

Compensatory Fiscal Policy

I

The competitive capitalist system under democratic political forms has come upon evil days.

In spite of increased aggregate production and much larger potential production, we have acute unemployment, acute shortages of material goods for many persons; and, more important, we lack a feeling of security upon which the building of a good life depends.

II

The magnitude of surface symptoms suggests that the causes of our difficulties must be fundamental. Measures to be constructive must be correspondingly fundamental.

III

Among several important causes, one clearly seems to be that the relation between purchasing power and production has been incompletely understood, and, accordingly, the role of the national state in relation to purchasing power and production has been erroneously conceived.

Although this misunderstanding has been general and has existed for a long time, an acute condition has only recently appeared. That it has been so long deferred is due to the fact that until recently governments have been converting national assets (the national domain) into purchasing power. This purchasing power, supplementing that arising directly from production, has mitigated somewhat the deplorable conditions which have existed since the industrial revolution.

IV

The conception of the role of the national state (whether democratic or totalitarian), in relation to purchasing power and

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production, is undergoing profound change. This change is based on two separate but related considerations:

1. The operation of a private, competitive, capitalist system, based in part on private debt (credit) involves necessarily from time to time increases and decreases in aggregate purchasing power with no corresponding increase or decrease in potential production. The consequence is unemployment and distorted price relationships that are morally and politically destructive. Therefore, for these changes in aggregate purchasing power, (arising from the very nature of private enterprise), the national state must compensate in the management of its budget, or otherwise.

2. The effect of the application of science and technology to production is to increase potential production. This increase in potential production does not of itself insure either (a) that there will be corresponding increase of purchasing power, or (b) if there be such increase in purchasing power, that it will be spent on consumption, or invested, in new plant. Unless and until the increase in potential production results in increased purchasing power, and this increased purchasing power spent on consumption or invested in new plant, the result will be unemployment, and partially idle plant. Accordingly, to insure full production, the national state must be prepared to insure the necessary purchasing power through the management of its budget, or otherwise.

In summary, a private, competitive, capitalist system with progressive technological improvement requires on the part of the national state deliberate action of a compensatory character affecting purchasing power.

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V

The necessary compensatory action is most readily taken by the national state through the management of the national budget.

Compensatory management of the national budget requires correlation of policy in handling all national measures affecting money, credit, taxation, and expenditure.

VI

The principle of the compensatory budget requires an important extension of the common concept of the function of taxation.

The compensatory effect of the budget is produced, not by the absolute level of income or expenditure par se, but by the magnitude (and method of obtaining) the net cash deficit or surplus. This deficit or surplus may be altered either by changes in disbursements or by changes in receipts.

It follows therefore that taxation, in providing revenues to the national state, concurrently gives one method of controlling the size of the deficit or surplus. That is to say, taxation provides a mechanism whereby purchasing (and investing) power in private hands can be reduced or increased in amounts and in a manner conforming to general public policy.

It follows similarly that the expenditures and disbursements of the national state, in providing for the common services, concurrently gives another method of controlling the size of the deficit or surplus. That is to say, expenditures and disbursements provide a mechanism whereby purchasing and investing power in private hands can be increased or decreased in amounts and in a manner conforming to general public policy.

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VII

A number of questions of public policy are involved in the administration of a compensatory budget.

1. What should be the absolute level of income and disbursement about which variations take place?
2. What should be the magnitude of the deficit or surplus at any particular time, and what agency should make this determination?
3. Shall the operation be applied to expenditure, or to income, or to both, and to what degree?
4. Shall the direction of increased (or reduced) purchasing power be toward producers, or toward consumers, or toward both, and to what degree? If toward producers, which? If toward consumers, which?

VIII

The importance of the policy questions raised above may be judged by relating the gravity of the present position to the magnitude of current production possibilities.

We can produce annually with reasonably full employment, ninety billion dollars worth of goods and services; we are in fact producing slightly more than sixty. A current deficiency of production and of purchasing power of about thirty billion dollars annually is indicated.

If we allow for expenditure or investment to turn three times a year, in order to raise purchasing power thirty billion dollars, ten billion dollars in the aggregate would need to be added to current levels by public and private enterprise to secure reasonably full employment and production.

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Private enterprise can hardly add more than at the rate of four billion per year this year. Even this figure assumes high activity for housing, utilities, railroads, and industrial investment. This leaves at least six billion dollars per year of production that the federal government has available to work with this year, this being at this time the indicated appropriate deficiency of net (cash) disbursements over income on whatever absolute level.

The adoption of a compensatory budget policy raises certain difficulties and dangers.

1. The problem of timing is a difficult one at best. Existing mechanisms for expenditure and for taxation were not devised with such policy in mind and are clumsy for the purpose.

2. Bottle necks will develop. They will disappear. Foresight will reduce their number and severity.

3. Unless a reasonable degree of competition is maintained, there is likelihood that the great benefits of full production will go to organized groups best able to take toll on increased purchasing power.

4. Strikes and lockouts, reducing production, might defeat the program.

5. Over-emphasis on fiscal policy, particularly in its initial successful phases, might cause neglect of other measures necessary and proper for satisfactory restoration of private employment.

6. Public misunderstanding may result in loss of confidence. The implications of the policy are so foreign to conventional ideas, and to ideals of private prudence, that great resistance of both an intellectual and moral nature will be encountered.

-6-

7. The most serious danger is that of congressional interference with budget planning, of over-appropriating and under-taxing on a purely political basis. We do not have the tradition of an executive budget as in England. We need the item veto provision badly. The proposed Fiscal Advisory Board will be a protection as it develops prestige. The dangers here, though very real, must be faced and risked for the sake of the benefits that may result.

X

Although a number of measures are desirable to secure the benefits which seem attainable, among these measures the adoption and administration of a compensatory budget policy is indispensable. The benefits to be gained are very great. These are:

1. Reasonably full employment, an increase of about 50% in production and therefore in the material standard of life. There would be a marked increase in the consumption of agricultural products.

2. Elimination of wide swings in employment and production would have a marked influence on the stability of employment. No insurance scheme, though necessary, can substitute for security itself.

3. Fuller use of industrial and agricultural overhead will result in a reduction of average costs. The saving will be divided between profit, wages, and lower prices.

4. With reasonably full employment, adequate purchasing power, and near capacity production, many problems now appearing to call for government intervention or control might solve themselves. In other words, the assuming of control by the national state (the authority for which is generally conceded) over monetary and central fiscal policy in this manner would lessen the demand and need for central

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government control in other parts of the economy.

5. An opportunity is provided to direct the first fruits of this increased production into socially useful channels, such as public health, education, old age security, slum clearance, etc.

6. In time it would be possible to restore to employment many young people, many older people, and many women. Not only would their contribution in production be of great importance, but present enforced leisure is demoralizing to individuals and to the community.

7. Reasonably full employment and production would simplify the problem of American attitude toward foreign trade. We are in a position to receive goods and services from abroad on balance for a long time if we can organize to receive them. This, of course, would contribute to friendly international commercial relations.

Boardsley Ruml

September 26, 1938

JR

GRAY

Praha

Dated September 22, 1938

Rec'd 1:10 p.m.

Secretary of State,
Washington.

RUSH.

219, September 22, 2 p.m.

Your numbers 62 and 63, September 15 and 19.

British Legation is informing British inquirers through the several British consulates that the situation is critical and that they should be prepared to leave as soon as possible. This they are doing orally after British subjects have first been summoned to the Consulates "to complete registration records" we cannot follow like method because of having only one Consulate in the country and the large number of Americans scattered over the whole of Czechoslovakia.

The Consulate General has confidentially inquired of the Ministry of Railways as to train facilities for American citizens in case of emergency and has been told that no assurances can be given in such an event that train transportation from Praha to any

border

-2- #469, September 21, 6 p.m., from Berlin.

whether the advocates of diplomatic methods possess a program of action through which such a goal can be reached before the bleeding German victims cry out for other help. Czechs are distributing in the Sudeten area explosives and poison gas, as well as gas masks for their own people. The intention is attributed to the Czechs not only of blowing up the famous health resorts in this region but also of wrecking vengeance on Sudeten inhabitants.

The BOERSEN ZEITUNG attacks the American press for espousing the Czech cause denouncing such tactics as malicious meddling in violation of the Wilsonian concept of self-determination.

WILSON

PEG:HTM

EDA

PLAIN

LONDON

Dated September 22, 1938

Received 4:30 a.m.

Secretary of State

Washington

996, September 22, 7 p.m. (SECTION ONE).

FOR TREASURY FROM BUTTERWORTH.

British security markets were weak today. There is a growing realization in the city of the strength of Germany's diplomatic and military position and of the fact that Hitler's hand has been greatly strengthened since his first meeting with Chamberlain. A sense of dejection and foreboding gained ground today but did not translate itself into market action.

The dollar which opened at 4.82 3/4ths bid has been supported by the British authorities sporadically throughout the day. As soon as the report of the Czech Cabinet's resignation came through it moved to 4.81 1/8th and thereafter has fluctuated around a 1/2. On the whole the volume has not been large. 334 bars were dealt in at gold fixing at 143s. 11d and it is believed that the British authorities had to absorb the lot. Lloyds brokers are pursuing such a cautious policy as regards the size of shipments to be covered by war risk insurance that most arbitrageurs are not interested in shipping. (END SECTION ONE).

KENNEDY

CSB

REB

GRAY

London

Dated September 22, 1938

Rec'd 4:10 p. m.

Secretary of State,
Washington.

996, September 22, 7 p. m. (SECTION TWO)

The franc was under decided pressure today and a Bank of England official states in confidence that his information is that six French Cabinet ministers have tendered their resignations, to take effect upon the termination of the crisis.

(END MESSAGE)

KENNEDY

CSB

PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Paris, France

DATE: September 22, 1938, 5 p.m.

NO.: 1543

FROM COCHRAN.

Statement of the Bank of France as of the fifteenth of September showed note circulation up 5.3 billion francs. Discounts were up 2.4 billion and (?) advances to State up 3 billion, leaving coverage 43.69 versus 45.89.

At five o'clock I had a conversation with my friend in the Bank of France. The Statement of the Bank of France still had had a bad effect on the market today in spite of the fact that its unsatisfactory character had been considerably discounted. Today the pressure on the franc was one-third heavier than it was yesterday, even with spot rate moving from 178.34 to .50. Three months sterling premium moved from 4.25 to 5.50. No new financial plans were being considered, according to my friend. According to reports of private bankers to the Bank of France, the Finance Ministry has asked their advice as to the best way to raise funds. The report that the Czechoslovak Government resigned following the acceptance of the proposals of Great Britain and

France

- 2 -

France and the news of the Czech moratorium, caused a weakening in rentes and other securities. The general uneasiness is increased because of French building and other strikes, as well as criticism by the left political groups of French foreign policy.

I had a letter from Governor Rooth of the Swedish Central Bank at Stockholm, written September 21, which was as follows:

END SECTION ONE.

BULLITT.

EA:LWW

REB

GRAY

Paris

Dated September 22, 1938

Rec'd 2:35 p. m.

Secretary of State,
Washington.

1543, September 22, 5 p. m. (SECTION TWO)

"We have since the end of August got about six million pounds which we have exchanged for dollars. Formerly most of this money has come from abroad. Some of that part, however, no doubt represents coverings of Swedish exporters. The bulk of the sterling amounts now bought is probably foreign flight capital. Part of this capital comes from the neighboring countries mainly Norway and Finland. Another part of it comes through British, Dutch and Swiss banks.

We have at the same time increased our gold holdings but we still hold a very substantial amount in sterling. I am, however, not yet able to share the great optimism of the market just now. The demands from Poland and Hungary to get part of Czechoslovakia as well as the attitude of the German press last night when they claimed not only Sudeten Deutschland at once but also the whole of Bohemia and Moravia have given me the impression that it will probably last some time before it comes to a settlement.

I do

REB

2-#1543, From Paris, Sept. 22, 5p.m.
(Sec. Two)

I do hope that Chamberlain will be able to go to Godesberg tomorrow, but I very much doubt whether he will find the other man willing to agree to a general settlement. It seems to me as if the latter's willingness to play a very hazardous game of poker should be increasing."

BULLITT

CSB

SECTION THREE, TELEGRAM NO. 1543 of September 22 from Paris

At noon today I had a telephone conversation with Jacobsson, the Swedish economist of the Bank for International Settlements at Basel. Jacobsson said about the same thing as Rooth, i.e., he was afraid the Germans might be sufficiently encouraged by their success up to this time to press on to acquire sites of important armament works and iron industries located in Czechoslovakia proper.

This afternoon I was visited by the representative of the Paris branch of the Bank of Italy. My friend told me that he is confident the Germans will not go further than to seek absorption of the Sudetens and freeing the Rumanian and Polish minorities, along the lines which Mussolini suggested. This representative told me that many Italians, while they stood by the position of the Italian Government to date, would be happy to see a general European agreement to stop Germany lest Italy be embarrassed by further moves on the part of Germany.

END MESSAGE.

BULLITT.

September 22, 1938

My dear Mr. President:

Inclosed is a confidential report from Mr. Royall Tyler, who went to Germany at my special request.

Sincerely yours,

(Signed) H. Morgenthau, Jr.

The President,
The White House.

September 22, 1938

My dear Mr. President:

Inclosed is a confidential report from Mr. Royall Tyler, who went to Germany at my special request.

Sincerely yours,

(Signed) H. Morgenthau, Jr.

The President,
The White House.



DEPARTMENT OF STATE
WASHINGTON

September 22, 1938.

My dear Mr. Secretary:

In accordance with your request, I enclose a complete second copy of Mr. Royall Tyler's report. A few minor corrections have been made on this copy.

Sincerely yours,

Herbert Feis

Herbert Feis,
Adviser on International
Economic Affairs.

Enclosure:

Paraphrase, Sections 1,
2, 3, No. 69 of September 21
from Bern.

The Honorable

Henry Morgenthau, Jr.,

Secretary of the Treasury.

PARAPHRASE OF TELEGRAM

From Bern

No. 69, September 21, 9 a.m.

Department's 41, August 30, 6 p.m. For the
Secretary of the Treasury.

I have been handed the following report:

"September 20. I spent in Berlin 5 days, in
Munich 2, Vienna 2, Milan 2. I interviewed diplomats,
military men, professors, bankers, industrialists, and
other persons.

In Germany banking and business circles are under-
going strain of a severe nature on account of preferen-
tial allotment of skilled labor and raw materials for
armaments, also because of the increased costs of
labor and because of uncertainty with regard to the in-
tentions of the Government concerning six months delivery
bills which may not be rediscounted at the Reichsbank
and have been issued since April last to a total amount
of more than three billion marks, to be met, theoretically,
when they mature, either from current budgetary receipts
or from the proceeds of a long term loan. The total
annual budget receipts amount to about 18 billion. There
has not yet been absorbed the last long term issue, and
there was recently required official support in order
to prevent more spectacular declines in the quotations
for state bonds. With regard to the last issue, the
failure

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to absorb it impresses general opinion, as issues which have come out previously were promptly taken up. Business circles are afraid that delivery bills mean a renewed growth of floating debt which has not been disclosed and the failure of the consolidation plans of Schacht, especially as the prolongation of mobilization results in severe additional drains on the treasury. According to current estimates, the indebtedness of the Reich, of which perhaps a half is undisclosed, is more than 50 billion marks.

A portion, but not all, of the local business people hold the hope that this amount is manageable and they even consider that it might become larger without bringing to ruin the prospects of reverting, after a 50% or more devaluation, to exchange freedom subject to the proviso that international appeasement comes about and permits skilled labor and raw materials to go into other channels than the production of armaments. However, few if any deny that the trend at present is downwards. The more hopeful point to the manner in which the achievements of the last five years have astonished the world and declare, for example, that any shortage existing at present will disappear soon due to a new process of extracting a substitute for wool from inedible species of sea fish, of which the supply cannot be exhausted. However, even the most optimistic opinions are dependent

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upon a halt in the race for armaments. I have not met any bankers or businessmen who believe that the German so-called miracle of economics, which has autarchy as its basis, can keep on working indefinitely. It is the hope of everyone to see Germany back in circuit (?) of one of exchange countries before the system under which she now operates has developed too far. There is another source of worry in the close relationship between the level of the public debt and prices with the effect felt with each new demand on the treasury. Even though paper wages have not gone up, it is said by the manufacturers that the real cost to business of labor is, at a rough estimate, 15% greater than several years ago, that this increase is in various ways disguised, and that labor is more poorly off than previously for the cause that the currency's real purchasing power has dropped more than a proportionate amount through deterioration in quality of products. For example, a suit which formerly would have lasted three or four years is now only good for one. According to the manufacturers, their profits on staple products have been reduced to the replacement point or less.

SECTION TWO

Employment at the same time, with hundreds and hundreds of new semi-official and official positions, is high, relatively well paid, and the restaurants in Berlin, full to overflowing, remind one of the inflation years after the war. According to some Germans, small yields on investments and doubts as to the future of the currency render people in general careless of their money and not willing to create savings.

At present the note circulation is around nine billion and has increased almost two billion over a year (ago?), and of that increase Austria accounts for one-half a billion. Since the Nazis came into power the circulation has almost doubled. The optimistic ones say, in explanation, that now currency has production as its basis, and since production since 1932 has increased more than has note circulation the currency of Germany is at present better covered than it was formerly. It is pointed out by the critics that the real purchasing power of the mark is declining. From a good source come stories of two Reichsbank notes having been found with identical series numbers. Also, there are reports of brand new mark notes being continually offered

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offered in London in Reichsbank wrappings in such quantities as to cause people to suspect that the German authorities are exporting them. Such tales as these sap confidence and tend to drive prices up. In Berlin to purchase a meal with tourist marks is about twice as expensive in dollars as the same meal in New York, given restaurants and food of equal quality. This is true as well in a number of beer parlors and small hotels. There is no general shortage of food, but real butter cannot be obtained, the white bread (so-called) is scarce, is just about edible, and it is reported that eggs and milk frequently run short, so that the children are thus not receiving proper nourishment. According to several sources rickets are becoming more and more prevalent. The impression in general is that the situation in Germany is becoming decidedly worse; in spite of the enormous ingenuity and the hard work devoted to keeping it running there are signs of strain in the system. For the future, hope is conditioned upon improvement in the international situation. Believing that the chances in their favor are not sufficiently good, the Army is heavily against war. The young men are very enthusiastically for the system, which provides for them a never stopping boy scout jamboree, but

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but the difficulties which beset business, tax burdens, and the high cost of living are a sobering influence on those who marry or those who have to earn their living outside of employment by the Army, the Party, or the State. The presence of Herr Schacht in the Reichsbank is yet considered to be a guaranty, to a certain extent, of the will to resist follies of an extreme nature along production currency lines, but those who are skeptical note that several times Schacht has sworn to resign if certain things occurred and then has always swallowed them. According to these people except to be shot he will not retire. Speaking generally, the diplomats of foreign countries appear to be more hopeful for the future than do the German people other than those who are officials. Isolation is lamented by numerous Germans. From a German source comes a report that the Hungarian Prime Minister gave the Government of Germany a warning that his country would stay neutral if a war over Czechoslovakia should come.

I have an impression that by far the majority of Germans, even at the height of the crisis, did not believe in war. I found the people courteous as a rule, indeed to an extent contrasting with Americans, they were always ready

to

-4-

to talk, frequently in an outspoken manner. The opinion was heard that should there be war Germany would again be left in the lurch by Italy, and this was contrasted with the Italian conviction that Italy would be drawn in at once because Germany has such a hold over Mussolini. The personal prestige of Hitler is as great as always and there will be a further increase in his prestige if the Sudeten land is annexed, but all the other Nazi leaders are openly criticized, there being statements, for example, that they had to take away the management of Department Funds from Goering and give them to General Keitel. It is feared by some that an attempt to capture control of the Army is being planned by Himmler. There are stories about the removal of Beck, the Chief of the General Staff, who is considered to be a bulwark against interference with the Army by the Nazis. In the civilian world there is no indication of any organized resistance directed against the régime of the Nazis. (End of Section Two)

A sad impression is produced by Vienna. There is a prevailing sense of insecurity and many shops are shut, although open outrages are not occurring. For the Austrians the result of the schilling-mark conversion has been a substantial increase in the cost of living.

The laboring classes of Austria have without doubt been pleased by the enormous effort made by the German Government to take care of the unemployed; on the other hand, the rise in living costs has left some of them no better off than they were before on the dole, but now they are having to work, which is not to the taste of all Austrians. There is dissatisfaction among many Austrian Nazis, out of the sense that preferential treatment has been given the Prussians in the matter of jobs. You would still find in Vienna comic stories, for example, that about Buerckel, who is the present chief of the Nazis in charge of Austria, to the effect that upon visiting Schussenigg, who is now confined in the Hotel Metropole, and offering to Schussenigg a free pass abroad and a substantial amount of dollars on condition that Schussenigg would reveal to him, Buerckel, how he managed to get along with the Austrian Nazis for almost four years. Great efforts are being made by Germany to conciliate the Austrians, for example, in Vienna the white bread is far better than it is in Berlin, and genuine butter is

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obtainable, and food is cheaper.

A good general impression is left by Munich. The display of Aryan signs is infrequent. There is a welcome in the beer houses to Americans, and there is irrepressibly anxious discussion of affairs, indulging in free criticism of the system, but for Hitler, even in Munich, universal respect. There is something impressive in the calm of the people. Great admiration was expressed for Chamberlain at the height of the crisis. Anti-Semitic measures met almost universal disapproval in Germany.

In Milan I found striking deterioration compared with the six months past. Anti-Semitic measures are highly unpopular, and there is astonishing outspokenness on the part of the non-Jewish Italians marked by resentment and humiliation at having to witness events. According to the businessmen of Milan, this is the universal attitude throughout Italy, Jews being regarded as patriotic and good citizens. 17 gold medals of gallantry, the highest Italian military distinction, were won by Jews out of a total number of 40 awards. It is said that Fascist prestige suffered a bigger blow from the anti-Jewish measures than was caused by the Anschluss. The régime is now detested by all classes, including many who live on it, and Mussolini personally is hated. I found a general belief that the purpose of the anti-Jewish measures was to make trouble for England and France

- 3 -

in the Mohammedan countries and that the truckling to Germany under whose control the Italians say they now are, even to the extent of having to renounce South Tyrol and Trieste when called on and condemned to go to war with Germany [sic.]. The raw materials are exhausted in Italy and business is dead. I am informed that the debt of Italy to Germany for metals is now so great that further deliveries to Italy by Germany on credit are refused. There is a stoppage of building and civilian motor construction and even military airplane production and a great slowing down on armaments. Collection is taking place of every available scrap of metal, including garden railings and gates, as also in Germany. There is still plenty of food and it is good, but the prices are beyond most persons, and many workers are being laid off from their employment. Stories of this character are told even to foreigners, and hostile comment on current affairs in public places can be heard. That the whole affair will end up as in Spain is open talk. As for the King, he is regarded as having sold out to Il Duce. There is an expectation that before the end of October the King will sign the repeal of the Italian Constitution, replacing it by a cooperative state and accepting the appointment of the Grand Council of the Fascisti. There is also a rumor that decrees are soon to be published which will abolish private inheritance.

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As a matter of fact, the State is already taking land without compensation from private owners. Some think that the Prince of Piedmont may attempt to get control with army support against the Fascist party, with the knowledge that otherwise he will be discharged and that Aosta will be declared the Crown Prince. The question of succession of the throne is now being decided by the Grand Council of the Fascisti. There is cordial detestation throughout the country of the policy of the German axis. Those newspapers which with bombastic captions are claiming that Mussolini is dictating the solution of the Czech crisis are greeted with contemptuous shoulder shrugs. I heard one passerby observe that Chamberlain could do that but not a Mussolini or a Hitler. A condensation of the general impression received in the land may be conveyed by the reply of a Milan policeman on his beat. I asked him what Mussolini said in Trieste, and he answered "welcome to parole parole" [sic.]. He then asked where I came from, and when I informed him I came from the United States he said "you are lucky, I only wish I could go to America or anywhere else to get out of here".

EA:HF:LWW



DEPARTMENT OF STATE
WASHINGTON

September 23, 1938.

The Secretary of State presents his compliments to the Honorable the Secretary of the Treasury, and encloses one copy of telegram No. 220 of September 22 from Praha.

JR

GRAY

Praha

Dated September 22, 1938

Rec'd 1 p.m.

Secretary of State,
Washington.

220, September 22, 4 p.m.

Trading in securities suspended September 21 until further notice but foreign exchange market continued to function. Skoda debentures in London remained at 48 but the Czech loan and Praha bonds were not quoted. Government decree dated and effective September 21 seriously limits bank deposit withdrawals. On demand accounts as of that date deposits may not exceed 3% per month except ^{that} 600 crowns may be withdrawn on accounts under 20,000 crowns. Enterprises may withdraw 25%. Equally restrictive measures on savings deposits. Old Austro-Hungarian banknotes included in the banknote circulation figure of National Bank are excluded from sight liabilities in order that gold cover might remain above legal minimum of 25%. New legal measure provides higher fines and longer terms of imprisonment for persons smuggling currency and engaging in unauthorized exchange transactions.

Repeat to Commerce.

KLP

CARR

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE: September 22, 1938

TO Secretary Morgenthau

FROM A. Lochhead

Close SEPT. 22, 1938GOLD HELD IN LONDON

\$152,000,000

Insurance arranged for following ships:

<u>Sailing</u>	<u>Steamship</u>	<u>Amount</u>
Sept. 23	Manhattan	\$11,300,000
Sept. 24	Paris	<u>11,000,000</u>
		\$22,300,000

JR A portion of
this telegram must be
closely paraphrased be-
fore being communicated
to anyone. (C)


Berlin (part air)

Dated September 22, 1938

Rec'd 8:50 a.m., 23rd.

Secretary of State,
Washington.

475, September 22, 5 p.m.

14. FOR TREASURY FROM HEATH.

(GRAY) Despite the general apprehension of war the decline of the stock market during the first two weeks of the month was not great and following the announcement of Chamberlain's visit there has been a steady moderate improvement. Any tendency to unload Government bonds during the scare was presumably largely checked by the fear of the sellers being regarded as "unpatriotic". There was, however, an increased liquidation of short term credits under the Standstill Agreement by American, British and Dutch interests. As a result the registered mark rate fell a week ago to some 6.50 to the dollar the lowest on record. It is to be noted that in recent months there has been very little liquidation of the remaining British and Dutch standstill credits these holders preferring to wait for better days rather than sacrifice half the value of their credits. A large part

of

-2-

of the registered marks recently sold to travellers were furnished by the German Government itself through the Gold Discount Bank.

It is also reported that in spite of the severe penalties attaching to such operations, there is a recurrence of the "black market". I have been informed that at one time the rate fell to a figure as low as six percent of the reichsmark's normal value.

When, on the other hand, the war scare was highest, the Reichsbank was persuaded by an American banker to make a payment of \$1,000,000 subject to the usual rate of discount although the payment was not due for ten months. Evidently the Reichsbank had not been ordered to conserve exchange resources in anticipation of the possible outbreak of hostilities. The occurrence is the more remarkable since the transfer consisted of a Jewish emigré's fortune of 35,000,000 marks which he held in the Oeram Electric Light Globe company, and for which he was permitted to transfer the sum of \$4,000,000. It is possible that this unusual concession by the Government was made because the emigré might have brought suits against Oeram export shipments to countries outside of Germany.

There has undoubtedly been a very great strain on Government finance in connection with accelerated

western

-3- #475, September 22, 5 p.m., from Berlin (part air).

western fortifications and armaments and the recent large maneuvers (see my number 13). However, to a considerable extent, these expenditures were compensated for by postponing or curtailing work on other Government projects. The rumors of unusually heavy issuance of "delivery bills" were not supported by the composite statement for August of German banks which purchase most of the Treasury bill issues. The statement shows that the banks acquired only reichmarks 417,000,000 of Treasury bills during August as compared with reichmarks 450 million in June.

Recently the Government has been issuing about reichmarks 500 million monthly of Treasury bills a figure which is more than 40% of monthly tax revenues. Tax revenues for the five months of the fiscal year ending July 31 total reichmarks 6,291 million (March July 1937, 5,320 million reichmarks).

While there were other factors the monetary strain occasioned by the military preparations was undoubtedly largely responsible for the fact that in mid-September only 36% of the fresh credits of the Reichsbank had been repaid as compared with 60% for the first two weeks in August and 80% repayment during first half of September 1937. It is significant also that security

loans

-4- #475, September 22, 5 p.m., from Berlin (part air).

loans advanced slightly, usually at the middle of the month there is a decrease.

