1936 Poland received a credit of \$121 million from France for expenditure on war materials and fortifications. It is unlikely that France would have made the Rambouillet loan without some secret guarantee that it would at least not be used against France's allies, particularly Russia with which France has a mutual assistance pact.

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(b) The question of Danzig has not yet been definitely settled though the probability is that Poland is resigned to the complete absorption of Danzig by Germany.

(c) The treatment of the Polish minority in Germany and of the German minority in Poland is still a source of friction.

(d) There are still several outstanding economic questions between Poland and Germany:

1. Germany has not been meeting its payments on Polish railroad services regularly.

2. The status of Danzig currency has not yet been finally decided.

(e) Above all, any extension of Germany's power eastward necessarily endangers Poland. Such an expansion is not only a threat to the Polish corridor but also to Poland's very national existence. At the very best, in the event of a successful German expansion eastward, Poland, even if given territorial compensation in return for its assistance, would have to content itself with a subordinate position under the hegemony of Germany. This cannot but be known to the powers that be in Poland.

#### Poland and Lithuania

Since the seizure of Vilna by Poland in 1920 there have been no diplomatic relations between Poland and Lithuania. While Poland had pressed for resumption of such relations, Lithuania had obstinately refused to participate in League of Nations attempts at conciliation. Lithuania has refused to accept the conquest of Vilna. While it has a non-aggression pact with the U.S.S.R., this pact affords it no protection against third-party aggression. Lithuania thus has no important allies in Europe and is defenseless against the more powerful Poland.

#### Why did Poland force the resumption of diplomatic relations this March?

The most obvious interpretation of Poland's ultimatum to Lithuania demanding the recognition of the Polish status of Vilna and the resumption of normal diplomatic and commercial relations is that Poland utilized the uncertainty arising from the German invasion of Austria for its own immediate purpose. It has also been suggested that the failure of the Government-launched National Unity Movement and the growing opposition of the Peasants' Party as manifested at its Cracow Congress in February made a spectacular success essential for the maintenance of the Government's prestige and that Lithuania provided the easiest outlet.

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Of the four important powers which might have done something to deter Poland:

- (a) Germany had nothing to lose and everything to gain by encouraging Poland to follow in its footsteps. Poland's repudiation of collective action could not but be a blow to France and could not but increase her dependence on Germany. It is even possible that Poland had Germany's consent before it went as far as it did.
- (b) France certainly used its offices to keep Polish demands at a minimum, but it did very little else.
- (c) England was primarily interested in the immediate maintenance of peace and therefore exerted whatever pressure it could on both sides to come to a reasonable agreement.
- (d) Russia, it is plausibly rumored, first attempted to persuade Lithuania to put up a stand; but when it was clear that nothing could prevent a Polish victory, it ceased opposition to the ultimatum.

Poland was carrying out an action parallel to that of Germany in Austria. Whether Poland was pursuing an entirely independent and opportunistic policy, exploiting the European political certainty for its own immediate advantage, or whether it was acting at least with Germany's tacit consent cannot be known for certain. The greater plausibility of the latter interpretation, however, is confirmed by the fact that:

- (a) Germany simultaneously increased its concentration of troops near Memel.
- (b) German press comments a day or two after the Polish ultimatum was issued and its troops massed on the frontier were all favorable to Poland.

What is Poland's foreign policy likely to be in the next future?

From every point of view it is to the interest of Poland that peace be preserved. But as the possibility of a war between Germany and Russia increases, Poland must decide what her policy will be in the event of such war, especially as she will probably be the battleground and is certainly not in a position to resist invasion from both countries. Poland's decision must necessarily be affected by the general alignment of forces in Europe. Thus, if an alliance between England, France, and

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Russia were to emerge, the probability would be that Poland would be on the side of that alliance. If, however, as appears to be much more likely at present, England does not make any commitment in the East, and if the Franco-Soviet pact is weakened, as it may well be, then Poland is almost certain to be on the side of Germany. Its lukewarmness toward Barthou's project for an Eastern Locarno strengthens this conclusion.

The future orientation of Polish foreign policy, therefore, is still far from certain, though the weight of the evidence leans toward the view that Poland's relationship to Germany is closer than its relationship to Russia. There is no doubt that French influence in Poland has diminished; Hitler, in his speeches, continuously singles out Poland as a country with which, next to Japan and Italy, Germany has the most friendly relations; and the fear of Communism in Poland is enhanced by the proximity of Russia.

Can Poland pursue an independent role?

Probably not.

Poland can pursue a policy of aggression only if it has the support or acquiescence of Germany or/and Russia. If she steps on the toes of either, she would immediately be involved in a war with a stronger neighbor and would have to seek the assistance of the other power. By doing so she would inevitably be losing her independence of action.

Poland cannot embark on an eastward expansion without at least the tolerance of Germany. (It was rumored that when Poland concentrated troops on the Lithuanian border the number of German troops near Memel was immediately increased.) Germany's tolerance is needed because Russia's policy at this time is the preservation of the status quo. An expansion southward, i.e., in Czechoslovakia, would be impossible without Germany's prior approval.

Poland is inevitably faced with a choice between Germany and Russia. If it sides with Germany and Germany loses, the existing regime would be doomed. If it sides with Russia and Russia loses, the existing regime would likewise be doomed. If it sides with Russia and Russia wins, the danger of Communism would be very great. On the other hand, if it sides with Germany and Germany wins, there would be an immediate threat to the survival of an independent Poland. Its choice is, therefore, extraordinarily difficult. Poland is not sufficiently powerful to keep the peace between its two great neighbors, and it must inevitably be involved in any conflict between them.

Its decision, therefore, will be dictated, first and foremost, by the alignment of forces upon each side.

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