The total currency circulation reported September 15 was reichmarks 8,708 million as compared with reichmarks 8,744 million the week before and reichmarks 8,935 million on August 31. Normally during the second week there is a marked decrease of both currency circulation and Reichsbank credits.

There is no indication as to whether the new bond issue will be floated and bankers consulted are of the opinion that sizeable issue cannot be gotten out now without great increase of the usual pressure on banks, concerns and individuals. Rumors are persistent that the banks have not been able to get rid of all the April loan. On the other hand the great issuance and demand for Gold Discount Bank single bills during August would seem to indicate that a new long term offering could be made provided the usual pressure is applied.

Voluntary saving apparently continues at about the same rate. The net increase in savings accounts in August was 107 million reichmarks as compared with 108 million in August 1937. The figure of 17 billion reichmarks total savings deposits attained at the end

of

-5- #475, September 22, 5 p.m., from Berlin (part air).

of August 1938 was 1.9 billion higher than that of August 1937. This rate of such savings is, however, still below that of 1928 when savings accounts registered a net increase of 2.36 billion.

At the end of July the total disclosed debt of the Government was 22,936 million an increase of 491 million reichmarks over June 30 and 6 billion reichmarks over July 31, 1937. The increase is mainly accounted for in short term debt which augmented by 486 million reichmarks during the month. The foreign debt was carried by 1,304 million reichmarks as compared with 1,390 million reichmarks at the end of July 1937. It is to be remembered, however, that there has been an offset to the recent increase in the disclosed debt through the retirement of an unknown amount of the special bills forming the "undisclosed debt". Thus in June when German banks showed an increase of 450 million reichmarks in Treasury bill holdings there was a nearly corresponding decrease of ordinary bill holdings (Wachsel) of 400 million reichmarks. The "special bills" are included in the bank statements with ordinary bills. There was no decrease in ordinary bill holdings shown for July and August, in fact there was a slight increase.

On

-6- #475, September 22, 5 p.m., from Berlin (part air).

On the other hand the banks acquired large amounts of Gold Discount Bank single bills (in August 400 million reichmarks) without showing a corresponding increase in their bill holdings, therefore it would seem that some retirement of special bills must also have occurred during July and August.

WILSON

KLP

PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Berlin, Germany

DATE: September 22, 1938, 2 p.m. (By part air;
received 6:30 a.m., Sept. 23.)

NO.: 473

FOR TREASURY FROM HEATH. No. 13.

I had a conversation with Schacht yesterday. He denied the rumors that because of financial stringency the Government would have to abandon its new policy of ceasing to issue inflationary special bills, and that from now on Government expenditures would be met from invested revenues, loans and public issues of Treasury bills, or that it would secure further extension of non-renewable "delivery bills" for discount.

There was tacit admission by Schacht of the present strain on Government finances. He stated that there was nothing wrong with the "delivery bills" except that they had issued too many, and that the Government would simply have to cut down on expenditures. Schacht also said that possibly another president for the Reichsbank could resort to inflationary methods, but that in view of his record he could not do so; he would give up his position at once. However, Schacht admitted that there had been an unavoidable measure of inflation through his program of "putting Germany to work" through credit creation, but he asserted that this had not gone so

far

- 2 -

far as to be dangerous.

The projects of the Government, he admitted, call on the German people for increased savings. He said that the German Government would force increased rigorousness if they found that voluntary savings were not sufficient.

Schacht expressed the hope that real peace would follow the present Hitler-Chamberlain negotiations, which would permit reaching an understanding on international economic and monetary affairs. Should there be peace in Europe, he said that France, England and the United States would conclude a durable monetary agreement with gold as a basis. Germany would join such an agreement the minute that was done, he said, and they would be ready to make a readjustment of the mark's gold value. He asserted that the United States would have to accept lower interest rates on its foreign indebtedness as a necessary factor in the success of such an arrangement.

Schacht declared that his country was in a position where over night he could put exchange restrictions on payments for commodities. However, it would be necessary for some time to come to keep the restrictions on capital inactivity. Of course, after a monetary settlement there would have to be a trade understanding which would enable a departure from bilateralism, he said. Schacht was in thorough agreement with the views of Secretary Hull on

- 3 -

on international trade; however, Germany dissolved trade with our country on American terms until there had been readjustment of the debt interest burden, and a postponement and extension of amortization. The exchange for payment of the contractual interest on Germany's long term dollar debts he insisted was not at Germany's command. Schacht did not ~~mention~~ ^{discuss} the failure of Germany to keep up payments on the Austrian dollar obligations, but he did say that a debt had never been repudiated by his Government, and that on this matter it would be possible to come to some agreement after peace was assured. At the present time he asserted that they did not have available any extra funds for resuming interest payments on the Austrian indebtedness.

While talking about trade, Schacht mentioned the numerous treaties of Germany of the 1890's as models, since customs tariffs were fixed for a period of twelve years under these treaties.

Schacht asserted that he was in favor of giving full publicity to the budgetary and debt situation of Germany, and that he had stated so in his speech last spring. He added that the debt situation of Germany is bad, but that it is not nearly as bad as people abroad say it is.

Schacht

- 4 -

Schacht told me that he had quit his position as Minister of Economics because he did not want to accept the responsibility for measures taken without full authority; he expected to continue as president of the Reichsbank, and believed that he might eventually be given additional responsibilities, since it was worth something after all to have experience.

Throughout the conversation Schacht spoke with his usual confidence and decision about the monetary and financial plans of Germany. However, it is to be remembered that he is not in authority any more, although his counsel is sought. The Minister of Economics, Goering, has the real control of Germany's financial and commercial policy.

WILSON.

RECEIVED

JUN 27 1950

AMERICAN LEGATION
BERLIN

EA:LWW

Friday
September 23, 1938
8:50 a.m.

H.M.Jr: Hello.

Operator: Dr. Feis.

H.M.Jr: Yes.

O: Go ahead, please.

H.M.Jr: Herbert -

Herbert
Feis: Yes, sir.

H.M.Jr: Good morning.

F: Good morning.

H.M.Jr: Archie Lochhead is sitting here with me, see?

F: Yes.

H.M.Jr: And we're getting awfully fed up on these cables coming up from Pierson on Brazil - talking about stuff which he doesn't seem to know anything about -

F: Yes.

H.M.Jr: And it's perfectly assinine!

F: Yes.

H.M.Jr: Now Archie tells me that a couple of weeks ago we sent word down through the Federal Reserve to the Bank of Brazil on this very thing and we've been waiting to hear from them. Now, Pierson just doesn't seem to know about this arrangement we made a year or two ago, you see? And we've - both Archie Lochhead and I are very much disturbed because he seems to be - just gumming up the works.

F: He does know about - or he should.

H.M.Jr: Well, now this -

F: I know the fellow -

H.M.Jr: This is the suggestion that we have -

- 2 -

F: Right.

H.M.Jr: Archie knows all about this.

F: Right.

H.M.Jr: My suggestion is that we tell the Brazillian people here that of course we're interested and that we suggest that they send up on an aeroplane a representative of the Brazillian Treasury, - and then we'll talk to them here.

F: Ah - sure - sure, - ah -

H.M.Jr: I mean I'm just -

F: As for working out the form of it, you see? - Just what to say to them and whether to say it to them here or down there - I imagine down there is the place to say it.

H.M.Jr: No, well I don't think so, because - if you don't mind my saying that - I think they've been very stupid about it down there.

F: Well, I don't think that's - I don't think that's the Brazillian Government.

H.M.Jr: I don't think it is either.

F: No.

H.M.Jr: I think it's our people.

F: Well - yes, exactly.

H.M.Jr: So that's why I think we could - ought to handle it up here. I mean -

F: Ah - the Ambassador isn't here, is he? Is Brandao here?

H.M.Jr: Who?

F: Brandao, the Ambassador?

H.M.Jr: I don't - I don't know. No, my thought was if you fixed up some cable with Lochhead and sent word down reviewing the situation and saying that if they want to complete this suggestion of theirs we'd be very glad to have - ah - them send up a

representative of their Treasury with -

F: O. K. Could Archie come over, say at ten o'clock?

H.M.Jr: Sure.

F: Bringing along the record of your original arrangements with them?

H.M.Jr: Sure. But the way - that's just what I want - I mean -

F: Then we'll work it out and submit it to you.

H.M.Jr: I know how anxious you people are, and we're just as anxious and I think it - I can't understand Pierson; he's doing the same thing in Uruguay.

F: He is so eager -

H.M.Jr: Yeah.

F: - to develop that shop of his -

H.M.Jr: Yes.

F: And everything else goes by.

H.M.Jr: Well, and in doing that he's gumming the works.

F: Well - ah - if Archie'll come over at ten -

H.M.Jr: He will.

F: We'll work out a message -

H.M.Jr: Yes.

F: And I'll talk with Larry Dunnigan about this question of whether to do it up here or down there.

H.M.Jr: Well, my -

F: And have something ready to submit to you.

H.M.Jr: Right. Well now, my feeling is unless you people have some good - they've tried to do it down there and they - they've just got it all mixed up. Therefore I'm suggesting that we do it here.

- 4 -

F: I understand. Right.

H.M.Jr: Hello.

F: I'll have a report -

H.M.Jr: And Archie'll be over there at ten o'clock.

F: Right.

H.M.Jr: And all I felt was that if the Brazillians or the Uruguay people would send a Treasury representative to Washington - ah - we could explain it to them very quickly and - ah - if there's anything to be done we could do it.

F: Right. Now, our man may be suggesting something beyond what falls into the limits of your other arrangements.

H.M.Jr: Well, what Archie wants^{to} explain to you - that either Pierson does or doesn't know and he'll call up Wayne Taylor before he comes over to see you. Ah - what - ah - we've got all of the machinery there if Brazil wants to use it.

F: For doing everything that Pierson has in mind?

H.M.Jr: Yes.

F: All right. Let's get that down.

H.W.Jr: See?

F: All right.

H.M.Jr: And - and of course -/ and we've - and all that stuff went out two weeks ago.

F: I know and I remember the cable.

H.M.Jr: All right, Herbert.

F: Right, sir.

H.M.Jr: Thank you.

Friday
September 23, 1938
8:58 a.m.

Admiral
Leahy:

Admiral Leahy speaking.

H.M.Jr:

Good morning. Well, I guess the Nashville got off without any trouble.

L:

Ah - we saw in the paper that she sailed yesterday. I have no report of her departure - she should have reported; we haven't got it yet, but I have no doubt that she has sailed from - from Portsmouth and she's on her way.

H.M.Jr:

Well, following out your suggestion - I wanted to sort of put the Navy on notice that Monday I may ask for another cruiser or some - sort of a - something anyway to take the place the Honolulu.

L:

Uh huh. Well, I tell you -

H.M.Jr:

Because -

L:

- Mr. Secretary, I'd like to - well, it will require about ten days for the ship to get over there - it may take a day more than that.

H.M.Jr:

Well, couldn't you get them to get her ready?

L:

Yes, we've already told her to be ready to sail on notice.

H.M.Jr:

Yes.

L:

But it's - the way - the speed they make it's about - well, I'd say eight days to get over there.

H.M.Jr:

Well, could you get a clearance from the - ah - White House - to ah - ah - have her go as soon as possible?

L:

Well, I don't think we need to get a clearance from the White House, Mr. Secretary, but we do have to get permission from the State Department for the ship to go there but that will not be difficult.

H.M.Jr:

Right.

- 2 -

- L: Do you want me to send her now - to start right away?
- H.M.Jr: I think so because the worst that can happen is that - ah - I take it you want the Honolulu to come back anyway.
- L: Well, I don't care very much about when the Honolulu comes back -
- H.M.Jr: Well, the way I feel is this, Admiral, the situation looks very much worse.
- L: Oh huh.
- H.M.Jr: It's anybody's guess -
- L: Yes.
- H.M.Jr: And we have so much at stake that - ah - unless it's - ah - you tell me it's difficult for you to handle it I would appreciate it if you would send another cruiser out there.
- L: Well, would it be worth my time to send a cruiser and a big destroyer so we'd have two ships there?
- H.M.Jr: Well, that's that much better.
- L: Well, I'll do it. I'll send - I'll give them orders now and they ought to be there in the course of ten or eleven days from now.
- H.M.Jr: Well, if it takes that long I think I'd do it.
- L: All right, sir.
- H.M.Jr: And if everything is peaceful in Europe in ten days I'll be delighted to have you give me the laugh.
- L: Well, I won't give you the laugh but whenever you make up your mind, Mr. Secretary, that you don't need them any more, if you'll let me know I can stop it before it gets there you see.
- H.M.Jr: All right. Well, I'm saying today with the situation as it is I think it's serious enough and I'm going to ask you to send additional ships over there.

- 3 -

L: All right, sir. I'll send a cruiser and a big destroyer -

H.M.Jr: All right.

L: And either one will be able to take one of those shipments.

H.M.Jr: Fine. And I hope that you'll be able to give me the laugh.

L: Well, that's fine. I - that would be a pleasure; I've never been able to do it yet, Mr. Secretary.

H.M.Jr: Well, I hope so.

L: (Laughs)

H.M.Jr: Thank you so much.

L: All right, sir. We'll get it right away and it'll be there ready for-you in the course of ten or eleven days.

H.M.Jr: Thank you so much.

L: You're welcome, sir.

H.M.Jr: All right.

L: Goodbye.

CONFIDENTIAL

GC
JM

212A

0-2/2657-11-90

WAR DEPARTMENT
WAR DEPARTMENT GENERAL STAFF
MILITARY INTELLIGENCE DIVISION, G-2
WASHINGTON, D. C.

September 23, 1938.

MEMORANDUM NO. 19 FOR THE CHIEF OF STAFF:

Subject: The present European situation to
10:00 A.M., September 23, 1938.

General Situation. The immediate European situation has entered another extremely critical stage. As this is being written, the negotiations at Godesberg have been interrupted by the expedition of a letter to Hitler in which presumably Chamberlain has asked for guarantees that Germany will not enter Czechoslovakian territory while negotiations are still in progress. This seems to have created a postponement in the conversations and consternation in the German camp. Hitler's subordinates are reported by the press as saying that such a guarantee cannot be given in the present situation.

Meanwhile, conditions everywhere are greatly confused. The official Polish and Hungarian demands for a treatment of their minorities similar to that of the Sudetens have been coldly received, if not refused at this time, by the British Government. In Poland great anti-Czech demonstrations are being staged demanding the return of Teschen. These demonstrations are not believed to be entirely spontaneous. It is not unlikely that the populace is being officially diverted from unwholesome internal affairs to an external national cause. No recent information has been received of Hungarian activities in respect to the minority claims. A responsible Hungarian official in Washington has said that if the present Hungarian Government does not soon recover the territories lost to Czechoslovakia, a Nazi Government will.

An unconfirmed press report from Moscow states that Soviet Russia has issued a warning to Poland that if the latter enters Czechoslovakia, Russia will cancel the Polish-Soviet non-aggression pact.

During the last 24 hours the tension in Czechoslovakia has not abated. Amid tremendous demonstrations of patriotic

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enthusiasm Premier Hodza's "capitulation government" resigned yesterday morning. A new government of "national concentration and defense" has been formed in Czechoslovakia. General Syrový, Inspector General of the Army, becomes Premier and Minister of National Defense. Another General, Frantisek Nosal, Chief of Transportation and Supply in the War Ministry, is Minister of Public Works. (The report of yesterday that General Syrový was to be Minister of the Interior proved to be erroneous.) The press continues to report minor clashes between Sudeten Germans and Czech police along the border.

Military Situation.

Great Britain - Plans for air raid precautions were accelerated. These include opening of 14 stations for fitting gas masks in London and definite plans for the evacuation of sick in hospitals.

France - No change reported.

Italy - No change reported.

Germany - An Embassy cable dated September 22, 4:00 P.M. states in effect:

The War Office informed the Military Attache that no Freil Corps have crossed the frontier except possibly some individuals. Army movements presumably will await Hitler's orders depending upon results of Godesberg negotiations. At present Army units are held at least ten kilometers from the Czech border. Some desultory firing between Czech and German police but not between military units.

The Embassy also reports in effect as of 7:00 P.M., September 22, as follows:

That British and American Consular Officials in Munich report having observed movements of troops in that vicinity and that orders had been issued to march this P.M. The Military Attache however doubts if any definite orders have been issued.

Czechoslovakia - No known change. It is the opinion of a local Czech official, with military experience, that the Czech troops have not withdrawn from the fortified lines along the frontier.

Poland - The Military Attache in Warsaw reports as of 3:46 P.M., September 22:

2806

CONFIDENTIAL

Aggressive action in connection with the minority problem is being prepared by Poland. Have confirmed troop movements in unknown numbers to Katowice and Cieszyn.

CONFIDENTIAL

FEDERAL RESERVE BANK
OF NEW YORK

OFFICE CORRESPONDENCE

CONFIDENTIAL FILES

DATE September 23, 1938.

SUBJECT: TELEPHONE CONVERSATION WITH
DE NEDERLANDSCHE BANK.

FROM: L. W. Knoke

Mr. de Jongh called at 10:30 and stated that he planned to make another gold shipment of \$10,000,000 on the steamship Noordam scheduled to leave Rotterdam on Wednesday, September 23. He wanted to find out whether it would be possible for us to insure this gold for his account in our market.

I replied that I was hopeful that something could be done here although our market was thin and that for limited amounts, at least, insurance including war risk was being placed here at 17¢. I told him I would get busy and cable him tonight what, if anything, I had been able to do. He left the firm order with me for \$10,000,000 at a premium not exceeding 17 1/2¢.

I warned him that in all his shipments he should be sure to send us bars .995 fine or better, or in case of coin bars, bars whose fineness ranged from .899 to .917. If he sent other bars I pointed out that extra charges would be incurred as set forth in the Mint's tariff of which we had sent him a copy before.

He had sold \$3,500,000^{today} and he was going to ask us to release gold. The tension in Europe was great; everybody was awaiting the results of the meeting at Godesberg. On the whole things looked pretty serious.

LWK:KW

PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Paris, France

DATE: September 23, 1938, noon

NO.: 1551

FROM COCHRAN.

This morning at half-past eleven I visited at the Bank of France. The French stabilization fund had lost 720,000 pounds spot at from 178.53 to 178.55 by that hour; also, with three months sterling premium at six francs, it had lost 100,000 pounds forward. The growing pressure on the franc has been increased by a number of factors - the tense international situation, rumors that there is dissension in the French Cabinet, increased criticism by Frenchmen of the French foreign policy, and the revelations in the statement just released by the Bank of France.

At the Bank of France my friend does not know of any plans for new French financing, other than to pursue the present course. He realizes, however, that unless conditions improve, it will be futile to follow this indefinitely. As yet there are no figures available from London, but there sterling was also under pressure, especially when it was reported on the ticker that Chamberlain had not kept his appointment this morning with Hitler, and that there had been more Sudetens killed.

~~END SECTIONS ONE AND TWO.~~

BULLITT.

FEDERAL RESERVE BANK
OF NEW YORK

OFFICE CORRESPONDENCE

DATE September 25, 1938.CONFIDENTIAL FILESSUBJECT: TELEPHONE CONVERSATION WITH
BANK OF ENGLAND.L. W. Knoke

I called Bolton at 12:55. Things weren't so good, he said; today's course of events, as far as he could make out, had been about as follows: the conversations between the Prime Minister and Hitler had not commenced as was originally planned and instead a letter had been sent by Chamberlain to Hitler; it was believed that a reply had been received by Chamberlain but the conversation had not been taken up anew. Rumors were flying thick in Europe to the effect that the German demands had been greatly increased, that their minimum demands now included the evacuation of all minority territory in Czechoslovakia by midnight tonight and the demobilization of the Czech army under the supervision of a German military commission sitting in Prague. Another affair which was causing a lot of consternation in Europe was the Russian ultimatum to Poland. Meanwhile it was reported from various European sources that the Czechs were now determined to fight, that the Sudeten Frei Corps with the German SS and SA men had invaded the Sudetenland and were being resisted by the Czechs. Chamberlain might return tonight and if he did a state of emergency might be declared in England tomorrow. If Chamberlain did return one might take it for granted that it was due to the news not being good.

With all these rumors and counter-rumors there inevitably had prevailed a great state of alarm in all markets. He had supported sterling all day and had so far sold \$24,000,000 plus fairly big lines

FEDERAL RESERVE BANK
OF NEW YORK

OFFICE CORRESPONDENCE

DATE September 23, 1958.

CONFIDENTIAL FILES

SUBJECT: TELEPHONE CONVERSATION WITH
BANK OF ENGLAND.

L. W. Knobe

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of gold to the Dutch, Swedes, and others. His total losses for the day he figured at between £7,000,000 or £8,000,000 but he wasn't through yet. I told Bolton that the market here was also under pressure but that we had so far bought only about £25,000 at 4.79 13/16. We had been hesitant, I added, to go in on a larger scale because we didn't know whether it was his intention to leave today's gold prices to us unchanged. Bolton replied that he didn't want to encourage speculative purchases ^{of gold} and that, therefore, he had gradually raised his selling price for gold to 144s 9d from today's fixing of 144s 6d. The gold price, however, was no longer a good guide and it was practically impossible to give the market any relief by selling. He was planning to send us a range of sterling rates today of about 4.79 1/2 to 4.81 and would be very grateful if we would deal here either against his sterling order or his gold price. I told him that he could rest assured that we would do that.

I stated that according to an evening paper last night the Nashville had sailed from Portsmouth for home waters but that no reference had been made to gold. In reply to my question whether he had found it necessary to substitute packed gold for our earmarked gold, he stated that they had managed in the course of one night to pack all of our gold that was needed to complete the shipment on the Nashville. I hoped, I stated, that he would not

FEDERAL RESERVE BANK
OF NEW YORK

OFFICE CORRESPONDENCE

DATE: September 25, 1936.

CONFIDENTIAL FILES

SUBJECT: TELEPHONE CONVERSATION WITH
BANK OF ENGLAND.

FROM: L. W. Knoke

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hesitate to bill us for any extra labor made necessary by shortness of time. Bolton didn't think they would want to make a charge but nevertheless he would pass my comments on to the directors who had to make the decision.

I then asked him to get started with the packing of another \$25,000,000 of our gold and explained that the Treasury was considering making a second shipment on the Honolulu although nothing had as yet been definitely decided upon. My request was therefore made simply in order to be ready in case something should develop. Bolton asked how much time we would give him. I replied that all I knew was that the Honolulu would not sail until another boat had arrived, which I thought was surely a question of 3, 4 or 5 days. I suggested that when packing the second lot of \$25,000,000 he be sure that he wouldn't send us fine bars of a fineness below .998 or, if coin bars, of ~~not~~ less than .899 and ~~not~~ more than .917.

LWK:KW

JR

PLAIN

London

Dated September 23, 1938

Rec'd 2:35 p.m.

Secretary of State,
Washington.

1007, September 23, 6 p.m.

FOR TREASURY FROM BUTTERWORTH.

The state of mind of the British Treasury this afternoon was indescribably low. They offered to get in touch with me should events cause them to take any emergency steps. SEE my 922, September 14, 5 p.m.

The City was nervous and gloomy but again its state of mind was not fully reflected in market operations.

The dollar which opened at 4.81-1/4 bid was supported by the British control sporadically but broke the 4.80 level. In the circumstances the volume of trading was not large. The pressure on the franc was heavy and although the rate was held firmly the three months forward rate moved out to 6-1/4 discount with the French authorities apparently taking no steps to hold it in.

The

-2- #1007, September 23, 6 p.m., from London.

The average Treasury bill rate for today's issue was 19S 7D this compares with 18S 10 3/4D last week. The full STLG 40 million offered were allotted the total applications being STLG 58 million.

KENNEDY

KLP

EG

GRAY

Praha

Dated September 23, 1938

Rec'd 4:42 p.m.

Secretary of State,
Washington.

227, September 23, 7 p.m.

Drafts on foreign currency continued to be drawn but the supply of foreign exchange has been completely exhausted. Instructions of the National Bank require all rail tickets for international travel issued by tourist bureaus or railway office to be paid for in foreign exchange. No statement has been issued as to the exact gold cover percentage obtaining currently but it is rumored in well informed financial circles that Czechoslovak bank notes of hundred crown denomination may be excluded from the gold provisions. This type of manipulation is regarded with concern by the banking community.

It is reported from the linen textile center in the Sudetic area that a sharp and large increase in shipments of linen for export markets, primarily the United States, has taken place during the past two weeks. This is interpreted as a move on the part of producers in those

areas

-2- #227, September 23, 7 p.m. from Praha

areas to reduce the factory stocks of linen before any political change in that area is consummated. I understand that the bulk of these shipments are going to New York but are not shipped against actual orders. It is likely that they will be held as bonded goods for future sale in the United States.

We have also been informed by important forwarding agents in Praha that inquiries and requests for transport services received from firms in the Sudeten areas have been very heavy. Apparently the inquiring firms including factories, industries, stores, et cetera are doing everything possible to have their physical assets removed from the Sudeten area as soon as possible. We have been informed that the available transport facilities in the hands of forwarders are not sufficient to meet the demands from that area.

CARR

EMB:ROW

PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Paris, France

DATE: September 23, 1938, 6 p.m.

NO.: 1558

FROM COCHRAN.

At a quarter of six I had a talk with the Bank of France.

This afternoon there was somewhat of a lessening of the pressure which I described in my telegram No. 1551 of noon today. This was especially so after it was reported that at twenty-five minutes past three Hitler sent an answer to the letter which Chamberlain had sent him this morning. Therefore, the French stabilization fund on the whole had a better day today than it had yesterday. There is weakness in French rentes and shares.

The British equalization fund had lost the equivalent of twenty-five million dollars by five o'clock. This amount does not include gold bars offered by the fund. Flight from sterling has therefore begun again.

BULLITT.

EA:LWW

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE September 23, 1938

TO Mr. Oliphant
FROM Mr. Manning

Annexed is a copy of a memorandum which was given to Head by Admiral Peoples in connection with industrial mobilization. Head informs me that this memorandum was prepared by representatives of the Navy Department as being the ideas of the Army-Navy-Procurement group. The Admiral told Head that he intended adopting this as his idea and was going to send it forward to the Attorney General as his report. The Admiral has been out of town and no further action which has been taken has come to our attention.

J. Kelley

Attachment

FOREWORD

Shortness of time has prevented a comprehensive analysis of this very important subject, and has confined the scope of this approach to the immediate field of price control itself - without perhaps giving proper weight to the numerous other cross sections of our National economy from which the immediate field of price control should not and can not be divorced.

The following suggested approach to this problem is not submitted as the only means of reaching a solution thereof. It is hoped that it will serve as a springboard from which to leap.

A. The Objective: The directive received from Admiral Peoples defines the objective. Stated briefly, it is the drafting of a plan of price control, for peacetime application, which will prevent skyrocketing of prices.

The necessity for drafting such a plan immediately arises by reason of the present critical European situation. Should war break out in Europe, European belligerents would undoubtedly endeavor to obtain in large quantities a great variety of products from this country. These products would comprise not only items required directly and indirectly for war purposes, but also a great many that they normally produce themselves but which they would cease to produce because of the diversion of normal producing capacity to the manufacture of munitions indispensable to their war efforts. Such a situation developed rapidly during the

period, 1914 to 1916. The resulting expansion of our foreign market caused violent increases in demand for our products, resulted in a skyrocketing of prices, and a disruption of not only our price structure, but of our entire national economy. The international situation now may prove to be identical to that of the summer of 1914.

The orders of European belligerents, as well as of those who normally are supplied by those belligerents, may again flood this country to such an extent as to exceed our present normal capacity to produce. In any such eventuality we must be prepared to avert a disruption of our national price structure, with its inevitable ill effects upon our whole national economy. The plan below is an attempt to suggest a means to this end.

B. Postulates

1. In the event of immediate war in Europe, this country will assume a status of neutrality.
2. Any system of price control which may now be installed must be of such a character to be sufficiently flexible for immediate and smooth conversion to wartime application.
3. Any system of price control imposed must be such as to merit the wholehearted cooperation of industry, labor, and the public.

C. Principles

1. When inventories and capacity to produce exceed demand, a system of minimum price control is applicable, i.e., a figure below which the price of a given commodity is not permitted to fall. The application of this principle is suited to periods of depression. Outstanding examples

of it are embodied in the functioning of the H.A.A. and of the administration of the present agricultural surpluses. This principle is not applicable to the present problem, as it pertains to the control of skyrocketing of prices with its attendant disruption of the national economy.

2. When demand exceeds inventories and capacity to produce, price control of another nature is required. Under these conditions one of at least two means of control are available. First, for a given commodity, a definite fixed price must be set, or second, a maximum price must be established above which the price of that commodity would not be permitted to climb. This is the objective with which the present problem is concerned.

(a) The second of the alternatives just cited, namely, the maximum price beyond which the price of a given commodity would not be permitted to rise, is to be preferred for the following reasons:

(1) A definite fixed price is in effect a minimum as well as a maximum price and, as shown above, the minimum price principle is not applicable to the problem before us.

(2) Fixation of definite fixed prices presumes a fineness of perfection of administration not practically attainable.

(3) The establishment of workable fixed prices would require an army of administrative accountants, which in turn would make the method too unwieldy for prompt and effective administration.

(4) Lack of flexibility in price range below an upper limit would favor the low-cost, large-scale producer, and would tend to prevent the full cooperation of the small and marginal producers.

(5) Any tendency toward discouraging the small-volume producer would make the Government's position in peacetime extremely vulnerable to attack by unsympathetic elements - which in turn would tend to impair the effectiveness of the means of attaining the prescribed objective.

On the other hand, a system of maximum price controls:

(1) allows the forces of supply and demand to function elastically below upper limits.

(2) provides elastic means of control with upper limits established through trial and error, bringing in all production considered desirable and consistent with the prescribed objective, i.e., the prevention of sky-rocketing of prices.

(3) was tried and found effective during the World War.

D. Scope of Application:

The volume of work necessary and the staff required to extend price control to all materials and commodities make such a plan impracticable of application. For this reason alone price control should be restricted as much as possible. It is likely that control of the prices of basic materials and commodities at source of production will suffice. In any case, unnecessary control must be avoided.

It is believed that peacetime price control, at least initially, should be further restricted to items involved in foreign trade. If sufficient control can be exercised by our Government over the volume and distribution to American producers of foreign orders, it may be practicable to permit an upward price differential for foreign orders over and

above that prescribed for domestic consumption. With properly vested authority, this may even comprise a strong weapon for keeping prices in proper bounds. In any case, however, large volumes of foreign orders would make mandatory the imposition of price control over the items involved. Large foreign demand for these items would create domestic scarcity, and if uncontrolled, prices would rise rapidly.

It may be necessary soon to extend price control to items other than those involved in foreign trade. The effect of large volume foreign business would soon be reflected in increased public purchasing power, which of itself would create additional demand and hence tend to raise the general level of prices.

Incidentally, it must be borne in mind that the existing neutrality legislation limits the scope of products that may be exported to nations at war or to nations declared by the President to be belligerents. A further limiting factor is the prohibition against credit or loans which may be granted domestically to finance sales to nations now in debt to the United States.

The extent to which foreign orders should be encouraged by price differentials or otherwise is debatable. Rapid productive expansion beyond domestic peacetime needs would be desirable if we were drawn into the conflict; World War experience has proved that it would have disastrous repercussions if we were not.

As has already been indicated, one of the sources of foreign orders may be expected to be those for whom belligerents or potential belligerents have acted as suppliers, but whose productive capacity is now or may be preempted for war production.

Expansion of our own productive capacity over and above our normal peacetime ability to consume should be gauged to a considerable degree by our probable ability to hold a substantial amount of this newly acquired foreign trade with neutrals.

Some measure of aggressive action might even be desirable as a means of utilizing present idle capacity and of furnishing useful work for the present millions of our unemployed.

It must be borne in mind, however, that the peace time mission of price control is the maintenance of stable domestic prices and that only in war time or when war is imminent does the paramount consideration become one of bringing into production the last indispensable unit required for the war effort and for essential civilian consumption. Until it is evident that we will ourselves become a belligerent, and subject to the above reference to increased foreign trade possibilities, production to meet maximum peace time requirements should be the happy medium for which to strive in the system of price control adopted.

E. Type of Controls

Price control should be constructed primarily upon the principle of voluntary cooperation of all concerned. Arbitrary measures of duress normally are distasteful to American standards. In view of the limited direct means of enforcement at present available, control of a voluntary cooperative nature is mandatory in peacetime. In wartime, such cooperation is indispensable for the maintenance of public support of the war effort, without which maximum prosecution thereof cannot be attained.

F. Means of Controls

1. Agricultural Products: Governmental agencies now in being are, in effect, at the present time

~~indefiniteness~~ controlling the prices of a number of agricultural products. This control is of the minimum price type, since supply of these products considerably exceeds the demand for them. War abroad undoubtedly would create a market for the present surpluses, would likely eliminate these surpluses, and render unnecessary the type of control now exercised. The Government thereupon would be relieved of the necessity of acting in its present capacity as a corporation to buy and sell these products, but might continue to utilize its existing machinery to set upper limits of agricultural prices as the emphasis is shifted from minimum to maximum price control.

2. Industrial Controls Control of the prices of industrial output, both extractive and manufacturing, is quite another matter. It is believed that the normal means of doing business should here also be adhered to as closely as possible. The setting up of a governmental corporation to buy industrial products from the producer and to sell them to a foreign buyer, however, is not recommended. Such a departure from the normal means of conducting international trade appears entirely unnecessary and, in all likelihood, would entail most undesirable repercussions. It would set up an expensive temporary bureaucracy difficult subsequently to eliminate, and its administration might involve us politically from an international standpoint.

Here again it is believed desirable to utilize for price control purposes the framework which is now actually in existence, suggested as may be found necessary - such suggestions being made in a manner to fit into the projected wartime organization for the mobilization of American Industry.

Here also must be considered the fact that at present, compulsory means of enforcement are now largely non-existent, and that voluntary cooperation of industry must be relied upon.

The following means of price control in peacetime is therefore suggested:

(a) Direct Means,

(1) Trade Associations: We have at present trade associations for nearly all industries. The potential value of these associations in policing the members within their own organizations was demonstrated during the World War. It was again demonstrated during the days of the NRA, which, incidentally, served to revitalize and expand these associations as component parts of our industrial structure. Their framework is now available for peacetime and wartime application of price control.

(2) Commodity Committees: Commodity Committees composed of representatives of industry, of the Government, and of the public, could be set up in each industry to parallel trade association alignments. These Commodity Committees could be used to determine fair maximum prices for the voluntary application of the trade associations. One policy forming Price Control Authority to coordinate the work of the commodity committees could be established in Washington.

(3) Foreign Purchasing Agents: It is believed that the State Department through diplomatic negotiations could induce each foreign belligerent to establish within the United States a centralized purchasing agent. The J. F. Morgan Company acted in this capacity before we entered the World War. The desire of foreign belligerents to obtain and maintain

the good-will of our National Administration, and the fact that otherwise inevitable high prices and other ill effects of unrestricted competition could thereby be avoided, should furnish the incentive to accomplish this end. Our Government could appoint advisor-observers to act as liaison agents among the foreign belligerent purchasing agents, our own government, commodity committees and trade associations, thus making available full information to the policy forming committee in Washington and to the Administration for the determination of price control policies. Any additional administrative or legislative measures necessary to make price control measures more effective would thereby be brought to light.

(4) Export Quotas Export quotas could be used as a brake by the Administration on excessive exports. The records of our various fact-finding agencies, such as embodied in the Departments of Commerce, Labor and Interior, could be used to determine when the brakes should be applied.

(b) Indirect Means

(1) Financials It is a well recognized economic fact that the contraction and expansion of credit have a very definite indirect effect upon business activity, and hence upon the national price structure. Such a means of control is now exercised by such Government or Government controlled agencies as the Securities and Exchange Commission, the Reconstruction Finance Corporation, the Federal Reserve System and even the Treasury Department itself. The Securities and Exchange Commission, for example, controls the issuance of commercial securities; the Federal Reserve System sets rediscount rates, prescribes reserve balance requirements

of member banks, and enters into open market transactions to stabilize credit; the structure of the Reconstruction Finance Corporation is available to make loans to prevent undesirable business failures; and the Treasury Department regulates the issuance of long and short term public securities. All of the functions of these agencies can be coordinated indirectly to support the direct means of controlling prices.

(2) Numerous other indirect but nevertheless powerful means of enlisting the cooperation of industry in a price control program are available. Wages of labor, for instance, constitute a great portion of the costs of production, which, together with a reasonable profit, comprise the base upon which the price structure must be constructed. The Government has assumed an important position in the determination of labor wages. The determination of export quotas by the Government, previously mentioned, comprise another indirect method of enlisting the cooperation of industry in price control matters. Excess profit taxes now imposed and the threat of increasing them could also be employed for this purpose. The power of the purse in public grants of money is still another potent weapon for obtaining industrial cooperation. In fact, the Government now has so much of our national economy under review and so many indirect means of compelling the cooperation of industry with its policies that it can exercise powers tantamount to coercive action in making price control measures effective.

G. Application of the Means of Controls

The fact that the Government has adequate direct and indirect means of enlisting national compliance in a system of peacetime price

control is of little consequence if a proper organization is not set up for the timely application of control. Only when such powers are at the disposal of one authority can control become effective. It is for this reason that the above organization, with the central Price Control Code Authority superimposed upon all of the organization's component parts, is suggested.

It can be safely forecasted that the proposed organization will prove to be imperfect, and that mistakes will be made in constructing and in administering it. This is the price one must pay for any new undertaking. The really important consideration, however, if disturbed conditions abroad should culminate in a European war, is to get this price control mechanism functioning, and, through trial and error during the initial period of peacetime experimentation, discover its weaknesses and take remedial action to correct them. The remedial action required may prove to be either administrative or legislative in nature, but if the organization is non-existent when prices begin to skyrocket, the damage to our national economy will be incurred before the mechanism to control it can be made operative. To maintain the stability of our price structure, timely action by a control agency is imperative. Almost anyone knows when prices get out of line. The important factor is to have the organization to control them ready to function before prices become exorbitant.

In placing any price control mechanism in operation, we must not lose sight of the force of public opinion. The temper of the people is in times of peace different from the attitude of the public in times of war. In wartime emergency measures are expected. In peacetime the people must be educated to recognize the necessity for such measures as

price control. To this end appropriate publicity must be used to explain the necessity for price control measures, and the ^{people} must understand that price control, in the event of European war, is not only necessary to maintain our own economic stability, but may even be a means, properly controlled, for helping us to avoid being drawn into the conflict.

H. Transition from Peace to War: This organization suggested can be readily adapted to wartime use. The Trade associations can be used as war service committees now projected in the Industrial Mobilization Plan; the Commodity Committees can be employed in identical capacities as a part of the projected War Resources Administration; the Advisor-Observers to the foreign belligerent purchasing agents can form the nucleus of the projected War Trade Board; export quotas can be supplemented by export licenses, and the Federal Reserve System, the H. F. C. and the S.E.C. can continue to perform in wartime the identical functions they perform in times of peace.

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add*

FEDERAL RESERVE BANK
OF NEW YORK

September 23, 1938.

Dear Mr. Secretary:

The one sizable corporate security issue scheduled for this week (\$42,000,000 of Michigan Consolidated Gas Company bonds and notes) is reported to have been postponed, temporarily, because of market uncertainties growing out of the situation in Europe. This is perhaps the first direct evidence of the retarding effect of European war scares upon the new issues market, but so far the effect appears to be in terms of postponement for a week or two, rather than of complete withdrawal. The Michigan Consolidated Gas Company issue mentioned above may be marketed on short notice, and the registration of two or three other large issues is still expected within a week or two.

With the exception of \$5,000,000 of common stock of the Chesapeake and Potomac Telephone Company, to be purchased by American Telephone and Telegraph Company about September 30, there are no important additions to be made to the prospective issues which have been mentioned in previous reports.

Stockholders of the Commonwealth Edison Company subscribed to 97 per cent of the offering of \$39,467,900 convertible debenture 3 1/2s of 1958, rights to which expired September 21. This flotation was, accordingly, fully as successful as the similar one in June. The syndicate for \$30,000,000 Youngstown Sheet and Tube Company convertible debenture 4s of 1948, offered on September 8, was closed Tuesday, while about \$5,000,000 was still in the

9/23/38

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hands of the underwriters. Market quotations fell three or four points and the debentures are now quoted at about 96. This \$5,000,000 is the largest amount left unsold in the hands of dealers since the Bethlehem Steel issue a year ago, when over \$45,000,000 of a total issue of \$48,000,000, fell back on the underwriters, but does not now present a serious problem. It does serve to emphasize, however, the selective character of the market; corporate securities of highest quality are in excellent demand, but anything below top quality tends to drag a little.

In the municipal bond field, about \$13,200,000 was awarded this week. The few issues on which information is available seem to have been fairly well received. The largest issue was \$6,120,000 of Cuyahoga County, Ohio, 3 3/4s and 3 1/2s of 1940-49, the bulk of which was sold on the day of issue.

Last week, I neglected to mention the temporary borrowing of \$36,000,000 by New York City, the interest rates on which you may wish to know. The loans, which were allotted as usual to 26 banks, were for about 1 1/2 and 4 months at 0.40 per cent and for 10 months at 0.80 per cent. On the same day Massachusetts borrowed \$4,000,000 due in 2 1/3 months at 0.14 per cent.

Yours faithfully,



Brian Sproul,
First Vice President.

Hon. Henry Morgenthau, Jr.,
Secretary of the Treasury,
Treasury Department,
Washington, D.C.

EG

GRAY

Bombay

Dated September 24, 1938

Rec'd 6:38 a.m.

Secretary of State,
Washington.

September 24, 11 a.m.

FOR THE SECRETARY OF THE TREASURY.

Opening steady the silver market eased according to the European political news. Ready opened at rupees 52 per hundred tolas declined to 50-13 closed at 51-1. Stocks estimated at 3500 bars average daily offtake 25 bars. Silver valued at 2500 pounds en route to Bombay.

Price of gold declined steadily owing to rise in war risk insurance rates. Ready opened at rupees 36-6 per tola closed at 35-15-9.

WATERMAN

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FEDERAL RESERVE BANK
OF NEW YORK

OFFICE CORRESPONDENCE

DATE September 24, 1928.

CONFIDENTIAL FILES

SUBJECT TELEPHONE CONVERSATION WITH

L. W. Knobe

BANK OF ENGLAND.

Mr. Bolton called at 9:20 this morning. They had had a very bad time, he stated. It had taken them nearly half an hour to get the market under control and altogether they had had to sell \$35,000,000, starting at 4.78, pushing it up to 4.78 3/4, and finally closing at 4.78 1/4. There had been such a tremendous demand for dollars at times that all sorts of rates had been quoted. Selling had been of a panick stricken nature and had originated everywhere but particularly in Switzerland. Forward dollars had at one time been up to 1 1/2 for one month and 2 1/4 for three months and he had had to step in and knock these rates down.

As far as the New York market was concerned, Bolton was very anxious that we shouldn't let the rate go below 4.77 1/4, where he thought it might quite possibly open here, and that if at all possible we try and push it up from that figure. I explained that although trading had not started here yet we had thought it best to put in a buying order at 4.78 and that in view of what he had just told me we would gradually reduce it if selling became too heavy but would make a stand at 4.77 1/4 as suggested by him.

General news had been at their worst, Bolton said, when the London market opened. At that time it was understood that Chamberlain was returning home and the general impression was that negotiations had been broken off. Hence the heavy demand

FEDERAL RESERVE BANK
OF NEW YORK

OFFICE CORRESPONDENCE

DATE: September 24, 1938.

CONFIDENTIAL FILES

SUBJECT: TELEPHONE CONVERSATION WITH
BANK OF ENGLAND.

L. W. Knoke

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for dollars. However, at around 11 o'clock news had been received of Chamberlain's message to press representatives at the airport in Cologne which on the whole was a little more reassuring. Reports from Europe in general were not very hopeful except that there was noticeable a general stiffening up of opinion against Germany (France's declared intention to maintain the terms of the Franco-Czech alliance and the limited mobilization and requisitioning of supplies; tentative mobilization in Belgium, etc.)

The French fund had not operated at all during the morning and he had had no difficulty holding the rate at 1.78 1/2, Bolton said.

I asked him whether our sterling operations yesterday had been satisfactory to him and he replied that we had done a very good piece of work and that they had been very much pleased. He asked whether it would be all right if they finished packing the \$25,000,000, which I had requested yesterday, by Monday night. I replied that as far as I knew that would be in ample time; that the whole scheme was tentative.

LWK:KW

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WAR DEPARTMENT
WAR DEPARTMENT GENERAL STAFF
MILITARY INTELLIGENCE DIVISION, G-2
WASHINGTON, D. C.

G-2/2657-II-90

September 24, 1938.

MEMORANDUM NO. 20 FOR THE CHIEF OF STAFF:

Subject: The present European situation to
10:00 A.M., September 24, 1938.

General Situation. After a day of extreme anxiety, from which scarcely an informed individual in the world was spared, there emerged from the meeting at Godesberg a respite from the tension. The length of this respite depends upon a number of highly inflammable conditions, the aggravation of any one of which could quickly precipitate another acute crisis.

The Godesberg conversations resulted in a compromise which was reached only in the early hours of Saturday. Without this compromise, due almost entirely to the patient efforts of Sir Neville Chamberlain, it seems probable that German and Czech troops would by now have clashed on the frontier. The negotiations had almost broken down, due to reported movements of German troops, but were renewed through the intermediaries of Hitler and Chamberlain after an assurance by Hitler that he would not attack until the termination of negotiations. Then was produced a German memorandum giving the conditions of their "final offer" requisite to a peaceful solution. These conditions, possibly modified in the course of a three-hour conversation between Hitler and Chamberlain, were then accepted for transmission to the Czech Government by the British Premier. The memorandum is reliably reported to be a detailed scheme for "progressive evacuation of Sudeten land by Czech troops and its progressive occupation by German troops."

The terms of the ultimate German demands were a compromise, certainly with respect to the time limit set by Hitler for the transfer of the Sudeten areas. This compromise now appears to have postponed the date of the beginning of the transfer to October 1. It was a victory for Chamberlain, and possibly may prove to be of incalculable benefit in the cause of European peace.

While the tension has been relieved, the general situation created by the events of Friday is far from reassuring. The day of

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anxiety accelerated military precautions in every European country. The Czech mobilization, whether or not in answer to the concentrations of German troops near the frontier, was a pronounced development in the situation. Germany, partially mobilized, and Czechoslovakia, mobilized, face each other over a no man's land populated by civilians in the throes of war psychosis. The same is true along the frontiers touching Poland and Hungary.

The old Czech Government accepted the loss of the Sudeten areas in principle, and fell before public disapproval. It is not certain that the new semi-military Government will accede to the German demands, particularly in view of growing sentiment in their favor in the democracies, and governmental stiffening in Britain and France aroused by German intransigence. The general deterioration created by the Polish and Hungarian demands also forces Britain, France and Russia to a reconsideration of the whole issue. While Hitler's attitude toward these demands is not known, it is believed that he supports their claims at least to the same extent as the German ones. In any event, it seems evident that Germany refuses to give any guarantees as to the integrity of what remains of the Czech State after the German amputation. Mussolini has left no doubt that Italy favors the virtual dismemberment of Czechoslovakia.

Military Situation.

Great Britain - Official statements disclose a general speeding up of military precautions, but no specific measures are announced. A.A. guns are being hastily installed at the naval base at Alexandria. No reserves are known to have been called.

France - Following is the substance of a cable from the Ambassador in Paris dated 8:00 A.M., September 24:

At 4:00 A.M. this morning an order was published calling to active duty N.C.O.'s and soldiers of the two classes most recently released from the army, totalling 250,000 men, to report to assembly points at once. The Military Attache informs me that these orders bring all units on the Maginot Line to war strength, to a total of 400,000 men. Also that 10 divisions in rear of Maginot Line have been alerted with certain elements occupying advanced positions.

The Military Attache in Paris cabled as of 9:00 A.M., September 24, in substance:

Mobilization partially ordered. Maginot Line now held at war strength. There are 10 divisions alerted and some cover positions being occupied.

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The German divisions along the Czech frontier number approximately 31 infantry, 2 motorized and 3 mechanized. Along former Austrian frontier facing Moravian corridor is a concentration of 7 to 8 infantry divisions, one mechanized and one motorized division.

The press reports that garrisons along the Belgian, Italian and Spanish frontiers have been alerted and frontier guards increased.

Belgium - The Government has called to active duty reservist specialists assigned to fortification and frontier covering units. Part of the 1937 Class of artillery reservists has also been called.

Germany - The American Military Attache reported yesterday:

That there was continuous movement of troops south from Berlin, and that the A.A. defenses of Berlin were manned on the night of September 22. The Assistant Military Attache traveling along the frontier between Dreden and Goerlitz saw police and members of the Frei Corps, including some wounded. No troops or military activities apparent near the border.

Czechoslovakia - General mobilization was ordered at about 10:20 P.M. Except for the small district around Eger and Asch, the press reports that all Frei Corps seem to have been withdrawn into Germany.

A cable from the Minister in Prague dated noon, September 24 states in substance:

Mobilization proceeded during night with haste but without disorder and showing fine organization. Boy scouts and civil guards used largely to replace police. All types of transportation commandeered for movements. Men up to age of 40 were called, most of them were at their posts within 6 hours. They are a fine type of soldier, strong, obedient, ready to fight. There were 37 border incidents yesterday and this situation is serious. To date 250 Czech police have been either killed or taken prisoner. A blackout was held in Prague during the night with a practice alarm at 3:00 A.M. The populace is calm, orderly and glad of the mobilization order. War Office records were removed during the night. It is estimated there are 1,000,000 men in the field.

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CONFIDENTIAL

Hungary - The press reports the calling of numerous reservists and general military activity, including the formation of a Frei Corps.

Poland - No known change.

Russia - No known change.

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PLAIN

London

Dated Sept. 24, 1938

Rec'd 10:10 a.m.

Secretary of State
Washington.

1010. September 24, 1938

FOR TREASURY FROM BUTTERNORTH.

For the first time in years the City is fully manned on a Saturday. The atmosphere, of course, is one of grave tension and full explanation from the Prime Minister is anxiously awaited. It is noteworthy the manner in which City opinion has attempted to withhold judgment pending a full British Government statement.

Dollar dealings have been particularly large for a Saturday. The dollar opened at 4-781/2 bid and the Control has operated sporadically throughout the morning. The dollar closed at 4-773/4. The one months forward is 5/8 three months 2 gold fixing was 279 bars at 145s with the British authorities taking most if not all of the offerings.

Board of Trade announced last night that if a major war occurred involving Great Britain the British Government would establish a war risk insurance office for cargo carried in British or neutral vessels on the general lines of the scheme in force at the end of the last War.

ALC

KENNEDY

FEDERAL RESERVE BANK
OF NEW YORK

OFFICE CORRESPONDENCE

DATE: September 24, 1938.

CONFIDENTIAL FILES

SUBJECT: TELEPHONE CONVERSATION WITH

L. W. Knoke

BANK OF FRANCE.

Mr. Cariguel called at 10:10 and wanted to know how the franc was quoted here; also whether we had done anything against his orders. I replied that we had sold 1,000,000 at 2.87 7/8 but had pulled the order out when his call came in. Would it be all right for us to continue selling? Cariguel replied that he wanted us to operate against his orders but if we were offered a large amount of francs would we please let him know at once. They wouldn't mind our selling but if we had to buy francs he would like to be advised at once.

I asked him how the whole situation looked to him and Cariguel replied that so long as the world was gaining time it was all to the good.

LWK:KW

Cariguel called again at 12:05 to find out what we had done in the market and I told him we had sold 9,350,000 which he thought was splendid. (It was quite obvious that he had expected we would have to buy rather than sell and that he was considerably relieved.)

PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Rio de Janeiro
DATE: September 24, noon
NO.: 222

My 215, September 17, noon.

I am informed by the Director of Exchange that the Bank is unable at this time to allocate any exchange on account of entire absence of export bills in the market. The director is hopeful that exchange may be available by next week. The situation in Europe is responsible for this situation, he explained, and added that although Germany is in the market for coffee the Bank of Brazil has suspended all sales of coffee in compensation marks.

STRICTLY CONFIDENTIAL. According to the Director of Exchange, the shipment of gold referred to in my telegram under reference did not materialize as reported but will go forward~~d~~ on the 29th of September.

Please inform Commerce.

CAFFERY

EA:DJW

FEDERAL RESERVE BANK
OF NEW YORK

OFFICE CORRESPONDENCE

DATE September 24, 1938.TO CONFIDENTIAL FILESSUBJECT: TELEPHONE CONVERSATION WITHFROM L. W. KnobeBANK OF ENGLAND.

I called Bolton at 1 o'clock and told him that sterling here had been up to 4.78 5/8 on best buying orders from Europe but that after these had been filled the market had eased to 4.77 5/8 where it stood at the moment with business very small. I added that we had an order in to support it at 4.77 7/16 against his gold points but so far we had not done anything at all.

LWK:KW

Sunday, Sept. 25, 1939

8:45 p. m.

Present:

Dr. Feis
Mr. Moffett
Mr. Lochhead
Mrs. Klotz

The Secretary flew down from the Farm and came directly to his office. He had asked Dr. Feis and Mr. Moffett, from the State Department, to be present and they were on hand when the Secretary reached his office.

Mr. Moffett brought with him the summary of a message which was received just as he was leaving the State Department, reading as follows:

"1020 Sept. 25. 11 p.m.

Please deliver immediately for Secretary of the Treasury from Butterworth.

I have not yet been able to get through to Cochran but I had a word with Phillips who had not yet heard from the British Financial Attache in Paris. Phillips expressed appreciation for the information that such a note had been delivered and said that naturally he did not know what the tomorrow might bring forth but that looking at the position locally he did not see why any such French action should produce any unusual action here. I will of course see him tomorrow.

Kennedy.*

The Secretary told the group that Mr. Cochran telephoned him on the Farm this afternoon and reported that just after Deladier left Rueff, Rueff phoned and asked Cochran to come to the French Treasury. When Cochran arrived at the French Treasury the British Financial Attache went out and, therefore, Cochran

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assumed that the British had gotten the same message.

The message given to Cochran and reported by him to the Secretary over the phone was as follows:

"In the present situation the Government could not permit an important diminution (loss) of its metallic reserve indispensable to the defense of the country.

"It hopes that in the course of the coming days the exchange market will remain sufficiently in equilibrium so that important losses will not have to be envisaged. Nevertheless, in case an important movement of exportation of capital should appear the Government would be obliged to take without delay measures capable of stopping it.

"To this end it would give instructions to the exchange equalization fund and would ask the principal intermediaries to participate in the exchange market not to give exchange except on justification of commercial needs and to refuse every demand not justified by commercial or tourist reasons. If the necessity of such a decision should arise, the French Government would inform the Government of the United States without delay. It hopes that in this case the latter would undertake to support its action through requesting the banks which intervene on the American market to yield foreign exchange against francs only on the same condition."

The Secretary said he told Cochran to get in touch with Butterworth and also to give the story to Ambassador Bullitt because up to that time Cochran had not notified Mr. Bullitt.

At 4:20, the Secretary said, he telephoned to Mr. Butterworth and told him to get in touch with Phillips, of the British Treasury, as he, the Secretary, did not think that we should give any answer to the French until we had consulted with our partner in the Tripartite Agreement - the British. Mr. Butterworth said that he

-3-

doubted whether the English would take the measures requested by the French Treasury at this time.

Mr. Moffett let the Secretary read the cables from Ambassadors Kennedy and Bullitt, referring to the note of Hitler to the Czechoslovakians which had been transmitted through Mr. Chamberlain. Neither of these notes contained the exact text of the message. Mr. Moffett explained that that was just starting to come into the State Department as he was leaving to come to the Treasury and that it probably would not be completed for several hours.

He said that Mr. Hull was with the President at this moment. The Secretary telephoned the White House usher to get a message to the President that he, the Secretary, was at his desk.

HM, Jr inquired of Mr. Moffett, "Just what is the situation tonight?" Mr. Moffett replied, "The British and French have received these new proposals. They have submitted them to Prague without recommendation pro or con. Chamberlain has returned to London. He is in favor of accepting them in toto because he feels that they cannot make a dent in Germany in case of war."

Continuing he said, "France -- there has been a strong feeling of war. Even Chautemps has deserted and gone over into the war party. Bonnet alone is standing for peace on any basis.

"The British Government," he said, "is working very hard to try and bring labor to the point where it does not do more than fight politically. I think it looks very probable that the Czechs would reject Hitler's terms. Then the French and British will have a new problem to face. The Poles are getting more and more anxious to profit by the action. They say that Benes is a tool of Moscow."

At this point, HM, Jr asked, "Is the October first date correct," and Moffett answered, "Until I get the full text, I do not know." Moffett further said, "Bullitt saw the French this morning and Bonnet said 'The mere fact that the British called us over is an indication that they have not rejected this plan'."

"It looks now," Mr. Moffett added, "as if the

-4-

British will try and compromise by making a new proposal somewhere between the first and second proposals."

The Secretary then said to the group, "Every time the French have put us on notice like this, they have gone through and taken the road of least resistance. Saturday it took the British a long time to fix the market. I have not given the French any answer, but I do not see how we can refuse what they ask us to do." Dr. Feis remarked, "I agree." The Secretary added, "When I see the press tomorrow they will ask me whether the Tripartite Agreement is still on."

Mr. Morgenthau then asked Dr. Feis and Mr. Moffett if they thought we should try to meet the request of the French and they both agreed that it would be well to do so, if possible. Feis commented, "This would not be competitive devaluation."

At this point the usher at the White House telephoned and said the President wished to see the Secretary immediately. He left at once for the White House.

* * * * *

HM, Jr returned from the White House at ten minutes of eight. He said the President had told him that anything he did was o. k. with the President.

Mr. Morgenthau then telephoned to George Harrison and the following is a record of their conversation:

HM, Jr: We have a suggestion from the French that they may put on more or less of an exchange control in that they will examine all foreign exchange operations. If they do that -- they have not yet decided definitely -- they want us to cooperate and ask our banks to do the same thing. It will depend on whether they have a good or a bad day tomorrow.

If you remember, when the Tripartite Agreement went through, I think you got busy about midnight and asked the various bank presidents to do something like that. Are you at home now?

Gov. Harrison: Yes.

-5-

HM, Jr: Are you going to be home tonight? What is your telephone number?

Gov. Harrison: Yes. My telephone number is Butterfield 8-0618.

HM, Jr: If this thing should come, I think our banks should let through only legitimate transactions. I have not gotten that request yet, but they have put us on notice. I am going to send word back to them that if they do make that request, we will cooperate with them.

Gov. Harrison: I will do anything you want me to do, but the last time we did it the banks thought it was sort of silly. They felt it could have waited until the morning.

HM, Jr: All right. Let's see how things go.

Gov. Harrison: Unless I hear something more from you, I will do nothing.

HM, Jr: The British do not yet know what is in the Hitler note.

oOo-oOo

1120 Sept 25 11 pm
 Please deliver immediately
 to Sec. Treas. for Bulletin.

- I have not yet
 been able to get through
 to Cochran but I had a
 word with Phillips
 who had not yet heard
 from the Pres. financial
 attaché - Paris Phillips
 expressed appreciation
 for the info that such
 a note had been delivered
 and said that naturally
 he did not know

what the law might
 bring forth but that
 looking at the position
 broadly he did not see
 why any such French
 action should produce
 any unusual action
 here. I will of course
 see him tomorrow

(K)

In the present situation
 the Gov. could not
 permit an important
 diminution (loss) of
 its metallic
 reserve, indispensable
 to the defense of
 the country.

It hopes that in
 the course of the
 coming days the
 exchange market

will remain
 sufficiently in
 equilibrium so
 that important
 losses will not
 have to be envisaged
~~Methods~~ the less
 in case an
 important movement
 of exportation of
 capital should

appear the gov. would be obliged to take without delay measures capable of stopping it.

To this end it would give instructions to the exchange equalization fund

and would ask the principal intermediaries to participate in the exchange market not to give exchange except on justification of commercial

needs and to
refuse every
demand not
justified by
commercial or
tourist reasons.
If the necessity
of such a decision
should arise
French gov.

would inform
the Gov. of U.S.
without delay.
It hopes that in
this case the
later would
undertake to
support its action
through requesting
the banks which

intervene on the
American Market
to yield foreign
exchange ~~to~~ ^{against} francs
only on the same
condition.

MJD

PLAIN

London

Dated September 25, 1938.

Rec'd. 5:10 p. m.

Secretary of State,
Washington.

1020, September 25, 11 p. m.

PLEASE DELIVER IMMEDIATELY FOR THE SECRETARY OF THE
TREASURY FROM BUTTERWORTH.

I have not yet been able to get through to Cochran but I had a word with Phillips who had not yet heard from the British financial attache in Paris. Phillips expressed appreciation for the information that such a note had been delivered and said that naturally he did not know what the tomorrow might bring forth but that looking at the position broadly he did not see why any such French action should produce "any unusual action here". I will of course see him tomorrow.

KENNEDY

EMB

ML

GRAY

Paris

Dated September 25, 1938

Rec'd 8:03 p.m.

Secretary of State
Washington

1582, September 25, 9 p. m.

FROM COCHRAN. (SECTION ONE)

Rueff called me to Ministry of Finance at 7:30 this evening. He delivered a memorandum dated September 25, of which the following is a translation:

"In the present situation the Government could not permit an important diminution of its metallic reserves indispensable to the defense of the country.

It hopes that in the course of the coming days the exchange market will remain sufficiently in equilibrium so that important losses will not have to be envisaged.

Nevertheless, in case an important movement of exportation of capital should appear, the Government would be obliged to take without delay measures capable of stopping it.

To this end it would give instructions to the exchange equalization fund and would ask the principal intermediaries who participate on the exchange market

not

ML -2- #1582, Sept. 25, 1938 8:03 p. m. from Paris. Sec.1

not to give exchange except on justifications of commercial needs and to refuse every demand not justified by commercial or tourist reasons.

If the necessity for such a decision should arise the government would inform the Government of the United States without delay. It hopes that in this case the latter would undertake to support its action through requesting the banks which intervene on the American market to yield exchange against franc only on the same condition".

(END OF SECTION ONE).

BULLITT

RGC:EMB

PARAPHRASE OF SECTION TWO OF TELEGRAM NO. 1582
of SEPTEMBER 25, 1938, FROM PARIS.

I was told by Rueff that this is only a strictly confidential warning. However, he insisted that the French Government must be prepared to act, in view of the present serious international situation. Action will not be taken if the Paris market is not too bad tomorrow. However, if losses on the market tomorrow should be too heavy, or at any time in the near future, notice will be given to us by Rueff, and the French will follow the procedure given above.

I asked Rueff if the French in such a situation would maintain a rate of 179. His reply was that for such exchange as was yielded by the stabilization fund, that rate would be maintained. But he remarked that if the demand should be far in excess of this amount, presumably there would be developed a black market and a second rate. The stabilization fund still has a considerable amount of gold, Rueff assured me.

A similar message was given by Rueff to the Financial Counselor of the British Embassy in a separate interview this evening.

END OF MESSAGE.

BULLITT.

EA:LWW

AA

EG

PLAIN

London

Dated September 26, 1938

Rec'd 7:50 a.m.

Secretary of State,
Washington.

1022, September 26, noon.

FOR TREASURY FROM BUTTERWORTH.

The following short editorial in today's FINANCIAL NEWS is as much a reflection of the sudden hardening of attitude which the key individuals who give the initial impetus to city opinion, have arrived at over the weekend, as it is a lead to the city community:

"After all Mr. Chamberlain did not reach even the shadow of an agreement with Herr Hitler at Godesberg. And of negotiation in the ordinary sense of the term, by letter or by word of mouth, there was none for the two principals confined themselves chiefly to protestation on the one side and protest on the other. No one has yet succeeded in negotiating with the Fuehrer. It is his unalterable custom to treat his visitors not as plenipotentiaries with whom in the give-and-take of serious argument he can arrive at a constructive compromise, but as an audience called to

RECEIVE

-2- #1022, September 20, noon, from London

receive the progressive revelation of his mental workings. And the unfortunate Czechoslovakians have learned to their cost as Dr. Schuschnigg learned before them not only that Herr Hitler's is a one-way mind but that as the full text of the Fuehrer's final demands shows, where concessions to Germany's ambition are concerned, increase of appetite grows by what it feeds on. Small wonder is it that Mr. Chamberlain at Godesberg declined to act as a selling broker for the Fuehrer's new terms and consented merely to be a postman. After the sacrifice offered on the altar of expediency by the British and French cabinets sorely against their will and against the weight of a large section of public opinion in their countries; after the two governments had wrung Czechoslovakia's reluctant consent to terms less appropriate to a sovereign state than to a defeated adversary; after a British Prime Minister had envisaged the far-reaching change in his country's policy involved by the proposed guarantee of a central European frontier - after all that the formulation of newer and still more draconian terms by the Fuehrer was more than lamentable, it was unpardonable.

It

-3- #1022, September 26, noon, from London.

It is hard to escape the conclusion either that Herr Hitler is deliberately courting the possibility of a conflict or that he is recklessly playing with fire with criminal disregard of the possible consequences. He may seek peace but his actions do not ensue it. The policy which Great Britain should follow during the next few trying days is clear. Firmness on the Government's part offers the best hope of convincing Herr Hitler before he has irrevocably committed himself that this country is earnest in its desire for peace. Investors and all who do business in the city of London can strengthen the Government's hand and serve their own best interests by standing steady. That the strain of events will find a certain expression in the markets and the exchanges is indeed probable. But as we show elsewhere all available evidence suggests that the underlying technical position is as sound as it can well be. There is every reason why the financial community should maintain the admirable self-possession it has evinced hitherto through every phase of a protracted crisis."

The opening of the dollar was given out as 4.77 $\frac{1}{2}$ but the first effective business was done at 4.76 $\frac{1}{4}$ at which point the British authorities gave dollars. It

was

-4- #1022, September 26, noon, from London

was held there until about gold fixing time and then went to 4.75 3/4. The buying pressure has been heavy. Gold fixing was 365 bars at 145S 7D of which 95 were married and the remainder taken by the British fund this price gave a dollar parity of 34.63. Franc dealings are not large, the Bank of France buying sterling at 178 1/2 and selling at 179. Dealings are limited by the fact that most Paris offices are being denuded of a substantial part of their staffs and the Bank of France is to a great extent already supervising foreign exchange transactions.

London security markets are weak but the volume of trading is thus far minute. 3 1/2 percent war loan bonds for example are quoted 92-95.

KENNEDY

RR

I repeat was 365 bars at 145S 7D. of which 95 were married and the etc rept were married confirmed.

September 26, 1938

I spoke to Cochran in Paris at about 8:15 and told him to place call Mr. Rueff, French Treasury, and advise him that if the French decided to go ahead with modified exchange control we would glad to cooperate with them on the basis of the long memorandum which Cochran phoned me at four o'clock yesterday at the Farm.

Monday
September 26, 1938
8:50 a.m.

Admiral Leahy: Admiral Leahy speaking.

H.M.Jr: Good morning. How are you?

L: Very well, thank you sir.

H.M.Jr: Admiral, now - ah - in regard to the Honolulu, - ah - we do want to load another twenty-five million worth of gold on her -

L: Yes, sir

H.M.Jr: But, one - should we load that gold on her until she is about ready to shove off? I mean it might prove to be embarrassing for you to have twenty-five million dollars worth of gold on the Honolulu and then have her possibly go on some other mission.

L: She won't go on any other mission, Mr. Secretary, unless you - she won't go on any other mission. But I think it would be wise to load it when you want her to depart - she can depart at any time.

H.M.Jr: Well, how about this understanding that you want to keep a war ship in English waters?

L: Well, ah - the Ambassador to Great Britain wants to keep a ship there. We're not interested in that.

H.M.Jr: You're not? Have you anything else that you could - ah - could you put the gold on - have you got any large destroyer?

L: There's a destroyer on the way over there now; it sailed - it sailed Saturday.

H.M.Jr: Saturday?

L: And it will be there in about - well, I'd say give it five or six days more. I mean - are you in that much of a hurry to get out?

H.M.Jr: Well, I feel less comfortable this morning than I have any morning so far.

L: Well, I know, it's pretty bad.

H.M.Jr: And - ah - we've got all this gold and we have no way of getting it out. But I just - it takes some time to load it.

- 2 -

L: Ah -

H.M.Jr: And -

L: Yes.

H.M.Jr: And I just wanted - I mean, if we told them today I doubt whether they could have it loaded before Wednesday or Thursday.

L: Well, why not go ahead and do that? They can keep it there all right; they can put a guard on it. Of course, I don't see how anybody can bother them. They'll have - naturally they'll have a guard on it and they don't allow anybody on the ship but we'll - we'll tell her to sail as soon as they report that they have it on board - if you think that would be by Thursday?

H.M.Jr: I should think so.

L: Well that's all right, sir.

H.M.Jr: Well then why don't I tell them to load it - ah - begin - give them orders to load it as soon as it's convenient, see? Hello?

L: Hello.

H.M.Jr: As soon as they can get it packed. You see it takes them quite a while.

L: Yes.

H.M.Jr: And then she wouldn't leave, let's say, until - ah - that destroyer gets there.

L: That'll be all right.

H.M.Jr: Now what destroyer will that be?

L: It's the Summers.

H.M.Jr: The Summers? Well then - ah -
Wait a minute -

L: /Let me make sure of that. Let me make sure - if you want to know. I - I'll get that in a second.

H.M.Jr: Well - no, that doesn't make - ah -

- 3 -

L: Yes. I'm pretty sure it's the Summers.

H.M.Jr: Right. Well -

L: Does the Summers go to Europe? (Sounds as if the Admiral is speaking to someone in his office)
Yes, sir, that's right. (Spoken to the Secretary)

H.M.Jr: The Summers?

L: It's a big destroyer and it can carry twenty-five tons for you.

H.M.Jr: Well now, will she go to South- ah - will she go to - ah - where is she going in England?

L: She's ordered to go to Portsmouth, the same as the Honolulu.

H.M.Jr: Well there you are.

L: Yeah.

H.M.Jr: Well, that - well in an emergency that would take care of the Ambassador.

L: That'll take care of another - yes, it'll take care of an emergency. And then we have another ship under orders to go there, which is supposed to be sailing today -

H.M.Jr: Yes.

L: And that'll be there in ten days, - a cruiser.

H.M.Jr: A cruiser? Now, let me ask you this, - ah - how would you feel if - ah - ah - I tried to send over a - one of our two-thousand ton Coast Guard Cutters, - would that help any?

L: Well, ah - it depends. You see we've got - yes, it'll help if you're going to keep this up. We have now the Honolulu -

H.M.Jr: Yes.

L: That'll bring home a consignment for you - sailing sometime the end of this week.

H.M.Jr: That's right.

- 4 -

- L: Then we have the Summers which can bring over another consignment.
- H.M.Jr: Yeah.
- L: Then we have another cruiser going over there which can bring over the third.
- H.M.Jr: Well I don't need any more than I don't believe.
- L: So if you need any more than that it would help to send a - a Cutter over.
- H.M.Jr: Well - at that - that would be, let's see - after the Honolulu there's the Summers and then a cruiser -
- L: Yes, sir. Then of course the cruiser can bring a very much larger consignment if you want it to.
- H.M.Jr: Yeah.
- L: And, in a pinch I can send more ships over. That is I can send the Honolulu back.
- H.M.Jr: I see.
- L: I don't like to do it - it costs a lot of money - for me.
- H.M.Jr: Yeah. Well, ah - it costs - it will cost us to transport twenty-five million of gold - it will cost us a little over a hundred thousand dollars.
- L: Yeah.
- H.M.Jr: How much does it cost you to make a round trip?
- L: Well I don't know - it probably - it probably isn't that much though.
- H.M.Jr: No.
- L: It's fuel - only fuel, that's all.
- H.M.Jr: Yeah. Well, I tell you, what I'm going to do, if it's agreeable to you, I expect to see the President at one o'clock. Ah - this thing gets worse all the time; and I'm going to suggest that just in case - ah - that we do send over a Cutter just to have her there.

Lt: All right, sir.

H.M.Jr: On this gold - if that's entirely agreeable to you?

Lt: Well that's entirely agreeable to me - yes, sir. We don't - we don't care, but we'll handle it for you with these cruisers as rapidly as we can if you want us to do it.

H.M.Jr: Well then I think I'll leave the responsibility with you and I won't divide it.

Lt: All right, sir. Now you're going to order a load put on now, are you?

H.M.Jr: I'm going to tell them today to put twenty-five million on the Honolulu as soon as they can - comfortably. I mean I'm not going to show any - ah - fright, you see?

Lt: Yes.

H.M.Jr: But I do want to load it.

Lt: Yes.

H.M.Jr: And then the understanding will be that after the Summers gets there - or whatever the destroyer is - that the Honolulu will shove off.

Lt: Yes. I'll tell them then after they get - after they get a consignment put on board by - consigned to you and after the Summers arrives they'll come back.

H.M.Jr: But I think you'd better be thinking of getting another cruiser over there sooner than ten days.

Lt: Well, I don't think we can do that.

H.M.Jr: You don't?

Lt: Because it takes about - it takes about eight days to get over unless we speed them up pretty fast -

H.M.Jr: Yes.

Lt: And the ship is sailing today.

- 6 -

H.M.Jr: The cruiser is sailing today?

L: The cruiser is sailing today.

H.M.Jr: Well it could get over there in four days if necessary.

L: Ah - well hardly four.

H.M.Jr: Five.

L: Five - yes. Well, will you let me know if you see any - any need for that; I can speed it up of course.

H.M.Jr: But you've got the Summers on the way and what - what cruiser will that be?

L: (Speaks to someone in his office: What's the name of that cruiser?)
It's the Savannah.

H.M.Jr: Savannah? Well I think I'll leave the responsibility to the Navy as long as you are willing to take it.

L: All right, sir. We'll do that then. And I - without any further instructions from you will I tell the - ah - ? (conversation breaks off)

H.M.Jr: Hello. Hello. Hello.

L: Hello.

H.M.Jr: Yes.

L: I say, will I tell the Honolulu now that they're going to get a shipment without any further word from you?

H.M.Jr: Please.

L: I'll do that.

H.M.Jr: Thank you very much.

L: You're welcome, sir.

H.M.Jr: Thank you.

L: Goodbye.

September 26, 1938

9:15 a. m.

Present:

Mr. Lochhead
Dr. White
Mrs. Klotz

Mr. Lochhead: The President Roosevelt sails on Friday. Of course, we can't get war risk insurance on it, but I would advocate putting \$10,000,000 on.

HM, Jr: Sold! Done!

Mr. Lochhead: If I can cover marine risk, I will do it.

HM, Jr: All right. What else?

Mr. Lochhead: Things seem to be getting better in the market. Since opening, in better shape. Went to 4.75 $\frac{1}{2}$ and is coming back rather well. Back to 4.77 $\frac{1}{2}$ right now. The French rate has held steady. Was down. Is now 178.62. Rather interesting, the bankers have not made any special comment. Seems to be going through without too much concern over there, so I think it's all right. We are just sitting.

A cable came from Kennedy, came over for your information. It's in regard to the Chinese situation. You have an appointment at 11 o'clock. If you want to see them and you are going to see the President, I think it is a cable you should read.

HM, Jr: What else?

Mr. Lochhead: That's all.

HM, Jr: Harry?

Dr. White: One thing that is somewhat new that I thought you might consider is in order to prevent, or to discourage, further acquisition of dollars without in any way interfering with the flow of gold here, and possibly to put yourself in a position to defend yourself

-2-

against sterling should you wish to, because it looks to me at the slightest opportunity they are going down and if there is war that's one thing and if there is not it may end up 4.75, so the suggestion I would like to make for your consideration is to maintain your buying price for gold, but announce that you will increase your charge for selling gold from 1/4 of one percent to, for purposes of discussion, 5%.

The effect of that will be to introduce a risk of exchange on the part of those who want dollars which will act as a discouraging factor and in the event also of war, it will also be a discouraging factor in causing people to liquidate securities to get their dollars out, although less so.

And then I think that if you don't want to use it, if later on things are such that you feel you want to maintain whatever rate of sterling you want, all you have to do is put back -- either go from 5% to 5% or 2% or eliminate it. It would sort of serve notice that you are putting yourself in a position to protect yourself against exchange rates.

HM, Jr: I disagree with you. And the reason I disagree with you, as of this morning -- two things. The fundamental thing, I have announced and the papers have carried and I get great satisfaction out of it, "Morgenthau says business as usual." I sounded that keynote. Told it to the President and it's gone through everywhere. Everybody has picked it up. I think it's most important.

Dr. White: Sure.

HM, Jr: This would not be "business as usual". This would not be "business as usual". And the President read this article in the Times yesterday, somebody, about raising the whole question of gold and the President said, "Remember, I raised the question of what's going to happen when we get 80% or 90% of all the gold," and so I said, "Mr. President, so what! Who has a better suggestion?"

I don't want to do anything, as of today, to cast any doubt in anybody's mind as to the fact that we have grown up; we are the monetary center; we are conducting business as usual, and there is nothing in

-3-

the world which makes me believe I have to worry. Again, as of today, where I disagree with you, and I think Archie can or cannot (Secretary hesitated a long time here) -- never mind, I won't be facetious.

Dr. White: You can be if it is at my expense.

HM, Jr: No. The English have given every indication that they are trying to keep the pound -- they have gone the limit and they have taken the brunt. Am I right, Archie?

Mr. Lochhead: Oh, yes; they have taken the brunt on this.

HM, Jr: No indication that they are using this as an opportunity

Dr. White: This would help them in such a move.

HM, Jr: All I can say is I want all the suggestions I can get and I am going to do it like this and I will have to take my chance on instinct based on four years' experience.

Dr. White: The suggestion I made is clear?

HM, Jr: I got the idea.

Dr. White: No change in the buying price.

HM, Jr: I understand. Do you agree?

Mr. Lochhead: I agree with you. Two reasons. I won't go into it.

Dr. White: Just wanted to make the suggestion.

HM, Jr: You can bring it up twice a day.

Dr. White: Just wanted to plant the idea.

HM, Jr: Anything else?

Dr. White: The others relate to China and Japan and Germany.

HM, Jr: That sounds like commodities - Customs. Herman Oliphant spoke to me about that Saturday and I

-4-

thought we would get on this thing right after the 9:30 meeting.

Dr. White: At last, French exchange control has come.

Mr. Lochhead: The cable is in from France confirming Cochran's plan.

HM, Jr: Did either of you read the President's message? Mr. Hull went over there at midnight and it was agreed on and the President went on the air at 3 o'clock this morning.

The thing I can't make up my mind, putting economic pressure on Germany right now, what would the effect be?

Dr. White: All to the good.

Mr. Lochhead: Decisions are being made by the Commissioner.

HM, Jr: Last Monday the President told me about his idea. He was going to hint to England -- this is terribly confidential -- of an economic blockade. He did, I find out last night, make that suggestion to Sir Ronald Lindsey and I also know General Craig was against it. He had that last Monday and he said he had no answer. We come along and suggest that we declare Italy, Germany and Japan are dumping, all by ourselves. I don't know. I don't know what the effect would be .

That's my thought. I think this might be smart that we try it out on Japan first, who are not in the European arena.

Yesterday, in talking with the President, I got over to him, I said, "The Chinese have 20,000,000 ounces of silver which is free. The rest of the stuff is tied up. That's all they have got." And I said, "You have got to make up your mind whether you want to give them \$100,000,000 credit, knowing the minute

-5-

you give it to them it's gone. Mr. President, that's what you have to make up your mind." He said, "I want to wait and see what happens in Europe. If there is war in Europe, I will definitely give them credit. He waited a minute and he sort of gave a mental somersault and he said, "If there is no war in Europe, maybe I will do it anyway."

"But," I said, "it's boiling it right down. We have been given nothing but misinformation. The Yunnan-Foo road to Burma is not complete." He said, "Well, Wang said it was complete." I said, "That's the kind of information you have been getting. Boiling it down, they are down to \$10,000,000. That's about all. I said, "It's just a question of whether we want to do something." I think with the thing so (makes gesture of up and down) this way and the President very anxious to get in and stop this war in Europe, we make a move like this

"And that note I saw was emasculated by Mr. Hull. It's a typical Hull note. And we go along and declare the Germans and Italians are dumping and increase their duties by 50%

Dr. White: Or put on new duties.

HM, Jr: At this time, I don't want the responsibility.

Dr. White: In Italy?

HM, Jr: Or Germany. The responsibility is too great to recommend it, but I might consider doing it with Japan where the situation of my doing it or not doing it is not going to change whether Hankow falls or not. The die is cast. Supposing, Harry, you advise me and then subsequently somebody said the Treasury doing that was the deciding factor for world war.

Dr. White: I will grant it's safer, less risk involved, in doing it against Japan at this moment.

HM, Jr: And this other thing is not going to make Germany fight or not fight. If you said to me, "Mr. Morgenthau, your doing this is a chance to keep Germany from going into Czechoslovakia.....

Dr. White: I think the decision will rest on

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other things.

HM, Jr: It will rest on other things. Therefore, postponement of one week won't make any difference. Putting it in might give him the handle to take a blast at us. 'I have to fight because those American bolsheviks, that Jewish Secretary of the Treasury, is trying to strangle me economically and I have got to fight that.' And he might hang the whole thing on me.

If you said, 'You are doing it -- you have to have courage and maybe this will stop them from going in,' I will take that chance, but I don't believe it. On the other hand, I am wibling to do it with Japan and test it.

I have had two days clearly to think this thing through.

While this is going on, this note comes out this morning. And I think the reason the President showed it to me, he knew I would not approve of it. The only thing that I can't understand is why the Treasury has not pushed this forcibly with a definite recommendation during the past year. You have all flirted with it.

oOo-oOo

GROUP MEETING

September 26, 1938.
9:30 A. M.

Present: Mr. Oliphant
Mr. Gaston
Mr. Haas
Mr. Hanes
Mr. Lochhead
Mr. White
Mr. Upham
Mrs. Klotz

H.M.Jr: I've got to kind of mix this thing up; I can't go ... Cy, what's the latest word on Stewart, of San Francisco?

Upham: I have heard nothing more than when I talked to you last. Mr. Ransom was going to tell me, as soon as he talked with Marriner, but I haven't heard from him.

H.M.Jr: All right, before one o'clock

(Dowling comes in.

H.M.Jr: Some cigarettes, please.

Dowling: They're in the drawer.

H.M.Jr: No one knows it.)

..... I want to know - better write this down; I don't want it - I really want it - the so-called what, April or June report they made for the Bank of America; what is that one?

Gaston: April 20 it was finished up - April 20th examination.

H.M.Jr: All right. That - I want you to take out of that all references to Stewart, and criticisms of Stewart, see? I want to know who, in the Federal Reserve Bank of San Francisco - to whom was that given, and when, and was it given to anybody in the Federal Reserve in Washington? Now, the so-called April examination - the one before that, was there any reference to Stewart? How many times, in other words, when they examined the Bank of America, did they find that Stewart had this land; how many times did they criticize it; when did they

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begin to criticize it; was it, each time, shown to the Bank in San Francisco and the Board here? In other words, start right from the beginning, see? When did they begin to criticize, and when did they begin to show it?

(To Mr. Oliphant:) And then anything you have out of my diary, will you please return it before noon to Mrs. Klotz; anything on Giannini, and everything.

Oliphant: It's all in your hands.

H.M.Jr: I want everything back to Mrs. Klotz before noon. You've had it over a week now; if it's ready please send it back. I'll give you to five o'clock. I don't want my diary floating around.

And you (Mr. Upham) have got some stuff.

Upham: I have returned them all to Foley and Sherbondy.

Klotz: We've made a record of everything we've given them.

H.M.Jr: Everything out, I want it back by five o'clock. You've had it at least a week.

Upham: I had it a couple of days.

H.M.Jr: Now, what I am thinking about is this; I hope I am wrong: I don't think they are going to do anything about Stewart, see? I don't know whether I got this from you (Upham) or from Ransom, but - maybe I got it from Ransom - I don't think that - Eccles is just going to talk and, as a result of that, will simply say, "You'll have to see the Treasury." Now what I want to do is to get ready for that, and sort of giving the Board here a date on which, if they don't give us a satisfactory explanation of Mr. Stewart's extended position, why, then I would get another bank to represent us in San Francisco.

And then would you also look up the first statement I brought to Mr. Ransom's attention, you see, and the day we sat and pulled those things out and had them photostated and gave them to him.

Upham: The thirteenth, I think.

H.M.Jr: What?

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Upham: The thirteenth.

H.M.Jr: Well ...

Upham: I'll look it up. You want this by one o'clock?

H.M.Jr: Is that asking too much?

Upham: Oh no; no, indeed. Of course, they would have no interest in it until the date of his appointment, which only goes back two or three years.

H.M.Jr: My God, you're going to start joking this morning?

Upham: And the references go back at least ten years. See, the criticisms go back in the reports at least ten years.

H.M.Jr: How long has he been a Class C Director, and how long has he been a Director?

Oliphant: And what kind of a man did they pick when they picked him for a Director?

H.M.Jr: What?

Oliphant: What kind of a man did they pick, when they picked him, for a Director?

H.M.Jr: If these records go back ten years, didn't they know, at that time, that he had a - what do you call it?

Oliphant: A line?

H.M.Jr: - A line of credit?

Upham: Yes.

H.M.Jr: What?

Upham: Surely.

H.M.Jr: In other words, I am just not, in these difficult times - I've got so much to do - things coming so fast, I can't go around; I can't talk to Ransom or Eccles; I oughtn't to have to draw this to their attention but once. We were all here last night, and things are just coming too fast; I can't do these things more than once; I oughtn't to have to.

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If I were in their position, I wouldn't let more than twenty-four hours go without having this straightened out.

Upham: Was there something on this last night?

H.M.Jr: No, no; the European.

Upham: I'll probably hear from Mr. Ransom this morning on what Eccles did.

H.M.Jr: We got word last night on the farm that the French were serving us notice that if they had another bad day they'd put on a modified exchange control, and when Butterworth spoke to Sir Frederick Phillips, he had heard nothing about it.

I saw the President between seven and eight last night.

The other thing, which the President asked us to do, which we are doing, is, Waesche's watching the Italian and German liners to see if there is any change in their regular movements, and up to date there haven't been any.

And then we're going to load, as soon as possible, the Honolulu with another twenty-five million dollars worth of gold, and she'll sail - (words misunderstood) - and the Summers arrives, which ought to be Wednesday or Thursday.

Today we got a hundred thirty-seven million dollars worth of gold. All right.

Lockhead: And then, Mr. Secretary, I spoke to you about putting ten million of gold on the President Roosevelt, sailing on Thursday, if you want. And we might take up the question of the American Export Line, which is also sailing direct from London.

H.M.Jr: Now, I want to ask whether either Haas or White are making a study of when did the Allies, during the World War, begin to borrow money? I mean, when did they begin to get it, from what sources, and how fast? Are there any records?

White: No, I was just taking the period of the outbreak of the war, which wouldn't include that, but we

can easily put somebody on it.

Haas: I've got a diary on that.

Lochhead: Except immediately after the war.

H.M.Jr: Supposing George and Harry get together; this is what I have on my mind: I want you to take the important things, George, the commodities - you do these things. I'd like to take wheat, cotton, the important ones, and then sort of - you say you've got a list of the important events?

Haas: That's right.

H.M.Jr: This is what's in the back of my mind: The President's asked at Cabinet, two or three times now, for us to make a study of what authority the administration has to keep the system going. He did it when Hanes was there Friday; he did it the week before, and two weeks before. The last time he did it, I was bold enough to say, "Well, Mr. President, what I'd like to see is a nice healthy rise, first."

Now they are worrying so much about that, and there are so many other important things, which I think are much more important - now what I've got in the back of my mind is this: Have the so-called - England and France got the money to buy this stuff with, you see? This one thing, when they bought it in fourteen, fifteen, and sixteen, with the money we loaned

Haas: Uh huh.

H.M.Jr: But aren't we talking about something which wouldn't happen because they haven't got the money to buy it? Now the President is so worried about two- and three-dollar wheat, what I'd like you two fellows to get together - to see when wheat - for instance when wheat went to two dollars, was there any correlation when they began to borrow the money. See? I am just talking now. Maybe you can explode my theory, but if these fellows can't borrow a couple of billion dollars from us, they can't put wheat into it.

Haas: What I am afraid of, Mr. Secretary

H.M.Jr:

And then also, take wheat, for example; wheat was supposed to go up and cotton to go down; why did cotton go down? And the other thing - take a look at world stocks. How long was there a lag before these things went on? See? I just - it's all very nice; let the Department of Justice and the Treasury's General Counsel's office study all the things we have done.

I am again going to make a guess: When they get all through and done, they have no direct legal method they can use; they may be able to go through four or five corporations and do something, but when they get down to the direct method That's one of the things the President wants to do.

Oliphant:

I'd like to make this statement: All the methods which Justice and Commerce had suggested were shotgunned and designed to be just as hard on wheat and cotton, for instance, as they were on copper, and the methods we have been working on are discriminating methods that would allow the wheat and cotton, and that sort of thing, to go up, without an unnecessary run on it.

H.M.Jr:

We ought to take

Oliphant:

That is the important difference. We are thinking about, fundamentally, wheat and cotton, and that sort of thing. You wouldn't be particularly interested in the run of building materials?

H.M.Jr:

I don't want to see that run up.

Oliphant:

There are methods of discriminating against the building materials and leave the wheat and cotton run up.

H.M.Jr:

I still want to see you go ahead and follow that; I still want to see, lacking lending them a lot of money, have they the wherewithal to drive this thing up?

Gaston:

I just question it. My reaction is that wheat didn't shoot up until 1917 when the United States Government began to make the outright loans, and after the United States entered the war; that is when wheat began to shoot up.

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- H.M.Jr: Maybe we're right, and maybe not. This thing is important; that's why the President is concerned. Nothing is -- (words misunderstood). It killed Herbert Hoover.
- They always said there were certain justifications; if the bricklayer could get eighteen and twenty-four dollars a day for his work, and the riveter the same, why shouldn't the farmer get two dollars and twenty cents for his wheat.
- Gaston: Wheat was three dollars and sixteen cents the day they slapped that control on.
- H.M.Jr: You see, it's very interesting; I may be all wrong, but there may be something to it.
- Oliphant: I think you are all right when you talk about wheat and cotton, etc., and I think it's a different story when you talk about building material.
- H.M.Jr: The Allies are going to buy copper; they are going to buy steel, and all the rest.
- Oliphant: Those are different from wheat and cotton.
- H.M.Jr: I don't think anybody's studied this. You know of anybody, Hanes, looking that up from that angle?
- Hanes: I don't, no sir.
- H.M.Jr: Don't you think it's interesting?
- Hanes: The Attorney General had a report on what might be done, legally, without calling Congress, but I don't think he took it up from the angle you are talking about.
- H.M.Jr: Does anybody know that that particular angle is being explored?
- White: (Nods "No.") None.
- H.M.Jr: You work fairly fast on it, boys; if you're ninety per cent right, it's all right. Don't forget, in Miss Diamond you've got a very good librarian. Give me a shotgun opinion, and follow it up.

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Haas: When would you like the shotgun?

H.M.Jr: Oh, I'd like it in twenty-four hours, see?

Haas: We will give you some rough charts in that length of time, too.

Oliphant: Obviously the only source of funds are their securities here, naturally.

H.M.Jr: They are going to hustle (?) those.

Oliphant: They can't get a hold of them.

H.M.Jr: Well, I am worried about when the President has this one idea, and just that.

Haas: That isn't an immediate thing to worry about.

H.M.Jr: I don't think so.

What have you (Lochhead) got?

Lochhead: The market is quite erratic, running down to - again to about 4.75 3/4 against 4.77 at the opening. Now the Bank of England cable said they had done twenty-six million dollars in gold up to the time the cable was sent. They made no mention of the franc at all.

H.M.Jr: Did we get any of that Saturday?

Lochhead: Two hundred thousand dollars is all. We operated later on in the market - four thousand pounds. All the stuff they are doing, they are doing themselves, now. It's just a call-in from the Dutch bank. You recall, in the beginning they asked us to take gold, and we said we'd take up to twenty-five million; we took twenty-three. They turned around and have done twenty millions themselves; they're coming back and saying they are pretty well tied up, will we do some more over there? It is under the Tripartite. They have to ship it over and guarantee the insurance, so we don't have to worry about that. We have to worry about getting insurance, but they have to pay all the costs, and guarantee laying it down.

H.M.Jr: How'd you put that over on the Dutch?

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Lochhead: We gave them a little help on the way it was worked out, but they should take that responsibility. So shall I tell them it's all right for twenty-five?

H.M.Jr: Yes - sure.

(To Mr. Upham:) Why don't you go in Mrs. Klotz' room and call up Ronald Ransom, and come back.

Lochhead: Is it all right for me to run now?

H.M.Jr: Wait a minute. I'm unburdening myself so you people will know what I am thinking about. I had a chance to talk to the President about the Chinese situation. Incidentally, you're (Mr. Hanes) going to sit in on the Chinese situation, and I told him roughly, this. I understand I am not correct: I said, "Mr. President," I said, "as far as Europe is concerned, I guess you might as well make up your mind that the Nazis will control Europe from now on. We've got a slight chance to do something in the Pacific. When you boil everything down, as far as Chen and the rest tell me, they've got about ten million dollars of silver free that they can put their hands on. Archie gives me the bad news this morning that before they can reach the twenty million ounces of silver which they have as equity in their loans made in Europe, they've got to sell seventy-five million dollars"

Lochhead: Seventy-five million ounces.

H.M.Jr:"seventy-five million ounces. It's just a chance, Mr. President, whether you want to give them a credit of seventy-five million dollars and write it off at the beginning - a little more than the cost of one battle-ship - there is a slight chance of keeping peace in the Pacific. That's the position." He says, "Well, if there's war in Europe we'll give them the credit," and then he thought a few minutes and he said, "And if there isn't maybe we'll do it anyway."

Now I told him how Jones felt. Jones wanted to go along on this thing. Now what I told White, and I don't want to go into a long lengthy explanation - but I don't want to take the risk now; we've waited a year or two years to say that the Germans or Italians are dumping; why take that risk and do it this week? I - then if they are dumping or they

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are breaking any of our agreements, it's too bad we didn't do it before, but I am not going to do it this week, and give Mr. Hitler a chance to say that the United States is strangulating Germany and that's why they've got to go into Czechoslovakia in order to get their necessary supplies. I don't believe if we did announce Germany was dumping, it would keep Mr. Hitler from an announcement of that kind. There's nothing to be lost by waiting a week, inasmuch as we've waited a year, but I don't feel that way about Japan, because whether we do or don't isn't going to make Japan change her tactics in regard to Hankow, and if it's successful in connection with Japan, and then this thing - whatever happens in connection with this thing - "It worked with Japan; let's do it with Germany and Italy," provided we have the facts. (But to do this thing would give this fellow what he's looking for - every excuse to do it in Germany.) It would be - Hitler would say, "America is strangulating me; they won't let us do any business, and, therefore, I've got to fight." And I'm not going to stick my neck out.

- White: You feel the same way about your original plan, that if they did, you might
- H.M.Jr: No, no. I don't want to have anything about that; I don't want to do anything about that this week. Until this thing clears up - I can't give all the reasons, but I don't want to do anything on it.
- Oliphant: You don't want, this week, to get into those negotiations, but the Japanese thing is clear - clean.
- H.M.Jr: If it worked in Japan, and we could say to the President and Mr. Hull, "It worked in Japan, why not do it wherever the law dictates we should do it?" And, therefore, what can you fellows give me to show the President, by one o'clock, in connection with Japan?
- Oliphant: By one?
- H.M.Jr: By one. Now what I am saying is fairly important, and if anybody disagrees with me, please talk up, because I've been talking about pretty important things. Herman?

Oliphant: I agree with you, perfectly. I think - I don't know what it will look like a week from Monday, so far as Germany is concerned, but this week we ought to stay out of that "horse-biting" and all the rest in Europe. The Japan thing is entirely separate; we have apparently got a perfectly clear case there, and I think it ought to be tried there first.

H.M.Jr: Have you got a clear case?

Oliphant: I think we have.

White: You're satisfied?

Oliphant: If we can get the rest of that stuff out of the State Department, I think it will be clear enough. I'll have to check with Johnson on how much he was able to get Saturday.

H.M.Jr: Well, Herman, in this case I've got to be ninety-nine per cent sure, Herman.

Oliphant: I know that. I understand.

H.M.Jr: And if it can't be perfect by one o'clock, let it go over.

Oliphant: It will go over until we are.

H.M.Jr: I want a perfect, polished document.

Oliphant: Well, we don't go out on the end of a limb on a thing like that.

H.M.Jr: And in this case, if we are going to do it, is there anybody we might show it to - have on there as consultant?

White: I would suggest somebody.

H.M.Jr: Who?

White: Mr. Fox, of the Tariff Commission.

H.M.Jr: Good.

Oliphant: I am not going to bring it to you until it is safe, perfectly; until you've got solid earth under your feet.

- H.M.Jr: I want somebody like Fox, and some other people you think of, on it, and, "We've read this thing and we agree with the Treasury findings."
- White: See, it's their function to keep the President informed of just this thing. It's their duty, by law.
- H.M.Jr: John Fox is a former economist for Federal Trade; he's a Commissioner of Trade?
- White: Tariff Commission.
- H.M.Jr: Well, I'd like to have a memorandum as to where our responsibility begins and ends, and where the Tariff Commission's begins and ends. And, incidentally, Herman, if it could be done, that the Tariff Commission could serve notice on the President
- White: He said - I mentioned, talking something about that the other day, and he said it usually takes so long, but if circumstances were such that, in their opinion, speed was warranted, he thinks they could do it quickly.
- H.M.Jr: It would be nicer for me if it came from them, if it's their responsibility; if it's ours, I won't duck it.
- White: It's theirs.
- H.M.Jr: What?
- White: Legally, it's theirs.
- Oliphant: It isn't true; you are responsible for the administration of the tariff laws.
- H.M.Jr: Well, you boys get together.
- White: Well, I think we're both right.
- H.M.Jr: Well, I still say, let's get together.
- Oliphant: Well, you've got to talk fast; he makes a statement about what the law is, and I
- H.M.Jr: I am not getting in it, because you fellows go right outside and kiss each other.

Oliphant: That's what we always do, darn it.

H.M.Jr: Far be it from me to get between Oliphant and White.

Well, get together anyway. Anything else, Herman?

Oliphant: No. Now, on this thing, assuming, for instance, the Federal Tariff

H.M.Jr: I didn't get so far - I started to call you Dr. Oliphant and Dr. White.

Gaston: Yeah, but they are just a bunch of "Yes, but - " liberals. (Laughter)

Klotz: What?

H.M.Jr: "Yes, but - " liberals.

Oliphant: On this thing, let's assume that the Tariff Commission would go along on the thing, and the only howl that's liable to be raised around that time is liable to come from Henry.

H.M.Jr: Who?

Oliphant: Henry.

H.M.Jr: Who?

Oliphant: Henry - Wallace - the effect on the export of cotton.

H.M.Jr: Oh.

Oliphant: I don't know whether you want us to canvass that in advance.....

H.M.Jr: You'd better first let me see a polished document, and then

Oliphant: Would you want to know, in advance, what the effect would be on cotton?

H.M.Jr: Sure.

White: The case is not so clear as Germany, but you might be able to make a satisfactory case.

- Oliphant: But the effect of the export of cotton - I don't think there would be any other kickback on it.
- H.M.Jr: All right. What else, Herman; anything else?
- Oliphant: Nothing else, now.
- H.M.Jr: Nothing else now - that goes for an hour?
- Oliphant: Well, I've got five minutes, some of these days.
- H.M.Jr: All right. Herbert?
- Gaston: I suppose the President's note raises the possibility that we might get into direct negotiations with Germany on this thing, and I wondered whether you'd want to have the President and Hull informed as to just what we might be able to do toward Germany in case we don't like their action and in a way of interpretation of our laws, as a trading point.
- H.M.Jr: The President has had that; we've argued it all out; he knows that.
- Gaston: On this question of dumping, etc., we could take a much more drastic stand on our law.
- H.M.Jr: He's had that for weeks. Say, listen; I don't think Hitler will even read Roosevelt's note.
- Gaston: No.
- H.M.Jr: I don't think he will even read it.
- Haas: He's preparing his own speech.
- Gaston: I wonder whether the British asked us.....
- H.M.Jr: I am ^{talking} strictly in this room. I don't know....
- White: Ask me.
- Gaston: Never mind.
- H.M.Jr: Reminds me of Jesse Willard.
- Gaston: I - will we have a press conference at four?
- H.M.Jr: Sure. We'll again say that the Tripartite Treaty is functioning.

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Oliphant: I read, somewhere, a pretty elaborate memorandum on the effect of partial exchange control (words inaudible)

Klotz: Can't hear a word you're saying.

H.M.Jr: Herman, whatever happens this week, it is still working.

Oliphant: That's what the memorandum said; it's effective.

Gaston: If they haven't announced exchange control by four o'clock, then that answer will be all right.

Oliphant: I didn't write it yesterday.

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

Gaston: That's all.

H.M.Jr: George?

Haas: I have nothing new. I've got this book for you.

H.M.Jr: Put it on my desk.

Haas: We're working up a memorandum for you about - along the same lines you indicated on wheat here, only the Government bond market is the subject.

H.M.Jr: You want to hear this? I'm rather pleased about this. We went fifty-fifty with the Federal Reserve, last week, and bought up, each of us, about thirty-seven million dollars worth of bonds, so when the bonds began to gain a point, they began to sell. I said I didn't want to sell, but they began to sell, and sold about thirty-four million, and cleaned up. And last week - and Saturday morning they began to go bad, and Ransom said, "What shall I do?" I said to Archie Lochhead, "Call up Ransom and tell them inasmuch as they sold thirty-four million dollars worth of bonds, we won't go fifty-fifty with them until they bought back thirty-four million dollars worth of bonds." And they said, "All right," so they've got to buy back the thirty-four they sold before I go fifty-fifty. They said, "All right." I think that's pretty good, myself; I think that's a good day's work. Wouldn't you? They were so tickled they made about a quarter of a point profit.... And now the things are consider-

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ably below, and they asked me what to do, and I said, "Well, you buy back what you sold and I'll go fifty-fifty." They said, "All right."

Gaston: They thought they'd make a little profit, that's all.

H.M.Jr: I think it was rather neat; I thought it was good. I never said a word until they got all through. They are going to take care of the first thirty-four million.

(Points to Mr. Haas.)

Haas: That's all.

H.M.Jr: I think, in the papers, that the preliminary information on the Federal Reserve Index is ninety.

Haas: Eighty-eight.

H.M.Jr: They are September's.

Haas: September, they are estimating now. It was running about ninety, but the September isn't out.

H.M.Jr: When are you going to have a new trial balloon chart for us to go on?

Haas: I've got one estimate that came in the first of September, and the next one will be the first of October. In other words, I've got one you haven't seen.

H.M.Jr: Have you?

Haas: Uh huh, though they canged it slightly.

H.M.Jr: Nothing much?

Haas: Nothing much.

H.M.Jr: No use talking to the President now; I think as soon as you have the October

Haas: October.

H.M.Jr: October 1 in, let us know and we'll take a look at it.

Haas: All right.

H.M.Jr: (Nods to Mr. Hanes) Is that all, George?

Haas: (Nods "Yes.")

Hanes: I made an engagement with Harris for tomorrow at one o'clock. Is this going to change here?

H.M.Jr: What's his first name?

Hanes: Basil.
(H.M.Jr. and Mrs. Klotz writing, and speaking in low tone.)

H.M.Jr: Yes.

Hanes: That's all.

Oliphant: I didn't mention that following your directions, Hanes was helping us get in touch with the tung oil.

H.M.Jr: Mr. Hanes told me. Perfect coordination.

Oliphant: You're coming in today, aren't you?

Hanes: Ten o'clock. Yes.

White: The time is approaching when you, at one time, indicated you might want to release some figures in the stabilization fund for October first. We have drawn up something tentatively, but you - I don't know whether you want to pass that over.

H.M.Jr: No, I want to do it in connection with the quarterly figures on the balance of the Treasury.

White: Well, they are coming out the first of the month.

H.M.Jr: Well, Herbert has got to hold it until I pass on the figures. Does that register?

Gaston: That's right.

White: Mr. Chen was here; he might come back. He wanted to postpone it.

H.M.Jr: Eleven.

White: He was here about half an hour ago. You don't want to give any more thought to that German thing; you've made up your mind?

H.M.Jr: Definitely.

Klotz: He's said twice that very thing.

H.M.Jr: I think it would be very unwise.

Olyphant: This week, it would.

H.M.Jr: I think it would be plain foolhardy. If anybody can show me -- (words misunderstood; notes jumbled) doing anything on German customs -- I am willing to risk my neck.

White: Just say, "She's confronted with the knowledge that if they go into Czechoslovakia she can not export goods to the United States."

H.M.Jr: She knows it.

White: She knows it now.

H.M.Jr: It gives them a chance to say to their people, the reason they are going into Czechoslovakia - "the United States is choking us out."

Upham: Look, Harry, please. Now I think you're wrong.

Upham: Ronald has heard nothing from Marriner since six o'clock, our time, this morning. Marriner is probably in Ogden this morning.

H.M.Jr: Would you convey this message to Ronald Ransom, that Mr. Morgenthau is getting slightly impatient in regard to the decision with regard to Stewart.

Upham: Uh huh.

H.M.Jr: You think that's unwise, anybody?

Hanes: I think that's putting it pretty mildly.

H.M.Jr: All right. Slightly.

Upham: He thinks if the European situation gets any worse Marriner will be back here at once; he is quite worried about it.

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Klotz: Slightly worried.

H.M.Jr: That's another reason why we should have peace.
(Laughter)
What else?

Upham: That's all.

H.M.Jr: Well then, we are all clear until eleven, when we do China.

Oliphant: It's eleven?

H.M.Jr: Eleven. Now, let's see, Mr. Oliphant will be here, Mr. White and Mr. Hanes, and Mr. Lochhead.

Oliphant: And the Chinese won't.

White: The Chinese will.

H.M.Jr: The Chinese will.
O. K.

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WAR DEPARTMENT
WAR DEPARTMENT GENERAL STAFF
MILITARY INTELLIGENCE DIVISION, 3-2
WASHINGTON, D. C.

September 26, 1938.

MEMORANDUM NO. 21 FOR THE CHIEF OF STAFF:

Subject: The present European situation to
10:00 A.M., September 26, 1938.

General Situation. The details of events which occurred over the week-end are well covered in the press and radio. An interpretation of these events leads only to the conclusion that war between Germany and Czechoslovakia is inevitable unless Hitler makes unexpected concessions, or Prague accepts in toto the German demands under British and French pressure. In the event of a German attack, the war would tend to become general if Britain and France desist from applying this pressure.

Warlike preparations have already proceeded so far on the continent that it is difficult to see how, at the expiration of the German ultimatum, the clash can be avoided. The most optimistic hope only that it may be immediately avoided. Even the optimists seem to accept the inevitability sooner or later of a showdown between the totalitarian states and the democracies. From the active defensive measures already undertaken, particularly with respect to defense against aircraft, the presumption in responsible circles in all countries involved seems to be that the crisis is imminent.

Military Situation.

Great Britain - Following are paraphrases of messages received from the Military Attache, London, at times shown:

1:05 P.M., September 24.

British Navy taking every precaution short of calling reserves to active duty. Press has been advised by Admiralty to make no mention of naval movements. The Director of Military Intelligence stated at 1:00 P.M. to-day that mobilization not ordered and no movement troops initiated by War Office except pre-

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liminary measures by unit commanders. He assured me that he would give me prompt and accurate information as near that given the French as practicable. The Government is extremely anxious that the United States understand clearly the present issues and events.

On emerging from conference with Chief of Imperial General Staff General Ironside (commanding Eastern Command) said, "Hitler is now up against it. He will be beaten before this is over."

Everything depends on the meeting of the Cabinet to-day.

1:45 P.M., September 25.

Royal Air Force preparations remain as stated in cablegram September 15. Army preparations unchanged. Home Fleet left Invergordon for unknown destination. Air Ministry building protected with sandbags against air attack. Stretchers issued to all first aid stations afternoon 24th. Air raid shelters now being staked out in public parks, with construction to start 26th. Two shelters in Hyde Park to have capacity of 5,000 and 2,000 respectively. Others in Eaton Square, Regent Park, etc.

France -

Received from M/A, 10:57 A.M., September 25.

No change noted in the French-German military situation. Total number of reservists mobilized by France to date estimated at 1,50,000.

Czechoslovakia, as a result of complete mobilization, will have approximately 30 divisions within one week.

From the Press:

General Gamelin goes to London to-day to join the French Prime Minister in conferences with British authorities.

Additional measures for increasing the air raid protection of Paris have been taken, including preparations for wholesale evacuation of population, arrangements for extinguishing lights, setting up of 150 warning sirens, increase of fire brigades by over 6,000 volunteers, marking of locations of air raid refuges and roads for evacuation of civilians from the city. Forty-three thousand refuges are said to be available.

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Holland -

Sent to State Dept., 7:00 P.M., September 24.

An order has been issued cancelling all leaves for officers and enlisted men of the Army and Navy.

Portugal -

Sent to State Dept., 4:00 P.M., September 24.

Popular sentiment in Portugal is pro-England in present crisis.

Czechoslovakia -

Received from M/A, 5:23 P.M., September 24.

Military Intelligence here reports general distribution all around Czechoslovak border of German infantry regiments and brigades with artillery regiments and air units. This is in addition to troops mentioned September 20 and 2 divisions in Glatzneisse area. South from Berlin some important movements. It is not believed that troops are as yet in position for major attack. The heavy troop movement east through Munich reported yesterday may be in preparation for such an attack. Along the northern frontier of Hungary 7 brigades are reported as being located.

Germany -

Received from M/A, 10:25 A.M., September 25.

Troops stationed in and about Berlin given normal week-end furloughs. Gradually and quietly reservists are being called to active duty. Between Leobschutz and Cosel in upper Silesia on September 24th the 8th division was observed moving south in three columns. Aerial reconnaissance reveals widespread air defense measures in vicinity of Berlin with concentration of 400 bombers but no evidence of pursuit. Air forces apparently in full readiness.

Received from M/A, 9:15 A.M., September 26.

An increase in Germany's military preparations this week is indicated. There is no change in the military situation.

Hungary -

Sent to State Dept., 5:00 P.M., September 24.

Baron Apor (Undersecretary of State for Foreign Affairs) informed the U.S. Minister that regardless of

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rumors, no military alliance between Hungary-Poland-Germany for attack of Czech existed; Hungary will remain neutral if Germany attacks Czech.

Sent to State Dept., 2:00 P.M., September 25.

The Imredy Government has taken measures to prevent Hungarian Nazi from forming a free corps and invading Czechoslovakia. 4500 members were disarmed.

Air raid practice is planned to take place on a large scale in Budapest Sept. 26th. The air defense is pitifully lacking.

Poland -

Received from M/A (?) September 24.

It is estimated that units of the Krakow Corps motorized regiment and infantry division are concentrated at Cieszyn. Poland will protect the Teschen district inhabitants but otherwise will probably not take any further steps at the present time.

From the Press:

Prague accepts Polish demand as parley basis. Poland denounces Polish-Czech minority treaty of 1925. Polish-Czech border closed to all normal traffic. No further military preparations reported in last 48 hours.

Yugoslavia and Rumania - Unconfirmed press reports state that Hungary has been informed by Yugoslavia and Rumania that they will come to Czechoslovakia's aid in case of Hungary's unprovoked attack in accordance with the Little Entente agreement.

Soviet Russia - No information.

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Monday
September 26, 1938
10:11 a.m.

H.M.Jr: Hello.

Preston
Delano: Hello, there.

H.M.Jr: Good morning, Mr. Comptroller. How are you?

D: (Laughs) I'm a little weak. (Laughs)

H.M.Jr: A little weak?

D: (Laughs)

H.M.Jr: Ah - well, the - ah - what do you know?

D: Well, so far it's been - I think - rather gratifying.

H.M.Jr: Yeah.

D: Kiplinger and Whaley-Eaton were all right. Ah - most of the press was pretty fair I thought.

H.M.Jr: I thought so.

D: And Tom K. Smith called up from St. Louis and said there was a little badgering out there about this - about this relationship thing. And I think the Baltimore Sun took a fall out of it.

H.M.Jr: Uh huh.

D: But generally speaking - ah - in New York and around everywhere I thought we had very - exceptionally fair treatment.

H.M.Jr: Well now, when are you ready to go to work?

D: Oh, gosh!- I'm sunk here. Do you want to modify those terms?

H.M.Jr: Ah - well, I'm a farmer and I come from New England - and -

D: (Laughs)

H.M.Jr: I wouldn't take on a Massachusetts Yankee but I'm willing - ah -

D: (Laughs)

H.M.Jr: - ah - to try.

D: Well, what I had in mind was that I'd clean up here -

H.M.Jr: Yes.

D: You remember we talked about thirty days.

H.M.Jr: I know.

D: I'll cut that if I possibly can, Mr. Secretary.

H.M.Jr: Well, I tell you - ah - this is question number one: I think a great deal depends on what's happened on the Pacific coast.

D: Yes.

H.M.Jr: Ah - I'm sending - where are you now?

D: I'm in my office.

H.M.Jr: I'm sending word through Cy Upham to Ronald Ransom that I am getting slightly impatient ---

D: Uh huh.

H.M.Jr: -- with the fact that I have had no word from the boys about what action they're going to take in connection with that one Class B director out there.

D: Yeah. Yeah.

H.M.Jr: It's exactly two weeks since I brought it to their attention.

D: Uh huh.

H.M.Jr: And of course they've known all about it and I don't see why they need two weeks so I am sending them - I'm getting slightly impatient, see?

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D: Uh huh.

H.M.Jr: Now - because, with that man in the saddle out there it makes our job very much more difficult.

D: Yeah.

H.M.Jr: Now - ah -

D: I appreciate that.

H.M.Jr: Ransom's had no word from Eccles since Friday.

D: Uh huh.

H.M.Jr: And - ah - so he doesn't know.

D: Uh huh.

H.M.Jr: Now, the other thing which bothers me as much as anything is - ah - what your idea is - what we should do about Diggs.

D: Yeah. Uh huh.

H.M.Jr: And I wish you'd think about it and I'd like to talk to you about it as soon as you've got an idea.

D: All right, sir.

H.M.Jr: See? I mean, I think that's the next move.

D: Uh huh.

H.M.Jr: So the minute you can see through that - ah - and I'm going to tell Cy to talk openly to you and tell you anything that I am doing in connection with the banks -

D: Of course.

H.M.Jr: - from now on.

D: I appreciate that.

H.M.Jr: So you can talk openly to him.

D: I -

H.M.Jr: I do want your advice on the Diggs matter.

D: Well, I - I suppose we can do this, Mr. Secretary. I promised these fellows here that I would stay - enough to clean up this thing and I did make the commitment of thirty days.

H.M.Jr: I understand.

D: In the meantime what I want to do is to be free to talk to Cy and come over there and visit and take so much of your time as I think is essential.

H.M.Jr: Well, you can have all that's necessary.

D: Well, I appreciate that. I want to keep - ah - I do want to give you the benefit of any judgment I may have.

H.M.Jr: Yeah. Well -

D: And I do want to study a little bit - the thing.- I've just been digging myself out from - telegrams and all that sort of business and in a day or two, if that isn't too late, I would like to come over and talk to you.

H.M.Jr: Well I think - I think that the sooner you and Cy can advise me what we should do about Diggs, the better.

D: Right.

H.M.Jr: I think that that's the first move.

D: Right, sir.

H.M.Jr: And - ah - so whenever you're ready on that -

D: Yes.

H.M.Jr: Now, just for my own - did the White House let Mr. Fahey know?

D: Well now, I'm just simply appalled by that, because I can't find out.

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H.M.Jr: Uh huh.

D: Ah - when Frederic Delano called up the President and the President said he would talk to John Fahey -

H.M.Jr: Uh huh.

D: Ah - I haven't a word from Mr. Fahey at all and I was just simply - I didn't want to be convicted, you know, of bad manners in the matter -

H.M.Jr: Yes.

D: And I wrote him a letter explaining how this whole thing happened and how urgent the appointment became because of pressures.

H.M.Jr: Uh huh.

D: And I told him I hoped he understood. Now - you - we tried to get him on the telephone all that day and the next day -

H.M.Jr: Yes.

D: And the storm had blown everything out so we couldn't talk.

H.M.Jr: I see. I see.

D: Now, I - it's at rest that way - that I have a letter up there and there's a letter from this - from my board up there - ah - telling him the same thing.

H.M.Jr: Yes.

D: We haven't gotten through and I'm just simply sick about it. I was wondering - you have lunch with him today, don't you? - With the President?

H.M.Jr: As far as I know; I haven't heard.

D: Would you - would you be willing to just ask him if he did talk to Mr. Fahey?

H.M.Jr: Sure. Sure.

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D: And if he hasn't will he please take - I appreciate his tremendous responsibilities at the moment -

H.M.Jr: Yes.

D: - but I don't want to be - I don't want to leave a place with a bad taste, you know?

H.M.Jr: I understand. Ah - and then you will give this other matter - because that's really - what I am thinking of is supposing something happens, see?

D: Right away.

H.M.Jr: And then what are we going to do about Diggs? Do we want to put Cy in there right away, you see?

D: I think we should - just off hand, but I would like to think about it.

H.M.Jr: I want you to think about it carefully.

D: I will.

H.M.Jr: And then I think - ah - what are we going to do about Diggs and all the rest - ?

D: Yes. Well, I - just - just as soon as I - a couple of days is all right at it, isn't it?

H.M.Jr: Well, I'll leave it this way, - when you've got an idea give me a ring.

D: Right, sir. I'll do that.

H.M.Jr: Thank you.

D: Goodbye.

September 26, 1938

11:00 a. m.

Present:

Mr. Chen
Mr. Mou
Mr. Hanes
Mr. Oliphant
Mr. Lochhead
Dr. White
Mrs. Klotz

HM, Jr: I asked Mr. Hanes to come in. He is the new Assistant Secretary of the Treasury. He will be in here in a couple of minutes.

Mr. Chen: In last meeting you talked about forming American corporation and in the meantime made a few observations. I have a memorandum on it. This is very brief sketch. (Exhibit I)

HM, Jr: Fine!

Mr. Chen: It's only suggestions from us.

HM, Jr: Fine!

Mr. Chen: But no plans. No organization. And if this should meet with some of your approval, we will have discussion about it.

HM, Jr: Have you people seen this memorandum?

Dr. White: No. We were going over other figures.

HM, Jr: I will read it out loud. (Memorandum on Formation of American Corporation, attached hereto.)

Well, that's a very good memorandum and, without getting down to details, I think it would be along those lines.

Mr. Chen: Yes.

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HM, Jr: To my mind.

Mr. Chen: I have not cabled back to Kung about this. I thought I would wait. In the course of the next few days we have plans and under discussion, we will see.

HM, Jr: Now, Mr. Chen, have you had time to give me the picture on silver?

Mr. Chen: Yes, we have; this morning.

HM, Jr: Fine!

Mr. Lockheed: Here is a memorandum on the silver.

HM, Jr: (Reading) (Exhibit II)

"Washington, D. C., September 24th, 1938. Memorandum on silver"

Did you have this on the 24th?

Mr. Lockheed: On the 20th. We had it in the same terms. This has been brought up to date.

(Secretary reading as follows:)

"The Chinese Government is deeply grateful for the action of the U. S. Treasury in purchasing Chinese silver and also greatly appreciate the kind help in having an advance bid made yesterday under the current Purchase Agreement which is thus completed.

(To Mr. Hanes) To bring you up to date, we had another 10 million ounces which we would have normally bought on the 30th of September. Instead of that we advanced it 7 days in order to facilitate that. So that completed on the 23rd the last of the silver which we were under an agreement to purchase from them.

(Continued reading)

"After shipment of 10,000,000 ounces in pursuance of this advanced bid, there will be 84,560,000 ounces of silver available for

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"sale, of which 19,360,000 are unpledged and 65,000,000 ounces pledged as follows:

A. Unpledged

In London	10,360,000 oz.	
In Hongkong	<u>9,000,000</u> oz.	19,360,000 oz.

B. Pledged

H'kong & S'hai Bk	30,000,000 oz.	
French United Group	11,100,000 oz.	
Mendelssohn	16,700,000 oz.	
Chase (ex-Swiss)	<u>7,400,000</u> oz.	<u>65,200,000</u> oz.
	Total	84,560,000 oz.

HM, Jr: The French United Group?

Mr. Mou: Group of four banks, Lazard Brothers and so on.

HM, Jr: Now, the Hong Kong-Shanghai Bank, 30,000,000 oz., where is that?

Mr. Mou: In London. All in London.

HM, Jr: All of this is in London?

Mr. Lochhead: All of the pledged silver is in London.

HM, Jr: And the 65,000,000 pledged, they advanced you money?

Mr. Mou: Yes.

HM, Jr: How much?

Dr. White: If they sold it, it would be \$8½ millions free if they sold it at 43¢.

HM, Jr: (concluding the reading) "The sale of the aforementioned pledged silver held in London under lien to various lenders would necessitate the making of arrangements first satisfactory to the Treasury and then to the lenders.

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"The cooperation of the Treasury in effecting such arrangements would be greatly appreciated by the Chinese Government."

Mr. Lochhead: The French group, for instance, have silver pledged in London. Under ordinary circumstances when we buy silver, we only pay for it when it is delivered here. The French won't give up silver until it is paid for. We don't pay for it until it gets over here.

HM, Jr: That's that much that I asked for. What about what Governments they owe? (Exhibit III)

Dr. White: This is what the Government owes on the purchases of armaments, except it does not include all their liabilities. They bought new gasoline and some other things and we have asked, this morning, to get those and it does not include dollar debts the Chinese Nationals have.

Mr. Lochhead: This is a summary right down here and this figure is a breakdown.

HM, Jr: Well, they owe us \$21,000,000.

Mr. Lochhead: No, they don't owe us; they owe various people \$21,000,000.

HM, Jr: But for 1938 they owe us \$1,300,000.

Mr. Lochhead: That's right.

HM, Jr: They owe England, \$1,800,000; Germany, \$2,000,000; Italy, \$430,000; Switzerland, \$410,000; Austria, \$10,000; Finland, \$80,000; France, \$1,600,000. This is all 1938. Belgium, \$2,000,000; Czechoslovakia, \$1,000,000; Denmark, \$940,000.

You have not totaled up the 1938 debts, have you?

(Concluded reading) "Total amount to be paid including all countries about US\$ 21,800,000." For 1938.

"For further reference Minister approved budget for year 1939 armanent replenishment for purchase of airplanes, T.N.T. and

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"gunpowder, etc., amounting to US\$15,340,000; year 1938 being US \$31,170,000."

Dr. White: 1938, 1939, 1940 is \$38,000,000.

HM, Jr: How much for 1938? Let me cross-examine you fellows and I get it in my brain.

Let's first do it on the silver thing, because I started to talk, last night, to President Roosevelt about this thing.

They've got 84,000,000 ounces, total silver, of which, as I told him, 20,000,000 ounces is free. But I don't see where your statement holds water that they can't sell that 20,000,000.

Dr. White: There was a misunderstanding.

Mr. Lochhead: We thought it was all tied in. So the 20,000,000 is free.

HM, Jr: Well, what I told the President is correct?

Mr. Lochhead: Is correct. That in addition to the other silver would mean an additional \$8,000,000.

HM, Jr: What I told the President, last night, was roughly they had 20,000,000 of free silver which they could sell us and the rest of the silver was pledged. That's correct?

Mr. Lochhead: That's right.

HM, Jr: Now, as I understand it -- let's just run through this -- on the \$1,800,000 to England they have defaulted on the interest?

Mr. Chen: No. This is the purchase of armament.

HM, Jr: That's all munitions. That's all to private contractors.

Mr. Chen: Private contractors.

HM, Jr: This is not Government?

Mr. Chen: No.

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Mr. Lochhead: In other words, we call this the extra-ordinary budget.

HM, Jr.: But this sheet is for the purchase of war materials?

Mr. Mou: Yes.

HM, Jr.: And that's the money you owe?

Mr. Mou: Yes.

HM, Jr.: And I take it you got that money by pledging that 65,000,000 ounces of silver?

Mr. Mou: The proceeds of the 65,000,000 ounces are already used.

HM, Jr.: What did you use it for?

Mr. Mou: Various uses. We showed you in one memorandum. Maintenance of the currency and against the payment of five million United States dollars, war materials, and then loan payments; covered everything almost.

HM, Jr.: I see.

I haven't got this thing yet. We will go through this thing once more.

They have, roughly, 20,000,000 ounces they could sell today, which would give them \$9,000,000. That's all that they have got.

Dr. White: \$8½ million equity in the other.

HM, Jr.: But in order to help them on that, I would have to buy 65,000,000 ounces.

Dr. White: Which would give them \$8,500,000.

HM, Jr.: That's a big order.

Mr. Chen: It's going to be a big help to us.

HM, Jr.: But it's also a big order, Mr. Chen. Have you told my men when those pledges -- how long they run?

Mr. Lochhead: We have absolute details. One will

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run out September 30th.

HM, Jr: Which one?

Mr. Lochhead: The Hong Kong-Shanghai Bank. On the others, there is Chase Bank with three installments and one installment ran out on the 20th. Presumably has been reduced.

HM, Jr: How much is Chase?

Mr. Lochhead: Chase has loaned 500,000 L. (Exhibit IV)

HM, Jr: Against silver?

Mr. Lochhead: Against silver.

HM, Jr: Do these people figure about the same amount of velvet? Is that evenly divided among the four groups?

Mr. Lochhead: Yes, roughly. In each case, roughly, it's about the same. Apparently all working about on the same basis.

HM, Jr: Well, there isn't going to be much difficulty about the silver which is not pledged, but on the 65,000,000 ounces which is all pledged, that's an awful lot of silver even for me, Mr. Chen.

Mr. Chen: I am afraid we are appealing to you for assistance in this matter.

HM, Jr: I have a gold-lined stomach that sometimes gets indigestion from too much silver.

Well, let's say for the moment that that's that. Put that aside for a minute.

Mr. Olyphant: You get the picture of bills payable by years?

HM, Jr: Yes, I have it.

Dr. White: Is it certain that those do not include your service on the foreign debts? It does not include

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that, Mr. Chen?

Mr. Chen: No. It does not.

Mr. Lockheed: This is what I call the extraordinary budget, which does not appear in their regular budget.

HM, Jr: Let me ask you this, Mr. Chen. I am trying to get the whole picture. I am like the doctor. I want all the symptoms.

Mr. Chen: Please.

HM, Jr: I would take it that from this picture right now that if your Government wanted to buy any additional war materials, you have not got the money.

Mr. Chen: Have not got the money.

HM, Jr: Is that right?

Mr. Chen: That is right.

HM, Jr: And I also told the President that you had pledged all your tea on barter.

Mr. Chen: Just for this year.

HM, Jr: But you have pledged it to Russia.

Mr. Chen: I have memorandum on that. (Exhibit V)

HM, Jr: Have you a memorandum on barter with the Germans?

Mr. Chen: I cabled for full particulars.

This is just working memorandum on giving up tea to Russian Government.

HM, Jr: Thank you. I don't think I will read that just now, but I do want to add it.

Then we are right back where we were before, and that's in connection with tung oil.

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Mr. Chen: Tung oil is not mortgaged. Tin is not mortgaged, but is Provincial monopoly. They are conducting negotiations between the two Governments. Antimony and tungsten are not mortgaged.

HM, Jr: On any of those commodities are you prepared to talk today? Have you any more information?

Mr. Chen: We have some information, Sir. We can finish the figures on yearly production. And the question is the price. We have not found out price yet.

HM, Jr: On tung oil?

Mr. Chen: Tung oil is about 11 cents. Tin and antimony and tungsten, we have not the price.

HM, Jr: Eleven cents? Where delivered?

Mr. Chen: Delivered f. o. b. New York.

HM, Jr: Are our Treasury people -- have you made progress, anybody, on tung oil? Are we ready to talk?

Mr. Hanes: We have made some progress. I don't think we are ready to talk. We had our first conference this morning.

HM, Jr: I see.

Well, going on the theory that we want to help as rapidly as possible, the only other thing we could do -- I am having lunch with the President today -- would be to draw his attention to that 19,000,000 ounces and I will recommend that we give you a buying order on that right away.

Mr. Chen: Yes.

HM, Jr: What I am trying to do is, if I may ask -- I don't like to push too hard -- supposing we bought that 19,000,000 ounces of silver which is free, would you tell me what you would do with that money? What use you would make of that money?

Mr. Mou: The proceeds would go from Federal Reserve Bank to Chase, with which we keep all our accounts both

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England and New York, and from Chase we draw on instructions of Government for various war activities.

HM, Jr: Would it go towards payment of these materials already bought?

Mr. Mou: Most likely, Sir.

HM, Jr: You wouldn't use that for any new materials? You wouldn't use the \$9,000,000 to buy new war materials?

Mr. Mou: Unless they are pressed for certain aviation supplies, such as gasoline, they must buy at the moment. Then they may use it. Otherwise, I think it would apply to the old contracts first.

HM, Jr: Let me ask this: do you have -- who decides, for instance, if you have \$9,000,000 new money, who decides how that will be spent?

Mr. Mou: Minister of Finance, Dr. Kung.

HM, Jr: That's entirely with him?

Mr. Mou: Yes.

HM, Jr: Because what we are doing is -- with the 10,000,000 we bought Friday and this 20,000,000 is roughly \$14,000,000 which you would be getting, which is a lot of money. And you don't know what Dr. Kung would do with it?

Mr. Chen: I think most likely pay off old contracts. We hope to use this money to finance payment of war materials.

Mr. Oliphant: How do they do business with these countries from which they buy munitions? Is that done on a sort of open running account? If you paid one off now, would they advance you more munitions without cash?

Mr. Mou: Usually the first payment is by letter of credit and the subsequent ones by promissory notes and this would be made on promissory notes which are presented for payment when they are due.

HM, Jr: Have you a list of their external debts and to whom they owe and what the payments are and all....

Dr. White: We have some which we did not get from

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them; a little old.

Mr. Lochhead: But you have a list of the yearly details.

Dr. White: But they can easily give it to us.

HM, Jr: Would you get to work on that? How much does the Chinese Government owe as a Government debt in war materials?

Mr. Lochhead: We have a figure which was meant to cover the ordinary budget and this is the extraordinary.

HM, Jr: How much interest do they have to pay for the balance of this year and what are their interest charges for 1939?

Dr. White: We can get it.

HM, Jr: Balance of this year and 1939 -- in other words, external.

Dr. White: One of their difficulties is, was, that they need certain items, to continue to purchase certain items and there is not the certainty that those items are available in the United States.

HM, Jr: What do you mean?

Dr. White: Ammunition, etc. So what proportion of their total new assets they could devote to American purchases depends, in part at least, on whether or not they can buy whatever they need.

HM, Jr: Well there is, for instance, in the United States we have no private factories that manufactures guns.

Mr. Chen: No. Suppose war breaks out in Europe, we have to depend on this country to get munitions for continuation of the war. What are possibilities?

HM, Jr: I am talking about big guns. I don't know what Winchester and those people makes, but big guns -- because the question came up of putting guns on those war-snips we sold to Brazil and when it came to getting the guns there was no place they could get the guns. The Navy had to lend them guns. There is no big naval gun factory in the United States privately owned, so we don't have any

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munition makers bringing pressure on us to go to war, which is very nice.

I don't know what the answer is, Mr. Chen, to your question. I don't know what the answer is.

All I could do today would be this: I had a chance to talk to the President about this last night. I will talk to him about the 20,000,000 ounces and see how he feels about it and I won't waste any time and if it is all right, will try to give you an answer by tomorrow. This other stuff, we will have to have time to think about.

Do you (Mr. Hanes) think of anything you want to ask?

Mr. Hanes: No.

HM, Jr: I just want to ask Mr. Chen something. Will you (Mr. Chen) come with me in the other room? Excuse me a minute.

(Mr. Chen and the Secretary left, but returned in a minute or two.)

Well, I think, Mr. Chen, what we will do, I will have a chance to see the President and we will get in touch with you tomorrow.

Mr. Chen: Thank you.

HM, Jr: Just as soon as I know. Anything you people want to know?

Dr. White: We asked for some things this morning.

HM, Jr: Where do you want to see Mr. Chen, because I want to see you gentlemen.

Mr. Lochhead: They can drop into my room.

HM, Jr: Where do you see them?

Mr. Lochhead: In Room 296.

HM, Jr: Why not have Mr. Kiley take them down to

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296. These gentlemen will be here five minutes.

(Mr. Chen and Mr. Mou left the Secretary's office.)

HM, Jr.: What I said to him outside was that Ambassador Wang has been trying to see me and I did not want to see him because I did not know what he wanted. So he said all he wants to see me about is to say good-bye. So if you (Mrs. Klotz) will make an appointment for 10:30 tomorrow. I said, What shall I say to him? And he said, Just say good-bye. I said, That's all I wanted to know.

I don't see, gentlemen -- unless you have something else, I am going to say to the President, Buy this 19 million plus and then wait, and I don't think we ought to surround it with too many strings.

Dr. White: Except there should be a point made clear -- about collateral.

Mr. Lochhead: The point about collateral -- Chase is loaning \$2,500,000 against silver in London. The loan runs out and they don't pay it. They put it on a boat and bring it over here, so they liquidate the loan by selling in the market. So we have to be prepared to take the silver anyway or drop the price.

HM, Jr.: That goes for Chase?

Mr. Hanes: 500,000 L.

HM, Jr.: About \$2,500,000. That's roughly 6,000,000 ounces. What about the 65,000,000 ounces?

Mr. Lochhead: That's the same way.

HM, Jr.: Hongkong? Will they do the same?

Mr. Lochhead: Certainly. It is in London.

HM, Jr.: They have been doing that?

Mr. Lochhead: As long as they are not called on for collateral, it's a good loan, but if they are turned down they would have to liquidate and this is the market they would have to liquidate in.

Dr. White: But they would not liquidate unless

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it is turned down and they will not be turned down if they can pay the interest and they can continue to pay the interest if they getsome assistance here.

HM, Jr: What I am thinking about, gentlemen, is this: we have a situation as bad as any I have faced for another country; could not be any more desperate than these poor fellows. What I told the President, there is about \$9,000,000 left and that's about all and that, I guess, they owe. Now, the other stuff, before I make it too easy, maybe by withholding a little bit any action, maybe we can help them get an extension or something or do a little trading. Take the Hong Kong-Shanghai Bank. Some of these boys. I don't know, but maybe we could help them get an extension.

Mr. Lochhead: The two big ones, they don't need an extension. The French United does not come due until 1939; the Mendelssohn group, March 1939. It's Hong Kong-Shanghai and Chase.

HM, Jr: Chase would have to take care of ours first. When do they come due?

Mr. Lochhead: September 20th, October 20th and November 20th.

HM, Jr: All this year?

Mr. Lochhead. All this year. Hong Kong-Shanghai is due now. September 30th.

Dr. White: Another reason why it is the best policy, because if you were to offer to take this whole 64,000,000 ounces and make it possible for them to pay, it might stand in the way of doing something that's more important for them because it will be doing something by taking the 64,000,000. If, on the other hand, you don't take it, it still makes something you might do.

Mr. Oliphant: From our standpoint it's burdensome and not so much for them. Might save our energies for something else.

HM, Jr: What I was thinking about, I want to give the President this picture, no worse than it is, but he has got to sell it to Mr. Hull. I can't. I have tried

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since last July. And I said to the President last night, it's correct now, I said, 'Mr. President, here's all they have got. We will buy this tomorrow. The rest of the stuff is all pledged and you just have to make up your mind, do you want to give these fellows \$100,000,000 credit and the minute you give it just charge it off? But you have got to sell it to Mr. Hull. I can't sell it. I have tried to since last July.'

Dr. White: I think it is highly desirable to make the issue just as clear as that.

HM, Jr: Then we take that. Everything else they have is all tied up.

Mr. Oliphant: Very complicated. Lot of fussing trying to work it out.

HM, Jr: And look at the amount of silver it costs us! Doesn't help anybody. Helps them to the extent of \$8,000,000.

Mr. Hanes: They have free 20,000,000 ounces, which is about \$9,000,000, and equit in their loans of about \$8,000,000, which is \$17,000,000.

HM, Jr: What I want to recommend is, the 19,300,000 we buy that right away. All of that gives this fellow additional standing at home. Great jealousy about his coming over and I am doing this to build him up, and also he says anything we can do soothes their most shattered nerves at this time, and I want to build him up as the light haired boy, so when he demands certain things he can get it, plus the fact that when he came here it helped their foreign exchange, after he got on the clipper. The inside group knows how desperate they are. And, as I said to the President, does he want, as a last straw, to save the Pacific from the domination of the Japanese?

Dr. White: Look what happens if he doesn't. They are not going to get anything from England.

HM, Jr: Has Hanes seen that? (cable from Kennedy)

Mr. Lochhead: No.

HM, Jr: Has Oliphant:

Mr. Lochhead: No.

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HM, Jr: A cable from Kennedy giving the British viewpoint on the Chinese. (Cable #995, Exhibit VI)

Dr. White: The alternative seems almost as desperate.

Mr. Oliphant: Desperate from our standpoint.

Mr. Hanes: I should think if we made a trade on tung oil, it might be well to hold back a trade on the second purchase.

HM, Jr: When you say 'second purchase', what do you mean?

Mr. Hanes: After you have taken the 19,000,000 ounces and

HM, Jr: I made a purchase Friday and I call the 20,000,000 the second.

Mr. Hanes: I am talking about the third -- hold back a trade on the third until we have completed the trade on this wood oil.

HM, Jr: I would like to go slowly on the third anyway. I want to see more what's going to happen in Europe.

Mr. Hanes: Did I understand him that he had set a price of 11 cents?

HM, Jr: F.o.b. New York.

Mr. Hanes: That's all right. That's a good price.

Mr. Oliphant: The reason I am hopeless about tung oil -- for instance, whether or not it would get them real money. Throws us back on the \$100,000,000 credit. All this tung oil, which is a Japanese objective, dumped on the world market. In addition to that, if they get tied up on the transportation. The big substitute is perilla oil, which the Japanese control.

HM, Jr: Where does that grow?

Mr. Oliphant: Japan. All comes to us from Japan.

HM, Jr: I don't quite get your thinking.

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Mr. Oliphant: If the Japanese get the 25,000 tons of tung oil now at Hankow, that will all redound to the benefit of the Japanese and completely break the market here for such of the Chinese oil that does come here.

Dr. White: If they don't destroy it.

HM, Jr: He means if the Chinese don't destroy it.

How many thousand tons of tung oil would take care of the needs of the United States in a year.

Dr. White: About \$18,000,000 worth. The consumption of tung oil is 97,000,000 pounds in the United States.

Mr. Hanes: This is not a drop in the bucket. 25,000 tons is not very much.

Mr. Oliphant: I agree we must go ahead and get out of these commodities everything we can. And we are right now up to the \$100,000,000 credit. All this other stuff is chicken feed.

Mr. Hanes: Three years' supply would not be chicken feed if there is \$30,000,000 -- \$10,000,000 a year and three years' supply would go a long way on your \$100,000,000.

HM, Jr: John, are the paint and varnish people at all interested?

Mr. Hanes: Yes; I should say yes. This is the first conference we have had. Two men here now are Delaney Kountze and Elliott Phillips, of Devol and Reynolds Co., and we are going back now to the fellows who bring the material in, really the importers. They are just the manufacturers and converters. And we are going to talk to Archer Daniels and Spencer Kellogg. Importers have large investments in China.

HM, Jr: Do they use it for soap?

Mr. Hanes: No; as a base for paint.

HM, Jr: As of today, does anybody see why I should not recommend to the President that we buy this 19,300,000 ounces that they have free and unpledged? No.? O.K. Sold! This is a sad story.

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Mr. Oliphant: Isn't it! Even hocked their
last scraps.

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Exhibit I

387

Sept 26 1943
11-2-43

MEMORANDUM ON FORMATION OF AMERICAN CORPORATION

Supposing that some loan or credit arrangement is made involving future delivery of Chinese export commodities and purchasing of military supplies and materials in America, it is thought advisable to have an American Corporation formed which will co-operate with the Chinese Government.

The American Corporation will act as the purchasing agency of the Chinese Government in this Country and will be the exclusive distributor here for the Chinese export commodities involved. It shall maintain a branch at Hongkong, and, if necessary, several branches in the interior of China to effect close co-operation with the Chinese Government. It shall see to it that all commodities deliverable under the agreement shall be delivered in accordance with it. It shall supervise or effect the purchases in America on behalf of the Chinese Government directly with the manufacturers and at the most advantageous terms.

As transportation is an important problem in China and especially so in case of Hankow and the Canton-Hankow Railway being involved in war operations, the American Corporation should maintain an efficient shipping organization, and in co-operation with the Chinese Government work out solutions for future transportation difficulties. In case it is necessary to transport goods entirely by motor routes, a large fleet of say, 1000 trucks will have to be equipped, operated and maintained in order to insure continuous flow of goods both outward and inward.

The Chinese Government will create a Control Board whose function will be to acquire the required commodities from all producing districts in sufficient quantities and transport them to concentration points to be shipped via the main routes for the port of export. Place of delivery may be arranged between the Corporation and the Board from time to time according to changing circumstances.

For the purpose of supervising the proper fulfillment of the loan contract terms an appointee by the U.S. Government or by the Corporation may sit on the Chinese Board of Control.

view
This brief memorandum serves to convey our suggestion of an idea with a view to insure close co-operation and satisfactory working on both sides. If acceptable, details have to be worked out jointly.

Exhibit II

WASHINGTON, D.C.

24th September, 1938

MEMORANDUM ON SILVER

The Chinese Government is deeply grateful for the action of the U.S. Treasury in purchasing Chinese silver and also greatly appreciate the kind help in having an advance bid made yesterday under the current Purchase Agreement which is thus completed.

After shipment of 10,000,000 ounces in pursuance of this advanced bid, there will be 84,560,000 ounces of silver available for sale, of which 19,360,000 are unpledged and 65,000,000 ounces pledged as follows:-

A. Unpledged:

In London	10,360,000 Oz.	
In Hongkong	<u>9,000,000 Oz.</u>	19,360,000 Oz.

B. Pledged:

H'kong & S'hai Bank	30,000,000 Oz.	
French United Group	11,100,000 Oz.	
Mendelssohn	16,700,000 Oz.	
Chase (ex-Swiss)	<u>7,400,000 Oz.</u>	65,200,000 Oz.

Total		<u>84,560,000 Oz.</u>
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The sale of the aforementioned pledged silver held in London under lien to various lenders would necessitate the making of arrangements first satisfactory to the Treasury and then to the lenders. The cooperation of the Treasury in effecting such arrangements would be greatly appreciated by the Chinese Government.

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UNITED STATES

<u>Year</u>	<u>US\$</u>	
1938	<u>1,300,000</u>	US\$ 1,300,000
1939 onward no payment		

ENGLAND

1938		1,820,000	
1939	1st half US\$ 40,000		
	2nd half <u>60,000</u>	<u>100,000</u>	1,920,000
1940 onward no payment			

GERMANY

1938		2,040,000	
1939	1st half US\$330,000		
	2nd half <u>250,000</u>	580,000	
1940	1st half US\$ 50,000		
	2nd half <u>---</u>	<u>50,000</u>	2,670,000

ITALY

1938		430,000	
1939	1st half US\$170,000		
	2nd half <u>120,000</u>	290,000	
1940	1st half US\$ 80,000		
	2nd half <u>80,000</u>	160,000	
1941	1st half US\$ 70,000		
	2nd half <u>40,000</u>	110,000	
1942	1st half US\$ 70,000		
	2nd half <u>110,000</u>	<u>180,000</u>	1,170,000

SWITZERLAND

1938		410,000	
1939	1st half US\$ 5,000		
	2nd half <u>---</u>	<u>5,000</u>	415,000

AUSTRIA

1938		<u>10,000</u>	10,000
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FINLAND

1938		80,000	
1939	1st half US\$260,000	<u>260,000</u>	340,000

FRANCE

<u>Year</u>			<u>US\$</u>	
1938			1,660,000	
1939	1st half	US\$200,000		
	2nd half	<u>190,000</u>	390,000	
1940	1st half	US\$180,000		
	2nd half	<u>180,000</u>	360,000	
1941	1st half	US\$180,000		
	2nd half	<u>180,000</u>	360,000	
1942	1st half	US\$180,000		
	2nd half	<u>180,000</u>	360,000	
1943	1st half	US\$180,000		
	2nd half	<u>90,000</u>	<u>270,000</u>	US\$ 3,400,000

BELGIUM

1938		US\$	2,090,000	
1939	1st half	US\$770,000		
	2nd half	<u>180,000</u>	950,000	
1940	1st half	US\$ 80,000		
	2nd half	<u>80,000</u>	160,000	
1941	1st half	US\$ 30,000		
	2nd half	<u>30,000</u>	60,000	
1942	1st half	US\$ 30,000		
	2nd half	<u>30,000</u>	60,000	
1943	1st half	US\$ 30,000		
	2nd half	<u>10,000</u>	<u>40,000</u>	3,360,000

CZECHOSLOVAKIA

1938			1,390,000	
1939	1st half	US\$1,400,000		
	2nd half	<u>270,000</u>	1,670,000	
1940	1st half	US\$270,000		
	2nd half	<u>270,000</u>	540,000	
1941	1st half	US\$270,000		
	2nd half	<u>270,000</u>	540,000	
1942	1st half	US\$270,000		
	2nd half	<u>270,000</u>	540,000	
1943	1st half	US\$230,000		
	2nd half	<u>---</u>	<u>230,000</u>	4,910,000

DENMARK

<u>Year</u>		US\$		
1938			940,000	
1939	1st half	US\$780,000		
	2nd half	<u>570,000</u>	<u>1,350,000</u>	<u>2,290,000</u>
GRAND TOTAL				<u><u>US\$21,785,000</u></u>

Total amount to be paid including all countries about US\$21,800,000.

For your further reference Minister approved budget for year 1939 armament replenishment for purchase of airplanes, T.N.T. and gunpowder etc. amounting to US\$15,340,000; year 1938 being US\$31,170,000.

WASHINGTON, D.C.

24th September, 1958

MemorandumPayments to be made in respect of Purchases of Arms,
Ammunitions and Airplanes.(Equivalents in US\$ based on The Central
Bank of China's official rate of 29-1/2)

1938	US\$13,640,000
1939	3,600,000
1940	1,310,000
1941)	2,880,000
1942)	
1943)	
	<u>US\$21,430,000</u>
Besides the above, orders placed for other materials for military use and airplane parts amount to	US\$29,000,000
	<u>US\$50,430,000</u>
Total	<u><u>US\$50,430,000</u></u>

It is estimated that the stock of arms and ammunitions, including those arriving within this year, will be sufficient for six months according to the past twelve months' experience.

20th Sept 1938

Memorandum:

Amount of silver left over after completion of Current Purchase Instalment of 50,000,000 ounces expiring 30th September, 1938, will be as follows:

In London:	<u>Ounces</u>	<u>Ounces</u>
Unrefined	22,500,000	
Refined	<u>53,060,000</u>	75,560,000
 In Hongkong:		
Unrefined	<u>9,000,000</u>	<u>9,000,000</u>
Total		<u>84,560,000</u>

of which 65,200,000 ounces were pledged as per attached statement and, if valued at 42½ cents per ounce, is equivalent to US\$27,710,000.

The debt secured thereby is as follows:-

	<u>Amount</u>	<u>Equivalent at rates of Sept. 7th, 1938</u>
French United Group	F.Fcs. 100,000,000	U.S.\$ 2,709,000
Mendelssohn	Fls. 8,757,460	4,738,000
H. & S. B. C.	£ 2,000,000	9,663,000
Chase Bank	£ 500,000	<u>2,416,000</u>
Total		<u>U.S.\$19,526,000</u>

There is thus a margin of US\$7,000,000.

Various Credits and Advances against Deposit of Silver

Private & Confidential

Hongkong,
September 4th 1938.

Bank	Amount of Silver deposited	Equivalent in US\$ or £.Stg.		Form of Silver Refined or not Refined	Total amount of Credit	Amount Withdrawn	Equiv. in £. Stg.	Due date of Repayment	Date of Int.	Remarks
		@ 43 otc.	@ 19 d.							
Miss Banking Corp.	-	-	-	-	-	-	-	-	-	Retired
French United Group	12,000,000 Std Oz.925 fine	US\$ 4,777.778	£ 950,000-	Refined	F.Fes. 100,000,000	F.Fes. 100,000,000	£ 178.31 (1) £560,821.- @ 5 = US\$2,800,000	Nov.26,1939	3%	Plus quarterly commission of 5/8% An additional credit of F.Fes. 100,000,000 may be availed of under subsequent agreement Plus Commission quarterly @ 1/2%.
Mitsui Bussan Kaisha & Co.	18,000,000 Std Oz.925 fine	US\$ 7,166.667	£1,425,000-	Refined	Guilders 10,000,000	Guilders 8,757,459.60	£ 8,95.7/8 (2) £979,719.- @ 5 - US\$4,898,000	Nov.18,1939	3%	
Hongkong & Shanghai Bk	30,000,000 Oz. 999 fine	US\$12,900,000	£2,565,000-	5 m.Oz.refined 25m.Oz.un-refined	£2,000,000:-	£2,000,000:-	£2,000,000:- @ 5 = US\$10,000,000	Sep.30,1938	3%	
Bank National Bank	7,973,028.64 Std Oz.925 fine	US\$ 3,174,447	£ 631,198-	Refined	£ 500,000:-	£ 500,000:-	£ 500,000:- @ 5 = US\$2,500,000	1/3 Sep.20 1/3 Oct.20 1/3 Nov.19	3%	

Exceeds of drawings under credit

(1) \$496,273.- and an additional F.Fes. 10,000,000 which is at present deposited with Banque Franco-Chinoise, Paris.

(2) \$949,977.-

594-A
377A

Exhibit V

MEMORANDUM ON TEA AGAINST BARTER

AGREEMENT WITH U.S.S.R.

In order to fulfill a barter agreement with U.S.S.R. which calls for delivery of all kinds of tea produced in the various provinces, the Chinese Government has authorized the Foreign Trade Commission to control the purchase, transportation and export of teas from China. All teas suitable for exportation must be sold to the Commission and exported in its name. The Fu Hua Trading Company, a subsidiary company created by the Foreign Trade Commission, offers the teas to the market and the Exporters select the teas for U.S.S.R. to fulfill the contracted grades and quantities. Other tea exporters buy the balance in the usual manner. The operation is now being carried on at Hongkong very smoothly.

The kinds, quantities and approximate value of teas to be delivered to U.S.S.R. during the tea season of 1938/1939 are as follows:

<u>KINDS OF TEA</u>	<u>QUANTITY IN PICULS of 133-1/3 lbs.</u>	<u>VALUE IN CHINESE CURRENCY</u>
1. Keemun tea	16,000	\$ 1,606,000
2. Ninchow tea	3,900	169,000
3. Foochow tea	24,000	1,475,000
4. Hankow tea	30,000	1,401,400
5. Original tea dust	42,500	1,022,500
6. Chun-Mee tea	58,000	3,817,500
7. Hyson tea	9,000	612,500
8. Pingsuey & Imperials teas	30,000	1,284,000
9. Green brick tea	205,000 baskets	2,995,000
	Chinese Dollars....	<u>14,382,900</u>

32/2

In each kind of these teas specific quantity of each grade and price differentials are also provided. In case the tea crop is plentiful larger quantities may be delivered by mutual agreement.

In addition to the above the Foreign Trade Commission has undertaken to purchase for the account of the Exporters the following teas:

<u>KINDS OF TEA</u>	<u>QUANTITIES</u>	<u>VALUE IN CHINESE CURRENCY</u>
1. Green Leaf tea (Lochar)	1,000 Metric tons	\$ 270,000
2. Green Leaf tea (Sarmien & Sardi)	200 Metric tons	80,000
3. Green Brick tea (Tsutsan)	48,185 baskets (Approx. 2400 Metric tons)	869,460
4. Black Brick tea	9,600 baskets (about 768 Metric tons)	403,200
		<u>Chinese Dollar 1,422,660</u>

Delivery of the above items have been practically completed and all payments are applied against the barter agreement.

As to the terms and conditions under which the contracted teas are to be delivered a copy of covering letter written by the Foreign Trade Commission to the Exporters under date of June 15, 1938 is attached hereto for reference.

C O P Y

File No. FB 258

June 15, 1938

U.S.S.R. All Union Association
"Exportteh"
Hankow

Dear Sirs:

We hereby agree to sell to you various kinds of China Tea of the 1938 crop in the quantities, assortments and at the prices specified in the list enclosed in your letter No. 2/C under the date of June 1, 1938. The terms and conditions stated hereunder supercede previous correspondence exchanged between us.

QUANTITY: It is agreed that you order for the highest quality Keemun is reduced from 800 to 500 piculs, while the medium quality is increased from 2,400 to 2,700 piculs. It is understood that you shall have the right to increase the quantities over the figures, shown in your list, for these teas, which you have ordered in quantities less than those offered by us with our letter of May 28th, 1938. It is further understood that your increases shall be proportional for the various grades.

QUALITY: In no case shall the higher grades of teas be substituted with those of lower grades; for example, Highest with Good Medium, Good Medium with Medium, etc. Likewise, in these groups of teas, which have been ordered in higher grades only, no substitution of lower grades shall be allowed. In case of any short delivery of higher grades of teas, you shall be allowed to decrease the quantity of lower grades proportionally. You shall have the right to reject any artificially colored teas having defects.

PRICES: All prices appearing the above mentioned list of purchased teas are understood to be strictly F.O.B. Hongkong, with the exception of that part of original Tea Dust, which you may find it necessary to leave in China for pressing into Black Brick Tea for you. In the latter case, we shall absorb the transportation charges for the Tea Dust from the place of production to the place of pressing.

SELECTION & INSPECTION: Upon appearance of the market of samples of first and subsequent lots of teas, produced in the new season, we submit the same to you in places suitable to you, for selection of quality by your Tea Testers. The selected chops shall be considered as approved by you and supplied towards the execution of your order.

Upon delivery of the selected chops to the godowns for shipment, your testers shall be allowed to make a second inspection to establish the identity of the delivered lot with the sample selected. Your testers shall be given access to the purchased goods at any place where they may be stored, and at any reasonable hour from the time of approval to the time of loading on the out-going steamer at Hongkong.

-2-

Packing: All Teas are to be packed according to the usual standards for each particular kind;

- (a) Leaf Teas and Dust: In wooden half chests, lined with lead and covered by gunny cloth with three iron straps.
- (b) Brick Teas In bamboo baskets with hoops.
It is understood that the cost of packing is included in the F.O.B. Hongkong prices as specified in the list.

DELIVERY: All teas ordered by you shall be delivered in Hongkong on following dates:

- (a) Black Brick Tea & Original Tea Dust: In separate lots during the five months from June to October, 1938.
- (b) Green Leaf Tea: In separate lots from July to November 1938.
- (c) Green Brick Tea: In separate lots during the period from September 1938 to March 1939.

It is distinctly understood that prompt and actual deliveries shall be entirely contingent upon transport facilities. We shall not be responsible for delays or non-delivery occasioned by circumstances beyond our control.

Acceptance: Upon the second inspection, your representative shall issue certificate of acceptance, whereby we shall be relieved of all responsibilities in respect of the quality. It is understood that you shall have the privilege to store the cargo in our godowns free of charge for a period of not longer than one month from the date of acceptance. Should you find it necessary to store for longer periods, the customary storage charges have to be borne by you as follows: for any length less than half, half of the monthly rate; over half month, the regular monthly rate.

In addition to the above terms and conditions, we shall exert our utmost to do the following:

- (1) We shall keep you informed as to the appearance on the market of Keemun and Hankow Black Leaf Teas or any other kind of teas in excess of the quantities ordered by you, particularly the Green Leaf Tea "Hyson" of which you are prepared to place an additional order.
- (2) We shall keep you informed as to the actual date of shipment to and arrival at Hongkong of every lot of tea.
- (3) We shall, as far as circumstances permit, execute your order first with the first chops appearing on the market.

We thank you for your good order and shall appreciate your confirmation by signing the duplicate copy and returning the same to us.

Yours faithfully,

Foreign Trade Commission

Monday
September 26, 1938
11:52 a.m.

H.M.Jr: Hello.

Operator: Mr. Messersmith. Go ahead.

H.M.Jr: Hello. Hello.

George Messersmith: Good morning, Mr. Secretary.

H.M.Jr: How are you?

M: This is George Messersmith.

H.M.Jr: All right.

M: I'm sorry I haven't had a chance to see you since you came back. Ah - Mr. Secretary, we were talking this morning - we had a number of calls from abroad you know - the last few days -

H.M.Jr: Yes.

M: And we have difficulty in recording them. And - ah - it was mentioned to the Secretary about your arrangement over there and we're thinking of having the same thing installed here, but the Secretary wanted to know whether you found it entirely satisfactory.

H.M.Jr: Ah - yes.

M: Yes?

H.M.Jr: Yes.

M: All right.

H.M.Jr: Ah - do you know - do you know what the system is we have?

M: No, I really don't. I was awfully glad to hear about it and I thought I'd - if you would permit me I'll get in touch with one of your people to find out where you got it, et cetera.

H.M.Jr: Well, I think - ah - I don't know - we - I don't know which of our engineers supervised it but supposing I find out and have him get in touch with you directly -

- 2 -

M: Will you do that?

H.M.Jr: Because - ah - frankly, I don't advertise that I have this.

M: No. Quite.

H.M.Jr: And I'd like it kept as confidential as possible.

M: Yes. Well, we - ah - we're finding difficulty in recording the conversations you know.

H.M.Jr: Uh huh.

M: And we thought we wanted to use your system if it was --

H.M.Jr: Well, I - I'll tell you what I'll do - I'll have Lieutenant McKay - Lieutenant McKay -

M: Yes.

H.M.Jr: United States Coast Guard -

M: Yes.

H.M.Jr: Ah - who is a very confidential - I mean he's my Aide -

M: Yes.

H.M.Jr: And I'll have him get in touch with you right away.

M: Thank you very much.

H.M.Jr: Now just another - I have kept it very secret - will

M: Well, I mean, no one/know about it here - I mean we - I mean we're going to do the same thing.

H.M.Jr: Right. Well, I'll have Lieutenant McKay get in touch with you - do you want to set a time now and I'll tell him to be over there?

M: Oh, any time. I'm - I can't leave here, you see.

H.M.Jr: Well, I'll have him come over - McKay.

M: Thanks a lot.

H.M.Jr: Righto.

M: Goodbye.

OFFICE CORRESPONDENCE

DATE September 28, 1938.

CONFIDENTIAL FILES

SUBJECT TELEPHONE CONVERSATION WITH
BANK OF ENGLAND

L. W. Knoks

Mr. Bolton called at 9:45. They had had a fairly hectic day today, with the same atmosphere as that which prevailed in the beginning of August 1914. There had been a great deal of nervousness in all centers including London. The British people seemed to favor definite intervention in Czechoslovakia if Hitler insisted on his terms. Much the same could be said about France. The British and French military people had been in touch with each other. "That's the sort of situation we are living in."

The demand for dollars had been at almost any price. He had sold \$27,000,000 up to noon when a sudden and extraordinary change took place and dollars weakened two cents to 4.78, presumably on rumors that Hitler was not going to make his speech tonight. Shortly after the market had turned again and they were once more selling dollars at such a pace that he was afraid he would have to use our gold order which he had looked upon as a last resort.

He wanted to know whether the Britannic, the Normandie and the Franconia shipments had come in yet. I replied that as far as I understood the Normandie would arrive too late for his gold to go through today. In that case, Bolton said, he would be short about \$5,000,000 for which he would make prompt arrangements.

He then referred to our telephone conversation of Saturday and stated that the \$25,000,000 of gold was packed and ready. I

FEDERAL BUREAU OF INVESTIGATION
U. S. DEPARTMENT OF JUSTICE

CORRESPONDENCE

Date September 28, 1938.

CONFIDENTIAL FILES

SUBJECT: TELEPHONE CONVERSATION WITH
BANK OF ENGLAND.

L. W. Knoke

E

replied that the Treasury had decided to make the shipment, that instructions were being given to the commanding officer of the Honolulu the same as in the case of the Nashville, that I understood the boat was in Portsmouth now and ready to take the shipment, and that loading by Thursday would be perfectly all right. Bolton replied that they would go ahead with arrangements which would take a little time as they were doing their best to keep this shipment quiet just as they had done for the Nashville shipment. I told him that we would send him tonight the same kind of cables that we had sent for the previous shipment which Bolton said would be satisfactory to them.

I asked him to arrange space for us for \$10,000,000 worth of gold on the Roosevelt sailing on September 30, at the unchanged rate of 1/4 per cent and to cable us as soon as he had succeeded. We were considering here the question of insurance.

Bolton requested that in the future whenever a boat carrying gold for them was delayed we cable them to that effect if at all possible. I promised that we would do our best.

LWK:KW

PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Paris, France

DATE: September 26, 1938, noon

NO.: 1585

RUSH

FROM COCHRAN.

At 11 o'clock this morning I had a talk with my friend in the Bank of France. At a rate of 178.50 the French control had by that hour gained 35,000 pounds. This turn in the Paris market delighted my friend; he referred appreciatively to the peace appeal made by President Roosevelt which had been coming in over the news ticker. This morning by 11 o'clock my friend said that London had sold \$10,000,000; on Saturday London had given 36,000,000.

I had a telephone call from Rueff at 12 o'clock this morning. He said that (omission) was better this morning, and that as yet there had been no move to put into effect the plan which was transmitted in my telegram No. 1582 of yesterday.

BULLITT.

EA:LWW

FEDERAL RESERVE BANK
OF NEW YORK

OFFICE CORRESPONDENCE

DATE September 26, 1955.TO CONFIDENTIAL FILESSUBJECT: TELEPHONE CONVERSATION WITHFROM L. W. KnokeBANK OF FRANCE.

Cariguel called at 12:30. I quoted him the market here for sterling and francs and added that we had done nothing against his orders.

They had had a fairly good day, Cariguel said, having bought \$832,000. Very confidentially, he added that they had had an appalling day with regard to discounts having been called upon to rediscount francs 3 billion. Their note circulation was also going up by leaps and bounds and they found it difficult to cope with the situation.

If there was a pronounced change in the tone of the franc here would I let him know.

LWK:KW

RECEIVED
SEP 27 1955
FEDERAL RESERVE BANK
OF NEW YORK
120 WALL STREET
NEW YORK 20, N.Y.

MJD

GRAY

London

Dated September 26, 1938.

Rec'd. 3:35 p. m.

Secretary of State,
Washington.

1032, September 26, 5 p. m.

FOR TREASURY FROM BUTTERWORTH.

The British Treasury confirmed the receipt of the French note referred to in my 1020, September 25, 11 p. m. Phillips said that in the circumstances they proposed "to let it ride".

He went on to say that he understood that the French Treasury was drawing heavily on the Bank of France which was inevitable in view of the added expense arising out of the military measures. He also commented on the heavy character of the withdrawals from French banks which however were merely an inconvenience as long as the public did not rush to turn the resulting cash into goods.

As regards war preparations we went over again somewhat the same ground covered in my 922, September 14, 5 p. m. Phillips said if war should come they would obtain from Parliament powers in effect to do "whatever we like". But they propose to use these powers at any rate at first with restraint. They would not declare a general moratorium as was

done

MJD -2- No. 1032. September 26, 5 p. m. from London

done in 1914 and they would not close the banks for three days as was then done but for a few hours if at all. In this connection it was mentioned that due to the branch banking system individuals could without much delay arrange to have their checks cashed at one or more branches. They would start by appealing to British banking institutions and British residents not to apply for foreign exchange except for bona fide purposes; later they might have to undertake more rigorous measures. They would rather quickly ask British subjects to declare their foreign assets. As regards the rate of exchange Phillips said that the situation would have to be dealt with at the moment and that sterling would doubtless depreciate in terms of gold if for no other reason than that it would be difficult to get gold out fast enough. Incidentally he implied that a differentiation would be made between non-resident aliens and those normally resident in the United Kingdom along the lines of the 1931 legislation and he also implied that such non-resident aliens would be permitted to take their gold out of the country "when and as they are able to do so". In point of practice this seems to me unlikely.

Bolton telephoned me to say that he understood a further shipment of gold on the HONOLULU would be made and that the

gold

MJD -3- No. 1032, September 26, 5 p. m. from London.

gold is being made ready today in the Bank of England.

In the afternoon the dollar suddenly moved on a rumor that Hitler was to postpone his speech from 4.75-3/4 to 4.77-3/4 few takers of dollars available. But in the absence of any confirmation the rate quickly moved back and closed at 4.75½. The pressure has been fairly heavy.

KENNEDY

HPD

RECEIVED
SEP 27 1938
THE NATIONAL ARCHIVES
COLLEGE PARK, MARYLAND

CORRESPONDENCE

DATE September 28, 1938.

CONFIDENTIAL FILES

SUBJECT TELEPHONE CONVERSATION WITH
BANK OF ENGLAND.

L. W. Knoke

I called Bolton at 4:50 p.m. We had done nothing in sterling I told him; prior to Hitler's speech the rate had been up to 4.76 1/2 then dropped to 4.75 3/8, where it was now on the offered side.

I thanked him for booking space on the President Roosevelt and requested that if it all possible for them to handle this matter he book space for \$5,000,000 each on the American Shipper and the American Merchant both scheduled to sail on September 30 from Liverpool and from London respectively. Bolton replied that they always wanted to do everything they possibly could and that he would get busy the first thing in the morning.

LWK:KW

COPY
FEDERAL RESERVE BANK
OF NEW YORK

OFFICE CORRESPONDENCE

DATE September 26, 1938.

CONFIDENTIAL FILES

SUBJECT: TELEPHONE CONVERSATION WITH
DE NEDERLANDSCHE BANK

Mr. L. W. Knoke

Mr. de Jongh called at 9:20 this morning. Having released during the last two weeks or so a little over \$20,000,000 of their gold in New York, they were wondering what we would think if they asked us now to earmark some gold in Amsterdam. He also mentioned that all of the gold which they had earmarked for us on September 8 had now reached New York. I asked him what amount he had in mind and he replied about \$10,000,000 and added that his dollar sales today approximated \$5,000,000; they would not, of course, earmark the full amount of \$10,000,000 at once but do that gradually, according to their needs, as they sold dollars. I told him that naturally, particularly under prevailing conditions, I would have to discuss this matter with Washington and that I would telephone or cable our reply before the day was over.

I inquired how things looked in Europe at present and de Jongh thought not so very bright but it may all come out all right yet.

de Jongh wanted to know whether we could cover more insurance for him on the Noordam and said what we had done so far was altogether satisfactory. I replied that we were hopeful we could increase the amount and would let him know before the day was over. I asked him whether we had made it sufficiently clear in our cable that war risk insurance, as now written, covered only from the moment the gold was aboard steamer but not on land, de Jongh replied that he appreciated that.

Monday
September 26, 1938
4:55 p.m.

H.M.Jr: Hello.

Operator: Governor Ransom.

H.M.Jr: Hello.

Ronald Ransom: Hello. How are you this afternoon?

H.M.Jr: Well, I've been through two keyholes.

R: That's too bad.

H.M.Jr: But I just called up to say I appreciate the way you took care of the government bond market today. I think it was fine.

R: Well I think the New York bank handled that all right, don't you?

H.M.Jr: Fine.

R: It suited me and I'm glad it suits you.

H.M.Jr: Well, I haven't talked to anybody else, but Archie is in here and told me that / went along fine. everything

R: Yes. Well it seemed to me to be all right. I watched it all day and I didn't think we had to buy much - there doesn't seem to be much pressure. I thought you'd be interested in knowing that John McKee was over in Wheeling, West Virginia today on - attending some meeting of bankers of some kind there, and he called in and - ah - to see what the state of the Nation and the world was and told me that there had been some - ah - feeling apparently on the part of some of the bankers that European conditions might make the bond market weak and he said he thought he'd just speak out for once - he said, "Well, I don't know why it would be weak, we'd just buy all you've got to sell." And he said they seemed perfectly satisfied and he heard no more about it. I said, (Laughs) "Well, that's quick propaganda."

H.M.Jr: Yes.

- 2 -

H: Well I think that's got to be the attitude, Mr. Secretary -

H.M.Jr: Oh yes.

R: - for the time being.

H.M.Jr: Oh, we've got to have backbone now.

R: Right now. We'll never need it more.

H.M.Jr: That's right.

H: Ah - on the other matter that Cy spoke to me about - on the western front this morning - I just got word that Marriner will not get to Ogden until quite late this evening our time, so that indicates he stayed out there probably a day longer than he intended and I have a call for him in the morning.

H.M.Jr: And you got my message?

R: Yes. Ah - Cy told you what I said, didn't he?

H.M.Jr: I know. But I - I - I'm still - a little restless.

R: All right. I think you and I'll work that one out.

H.M.Jr: Well, ah - ah - after you've talked to Marriner I'd like to talk -

R: Surely.

H.M.Jr: - to you about it.

R: Surely. I'd be glad to.

H.M.Jr: Because I - I - I, frankly, - either the fellow does - ah - owe -

R: He is or isn't.

H.M.Jr: He either does or doesn't.

R: That's right.

H.M.Jr: And I don't see why it takes so long - either he and his - he's on - he owes fourteen million or he doesn't.

- 3 -

R: That's right. Well, you wait -

H.M.Jr: And -

R: You wait until I get some information about it from that side as well as this side -

H.M.Jr: Yes.

R: And then I'll surely talk to you.

H.M.Jr: Well, as soon as you talk to Marriner - and - and there are lots of collateral reasons -

R: Yes.

H.M.Jr: - why that ought to be done.

R: I'll come over and talk to you, if I may.

H.M.Jr: Please.

R: Thanks.

H.M.Jr: Goodnight.

410
H

PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Paris, France

DATE: September 26, 1938, 7 p.m.

NO.: 1598

RUEH

FROM COCHRAN.

At 8:40 p.m. I had a talk with the Bank of France. The stabilization fund gained 830,000 pounds on balance for the day. It also gained a few dollars. Sterling closed at around 178.45 to 178.50. For the day London lost 7,000,000 pounds of foreign exchange. Very weak Paris bourse, with losses up to 10 percent. However, the bourse closed above the worst. The banks report that there were considerable withdrawals, but everything was entirely orderly.

BULLITT.

EA:LWW

NEWS LETTER ON BRAZIL
FROM Charles A. Thomson
Foreign Policy Association

Confidential
Not for publication.

Buenos Aires,
September 26, 1938

On the night before I ended my month's stay in Brazil, I met with a group of some twenty university professors, industrialists, writers and economists. One of the questions we discussed referred to Brazil's foreign policy, in the case of a European war. "Brazil will never fight on the side of Germany," declared one member of the group, and his statement found unanimous support. The talk brought out -- what is always so striking to anyone who has known the hostility to Yankee imperialism in many Spanish-American countries -- Brazil's strong tradition of close friendship with the United States. These Brazilians hoped that the American states could keep out of a European war, but, come what may, they held that the nations of the New World should adopt and follow a common policy.

While realists tend to view President Vargas as a political opportunist par excellence, no Brazilians I talked with seriously believed that Vargas would -- no matter what flirtations he may have considered in the past -- attempt to carry Brazil away from its century-old alignment with the United States. In the field of trade Brazil has been willing to talk business with all customers. In the new rearmament program (to which I want to refer later), Germany won the right to provide the bulk of supplies for the army. But geography, historical tradition and economics are to be counted in the balance on the side of the United States.

Moreover, internal factors influence Brazil's attitude toward Germany. Brazilians have followed the negotiations on the Sudeten question with close attention. The arguments advanced for a plebiscite and for the minority rights of German residents in Czechoslovakia could theoretically be urged also in favor of the German colonies in Brazil. One journalist in a recent article opposed the principle of plebiscites, suggesting that if one were held in Brazil, the Germans and their sympathizers might win a majority in the three southern states of Parana, Santa Catarina and Rio Grande do Sul. While this is an exaggerated statement, informed observers do not minimize the threat of German penetration. They believe that the Nazis have been disposed to go just as far as they were permitted by counter forces.

Representatives of one Brazilian party told me that within the last six months they had been approached by certain Germans high in the business world, who asked what their attitude would be should the State of Rio Grande do Sul separate from Brazil to become a German colony or protectorate. The Germans offered this party, in return for a pledge not to oppose such a move, war materials, troops and other assistance to enable them to overturn the Vargas government

and take power in Rio. It was intimated that Italy would support the German move. But the baited hook failed to bring a nibble.

There is great need for a thorough study — it would take six months or a year — on the number and activities of Germans, Italians and Japanese in Brasil. Accurate facts are disappointingly scarce. The last national census was taken in 1920, and the next one is not due until 1940. Immigration statistics are an unsafe guide, for no one knows to what degree their totals have been modified by emigration, deaths and other factors. The most recent government estimates place the number of Italians in the country at 770,000; of Japanese at 134,000; and of Germans at 73,000. This latter figure seems incredibly low, since Sao Paulo State alone estimates its German population at 27,000; and the colonies resident in the other southern states of Parana, Santa Catharina and Rio Grande do Sul are larger in all probability. But the Germans in Brasil have been significant not alone for their number, but also for their close-knit organization, and their aggressive zeal within recent years for spreading Nazi doctrines and influence. This crusade finally became an open threat to Brazilian unity; and the Vargas regime took steps to scotch the danger. On April 19 last a decree barred foreigners and foreign organizations from engaging in any political activity in Brasil, and also forbade propaganda favoring political parties in the immigrants' home lands. This measure was supplemented by laws in the States of Santa Catharina and Rio Grande do Sul, requiring that teachers in German and other foreign schools be Brazilians and classes be conducted in Portuguese. Such was German resentment at these measures that the Nazi "cultural attache" in the Rio embassy, who was reported to have made even the German Ambassador play second fiddle — the attache was a Nazi, while the Ambassador was not — left for Berlin by special plane. It is not yet clear to what degree this political set-back will affect the German trade drive. For the first four months of 1938, Germany retained the lead over the United States in Brazilian imports it had won in 1936 and 1937.

At the same time President Vargas has eliminated from the political scene Brasil's domestic fascists, the Integralists. When on November 10, 1937 he made himself absolute dictator of Brasil, scrapped the 1934 constitution and proclaimed a more authoritarian document, he had the active support of this strong, nation-wide party. The Integralists were led to expect they would play a prominent role in the new set-up, with one or more cabinet positions. (Leaders of other Brazilian parties, experienced in the ways of local politics, firmly believe the Integralists were receiving financial aid from Germany and Italy; they were spending far more money than could reasonably be secured from sources in Brasil). But once Vargas had consolidated his position, the Integralists were thrown into the discard and

their party dissolved. After the abortive coup of last May, many of their members were jailed. The party is now underground; some observers believe it effectively crushed and its principal leaders discredited; others recall that it included numerous army and navy officers among its supporters and hold that it still retains sufficient force for a come-back should a favorable opportunity arise.

Thus President Vargas has taken action against both foreign and domestic fascists, and has made clear that his rule is dictatorship, Brazilian style. If you don't mind, I should like to put in here a few words as to how Brazil, with its Portuguese tradition, language and culture differs from Spanish-American countries. For Vargas is only to be understood in connection with his milieu. One of the lessons which a visit to Brazil teaches is that Brazilian conditions must necessarily be defined in Brazilian terms.

The Brazilian largely lacks the Spanish sense of personal dignity; he cares little for "front" or ceremony. He is informal, casual. At times he is unbelievably casual. Witness the Integralist attack on the Presidential Palace on May 11. The rebels did not trouble to post guards at the gates of the palace grounds; people drove in and out to see the fighting which was going on only twenty-five yards away. The Brazilian is tolerant, not fanatical. He makes no fetish of abstract principle. He lacks the cruelty of the Spaniard. He does not like to kill. The leader of the May revolt was not shot, but given only a ten-year sentence. The Brazilian has a genius for compromise; he does not recognize sharp lines of division; he does not make permanent enemies. Brazil does not have a color line, but rather a color zone — though the transition from white to black ranges by almost imperceptible stages. The same characteristic may be applied to social and political alignments. Brazil lacks a clear-cut Left and a clear-cut Right. The men who today are Vargas' enemies may be in his cabinet tomorrow. It is largely true that because President Vargas corresponds to this medium — and also to a certain transitional stage in Brazil's political development — he has been successful in holding power.

His government is of course a dictatorship. Talk of the plebiscite which was to ratify the November 1937 constitution is seldom heard. President Vargas and his associates are reported to feel they need not trouble with it. They apparently find it more convenient to govern directly by decree, than bother with a legislature. Interventors or federal commissioners, named by Vargas to replace former governors, rule all states except one. Civil liberties are at the whim of the authorities. Censorship muzzles the press;

there is no freedom of speech. One American remarked: "I never attempt to discuss politics, except in small groups at private houses; I don't write about it in letters, for you never know when they will be opened." Arrests are arbitrary. Just before I left Sao Paulo, some twenty of the most important leaders in the Salles de Oliveira party were seized at the order of the Interventor, and told they could choose between imprisonment and exile from the city of Sao Paulo. I talked to men who had been imprisoned on suspicion for long periods. They left no doubt in my mind as to the fact of extensive police brutality. It was not "respectable" politicians who suffered, but alleged communists and to a lesser degree Integralists arrested after the attempted coup of last May.

The Vargas regime rests primarily on the support of the army and navy. It is a military dictatorship; but it is more than that, for it commands considerable popular support, due to Vargas' virtuosity at political juggling and conciliation, and to his courting of the masses through social legislation and other means. The president's supreme political astuteness is accorded universal recognition. Vargas does not talk; no one apparently knows what is in his mind, or what he will do next. He does not hold grudges; if he needs a man, he will use him, no matter if that man has fought against him in the past; but the discard awaits any man or party whose usefulness is ended. The president balances the power of one political leader with another, one state with a second, one general with his rival. A foreign observer remarked: "Vargas has been double-crossing the generals so fast, that he has them all dizzy; no one of them knows how long he can stay on his horse." The president is careful to see that no member of his administration achieves too great power or position. Francisco Campos, Minister of the Interior and author of the 1937 constitution, has seen his personal star wax and wane. His reported admiration for fascist ideals is balanced by the democratic sentiments of Dr. Oswaldo Aranha, Foreign Minister, former Ambassador at Washington and friend of the United States. In the army, General Goes Monteiro, Chief of Staff, is played off against General Dutra, Minister of War. These two men, formerly friendly, are now reported to be at odds. Goes Monteiro is considered the more able and intelligent of the two, and is rated Brazil's best strategist; he was the star pupil of General Gamelin, when the latter — now France's Chief of Staff — was head of the French military mission in Brazil. Gossip has it that Aranha and Goes Monteiro favor holding the constitutional plebiscite and a gradual return to democratic norms, while Dutra opposes the plebiscite, and is suspected by some of ambitious to set himself up as the head of a neo-fascist regime. Talk of Vargas' possible overthrow turns most frequently on the Dutra-Goes Monteiro rivalry and friction.

President Vargas announced with his November 1937 coup the establishment of a New State in Brazil. Democracy had failed; Brazil henceforth was to have an authoritarian regime, which would unify the country in the face of a chaotic international situation, suppress subversive influences, and put new efficiency and drive into government. But what in practice, as distinguished from theory, does the New State stand for?

1. Direct government, that is, personal dictatorship. Vargas has ruled Brazil since the revolution of 1930, but there is some truth in the contention that events have limited his opportunities for constructive achievement. Between 1930 and 1934, attention necessarily centered first on consolidation of the new regime, then its defense against the 1932 Paulista revolt, and finally on the drafting of the 1934 constitution. The first Congress under this constitution was characterized by one foreign resident as "worse than a Ladies Aid Society"; talk blocked action. But with Congress out of the way after November 1937, governmental machinery began to hum. Office-holders were forbidden to hold more than one job; and the efficiency of the bureaucracy was stepped up. Some of the worst grafters were eliminated. (In this connection Vargas is generally credited with entire personal honesty.) The president and his advisers turned out decrees much more swiftly than Congress had produced laws. Since November 1937 it is stated that 500 laws and 3000 decrees have been issued. But much of this legislation is hastily and carelessly drafted. Formerly debate in Congress served to iron out defects, but now that chance is lost.

2. Centralized government, as opposed to the former emphasis on state's rights, which in Brazil has been carried farther than in the United States. To use a word coined by Foreign Minister Aranha in an interview, the tendency was to "Chinify" Brazil. In several cases the state militias were armies in all but name; and some were equipped with tanks and bombing planes. Brazil's only anti-aircraft guns were ordered by Governor Flores da Cunha for the state forces of Rio Grande do Sul, but arrived after he had been ousted. States had the power to levy export duties. Now President Vargas has reduced the power of the militias, particularly in those states where they might be used against him; and also decreed progressive elimination of the state export duties. Opposition to this trend toward centralization is strongest in Sao Paulo, Brazil's richest and most productive state, which seeks as far as possible to run its own affairs.

3. Nationalism. I have already mentioned the legislation against foreign organizations, and the quietus put on German activities. In addition the November 1937 constitution required the shareholders of

banks and insurance companies to be Brazilians (a provision not yet enforced) and pointed toward the progressive nationalization of mines and waterpower. Last April a decree excluded foreign interests from the petroleum industry, just at the time when a large refinery of Standard Oil of New Jersey was about to begin operations.

4. Rearmament. Along with the nationalistic emphasis has gone a program to strengthen the armed forces. This had been under discussion for years, but the November coup freed Vargas' hands for immediate action. Brazil plans to spend some \$100,000,000 on this program during the next five years. According to an agreement concluded before the President fell out with the Nazis, Germany is to provide the bulk of material for the army - heavy artillery, light artillery, anti-aircraft guns, etc. Brazil is scheduled to receive from Germany each year for the next five years 50,000,000 marks worth of supplies, or a total of 250,000,000 marks. Of this sum, approximately five-sixths can be paid in compensated marks, and the balance in free exchange. (Thus in spite of Washington's efforts to discourage Brazil's experiments in barter trade, the country -- barring a European war -- is committed by this arms agreement to compensated marks for at least five years. A high military authority told me he considered the dependence of Brazil's army on German supplies a great mistake; should a European conflict break, Brazil would be cut off from Germany, would have to turn to the United States for munitions, and would be handicapped by a confusing variety of models in its armament.) For the navy three submarines were bought from Italy, and negotiations are reported under way for three more. Three cruisers were ordered from England, and three others are to be built in Brazil, using fabricated material from the United States. In this way Brazil plans to secure the cruisers which it originally proposed to lease from the United States.

Some observers view Brazil's failure to obtain those cruisers as a crucial event profoundly influencing the recent trend toward dictatorship. According to this theory, the success of Argentina in blocking the proposed deal spread consternation among Brazilian leaders. Brazil had believed it enjoyed a favored position in American friendship. But Argentina, its most feared rival, had been able to ruin its prospects. President Vargas is reported to have called together army and navy chiefs and pledged them his support in building up Brazil's armed strength against this threatening development. Thus was born the alliance which made possible the November 1937 coup. For only Vargas could give the military leaders the money they wanted. Both of the leading candidates in the presidential campaign of that year had obligations to various interests and supporters; neither would be strong enough to take the step which alone could

make possible the enlarged expenditures for the armament program — suspension of service on the foreign debt. So the elections were called off, and Vargas with the backing of the army and navy made himself absolute dictator. Now the armed forces are getting what they want, and resumption of service on the foreign debt is a dead issue.

5. "mixed" economic policy. While the 1937 constitution pointed Brazil toward the "corporative organization of national economy," the most important recent shift in policy — that relating to coffee exports in the fall of 1937 — was away from regimentation and in the direction of liberalism and free trade. The government abandoned price defense, and the coffee export tax was reduced from 45 to 12 milreis a bag. But in May of this year over-production again threatened, and a decree required each grower to turn over to the government a "sacrifice quota" of 30% of his production (15% in the case of the finer coffees). However, coffee experts with whom I talked believe that Brazil is approaching an equilibrium between production and market demand. In the state of Sao Paulo alone between 300,000,000 and 400,000,000 trees have been cut down; the coffee borer has reduced output; there seems to be growing recognition that future emphasis must be on improvement of quality rather than increase of quantity. Hopes are expressed that the quota provision may be removed early in 1939, and future reestablishment of control avoided.

The fall in the world price of coffee has been compensated in the case of Brazil by a quantitative increase in exports. Nonetheless Brazil has suffered a recent recession; internal trade is estimated at about 25% below last year, but the decline has been less severe than in the United States.

The Brazilian government railroads have under consideration purchase of 26 locomotives and 1000 freight cars, worth some \$6,000,000. The Germans are after the order, and are reported to have offered four-year credits, but are unable to promise prompt delivery. Americans in Brazil, in view of the country's great need for improved and more extensive communications, argue that it is of strategic importance for the United States to secure this order. At the time of my stay, decision promised to hinge on the ability of the Export-Import Bank to offer credit terms which might compete with those of the Germans.

6. Social legislation. The Vargas regime since 1930 has been responsible for a large mass of social legislation, including the 8-hour day, one day's rest in seven, special protection for women and children, and now a minimum-wage law which is soon to go into effect. While labor supporters deny that this legislation has been very effective, employers report that it is enforced to an uncomfortable degree. Labor organization is under government control. Unions are

organized by the government, protected by the government and subordinate to the government. Strikes are forbidden. In Sao Paulo city the cost of living index rose from 100 in 1934 to 161 in 1938, the chief increases being in food items; but in other parts of Brazil, particularly the rural districts, the rise was less marked. Studies made in Sao Paulo estimate 10 milreis (about fifty cents in U. S. currency) to be the minimum living wage, to provide bare necessities for a family of five; but the great bulk of the wage-earners are reported to receive less than this minimum figure.

7. President Vargas has yet to show achievement in a field where a dictator usually makes his greatest claims — that of public works. One of the most frequently repeated charges made against him is that he is not a builder. Brazilian cities, such as Rio de Janeiro, Sao Paulo and Belo Horizonte, have been going through a construction boom, and many new government edifices have been erected. But Brazil has almost no paved roads, outside of a ten-mile stretch south of the city of Sao Paulo, and the section connecting the summer capital at Petropolis with Rio. Vargas has promised to initiate shortly paving of the road between Rio and Sao Paulo. Engineers also have under survey the route of a railroad across the northern edge of the Chaco to link the Brazilian city of Puerto Esperanca with Santa Cruz in Bolivia. But these developments are still substantially in the project stage.

Discussion is again under way on plans to exploit Brazil's vast ore deposits in Minas Geraes, much of which run 60% pure iron. The lack of good coal has handicapped development of heavy industry, but a number of blast furnaces and mills are now operating with charcoal and petroleum; this year Brazil exported some steel to Argentina. Optimism is expressed in certain circles at the possibilities of a new process for smelting at low temperatures. Some of Brazil's present leaders argue that if the country is to escape from a colonial status, where it exports raw materials and competes with plantation countries with low economic and social levels, it must industrialize, and should exhaust all efforts to that end.

How long can Vargas stay in power? No one in Brazil will answer this question, for no one knows. The President's wizardry at political juggling is an essential element in his success. But it also makes for almost a daily shift in guesses and for continuing uncertainty concerning the eventual trend of Brazilian politics. No one knows when Vargas' hand may slip and some one of the many balls in the air may escape his grasp. The most experienced observers

take refuge in the assertion that practically anything can happen. There are some who believe that opposition to the present regime is gradually coalescing. Yet this opposition may lack opportunity to strike, unless Vargas suffers defection on the part of his military associates, or the economic curve takes an acute turn downward. Should he hold on indefinitely, the continuance of dictatorship or a gradual return to democratic processes is likely to be determined by the relative strength of the various domestic and international pressures which play on the "fox of Cattete."

I don't want to close without at least a brief reference to the matter of cultural relations. This is not the time for any detailed analysis or definite recommendations. But my whole visit to Brazil only served to underline the words of Foreign Minister Aranha that "it is terribly important for our two peoples to understand each other." It is substantially true that we in the United States know least about the country in South America which is most important to us.

Let me limit myself here to two or three items which bear on this subject. First, Brazilians reveal to a unique degree a widespread desire, a genuine eagerness for closer ties of understanding with the people of the United States. One American diplomatic officer remarked, "We official representatives usually have to work very hard to develop interest in our country; here we have that interest served to us on a silver platter." Yet many Brazilians feel that we have come to take their friendship for granted; and that we believe no particular effort is necessary to retain it. One writer told me: "The United States has abandoned us; we are a nation of 40,000,000 people; we play an important role in South America; but you pay no attention to us. Italy and Germany are doing their best to win us for fascism. They furnish material to our newspapers; they have our journalists in their pay. They send us professors and lecturers. They give us radio broadcasts in Portuguese. But the United States is losing us. You need not copy fascist methods. But we need your active interest and support."

The situation in Sao Paulo University may serve as a case in point on the present situation. On its arts faculty are ten Italian professors and eight French. In addition to their Brazilian salary (which is low in comparison with foreign standards of living), their home salary is continued, their time in Brazil is considered double for a retirement allowance, and they are granted travelling expenses to return home once a year. The only American professor on the faculty is without any of these perquisites, which actually do not rank as luxuries, but serve to balance up the debit items involved

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in working abroad. His role is not that of propagandist -- certainly not, in the narrow and derogatory sense of the word. He is trying to do a sound and scholarly job of teaching American history. In addition, his command of Portuguese has opened to him newspaper columns, which have given his interpretations of American life a wide audience. Yet he has no support from his home land. In a situation which is complex and unstable he stands alone.

I cite this particular instance only because it illustrates a definite problem, on which we have yet to make any effective attack.

SECRET

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NEWS LETTER ON PARAGUAY
Charles A. Thomson
Foreign Policy Association

Confidential
Not for Publication.

Buenos Aires
October 10, 1938

Thanks to the kindness of Ambassador Spruille Braden, I have just witnessed the signing of the Chaco arbitral award, which definitely fixes the boundary between Bolivia and Paraguay. The ceremony was held under the white and gold magnificence of the "salón de honor" in the Argentine Foreign Office. Thus, the road to the long-sought peace is finally free of the last serious hurdle. In passing, I might say that informed opinion generally accords Spruille Braden major credit for the successful conclusion which has happily crowned three years of delicate and arduous negotiations.

During my recent visit to Paraguay, I found that country ready to welcome the Chaco peace. The overwhelmingly favorable majority in the plebiscite of August 10 surprised even the most experienced political observers. Geronimo Zubizarreta, the Liberal leader who had refused to sign the pact, found no support for his intransigent position. The voting in the plebiscite seems to have been essentially fair; it is reported that the government was prepared to use pressure to secure a favorable result, but found that such intervention would be superfluous. Opponents of the peace terms had criticized most the failure to give Paraguay any share in the alleged petroleum wealth along the western edge of the Chaco. Their chief complaint against the plebiscite was that its phrasing was loaded in favor of an affirmative vote. But they now appear willing to accept the popular decision, and declare that Paraguay will loyally abide by the peace terms and that no subsequent government will question their validity.

The war has made the army the dominant factor in the country. In the past, two major parties disputed control of Paraguay. At the end of the disastrous Five Year's War with Argentina, Brazil and Uruguay, a group of generals organized the Partido Nacional Republicano, known as the Colorados. This party ruled for 34 years, from 1870 to 1904. Meanwhile, civilian elements had formed the Liberal Party, and this group, although plagued at times by factional strife, dominated the political scene from 1904 to 1936. Foreign observers report that the Liberals are more blessed with able and intelligent leaders than their traditional opponents.

In February 1936 the Liberal president, Dr. Eusebio Ayala, who had served throughout the war, was overthrown by Colonel Rafael Franco. The Franco movement was backed by restive ex-service men - demobilized after fighting ended with the armistice of June 1935 - by labor unions and by some students. These elements considered the old parties discredited and sought a new political and economic alignment. Moreover, Ayala's position had been weakened, due to fears that he sought a second term,

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and to the jealousy excited among military leaders by the special favors heaped on General Estigarribia. Franco's regime made some efforts at land distribution and put on the books several pieces of social legislation, including establishment of a National Department of Labor, with power to settle industrial disputes. But politically his administration was a hybrid. Juan Stefanich, the leading figure in the cabinet, was credited with semi-fascist ideas and a nationalism which would return Paraguay to the dictatorial traditions of its first half century as a nation. Labor and the students, on the other hand, had been influenced by communist and socialist ideas. Franco failed to get his dissident supporters to pull together, despite efforts to unite them in a new party. He also proved unable to hold the entire support of the army - whose war-time leader, General Estigarribia, he had imprisoned - or to enlist the backing of the more solid and conservative civilian leaders. His government was overturned in August 1937 by certain army officers, in alliance with the Liberal politicians.

A provisional regime, headed by Felix Paiva, a professor, was set up. But the civilians in the present government are described as substantially "messenger boys" for the army officers, who hold the actual reins of power. Four men particularly stand out: Colonel Ramon Paredes, a shrewd politician in uniform who occupies the ranking cabinet post of Minister of the Interior; Colonel Antola, commander-in-chief of the army; Major Arturo Bray, half-English in blood, who fought with Britain's forces during the World War, and who now is Chief of Police of Asuncion; and Major Sosa Valdes, commander of three cavalry regiments. All of these men are under 45 years of age. Their rule is in effect a military dictatorship, which justifies itself on the ground that Paraguay needs above all order and tranquillity. The press is closely censored, and offending newspapers suspended. Many of the most important opposition leaders are in exile. The relation of this reigning quartette to General Estigarribia is not entirely clear. Some observers believe that the "Four Horsemen" prefer to keep Estigarribia in his present post in Washington, fearing that if he returns to Paraguay, they will be eclipsed. Some sentiment exists in the country for establishment of a strong national government, with Estigarribia at the head. On the other hand, it is reported that Estigarribia himself would prefer not to take office during this transitional period.

Army leaders declare that Paraguay is fundamentally a democratic country, and that their rule is temporary. Congressional elections were held on September 25th. The Colorados withdrew from the contest on August 31, charging lack of guarantees and official pressure in favor of the liberals. In consequence, the Liberals had no opposition and captured all seats in both houses. Paraguay has a compulsory voting law, so the Colorados cast blank ballots at the polls, whose number was reported to appropriate

30% of the total 125,000 votes cast. Despite this none too encouraging venture toward democratic "normalcy", hopes are expressed that the convening of congress will permit civilian influences gradually to reassert themselves, and that the process will be continued by presidential elections next March. On the other hand, some military leader may upset the apple-cart by another attempt at dictatorship. The army, which is believed to number around 15,000 men, still consumes from 60 to 80 percent of the government budget. The country's economic situation may decide the issue between democracy and dictatorship.

Paraguay came out of the Chaco conflict with increased economic strains; and this despite the fact that it fought the modern world's most economical war. Paraguay ended the struggle without any major increase in its foreign debt, which now stands at 600,000 pounds sterling - for a nation of less than 1,000,000 people. Bankers estimate that the internal debt does not exceed 13,000,000 gold pesos (or about \$9,000,000.). Service on the foreign debt was suspended during the conflict, but both interest and amortization payments have since been resumed. Food was not rationed; agricultural production was markedly increased. Paraguay now imposes no quotas on imports and only partial exchange control. Government salaries are paid up to date. During the struggle the common soldier was paid at the rate of one Paraguayan peso a day, and the total per diem cost per man, including supplies and food as well as pay, did not exceed, according to the Minister of War, nine Paraguayan pesos. (The Paraguayan peso is now quoted at 70 to the Argentine peso, or approximately 280 to the dollar.)

How did Paraguay carry on its war-time financing. In addition to using its small gold reserve, it requisitioned the great bulk of foreign exchange accruing from exports, paying exporters its equivalent in paper pesos. With this exchange it purchased what supplies were imported. The paper pesos were of course the product of the printing press, and the result was serious inflation, the peso declining from 19 to the Argentine peso to a ratio of 90, before recovering to the present ratio of 70. Moreover, the Government requisitioned annually from cattle-growers some seven or eight percent of their herds, paying them in script, which subsequently has been exchanged for gold peso bonds, and was included in the figure for the internal debt just mentioned. Local banks and business houses also made relatively small loans, which in great part are reported to have been repaid.

Outside purchases of military supplies were cut to a minimum. Paraguayan leaders declare that the country started the war with an army of 3,000 men, of whom only 1,000 were in the Chaco. (Some

informed sources, however, raise the 3,000 figure to 8,000.) It had at the finish 80,000 to 100,000 men, but never any more than 25,000 in the front line. Officials state that foreign purchases were principally rifle and machine-gun ammunition, some artillery ammunition, and a few planes, with ten the maximum number in active service at any one time. They assert that Paraguay imported no artillery, no hand-grenades, no airplane bombs. Supplies of the last two items were supplied by a domestic war industry. The hand-grenade became a very important weapon, the soldier often preferring it to the rifle; production started at the rate of 30 a day and finished at the rate of 130 an hour. Truck bodies at the start were turned out at the rate of one every seven days; at the end seven per hour. But the Paraguayans assert that their best source of supplies was Bolivia, and that at the end of the war 80 percent of their armament had been captured from the enemy, including 40,000 rifles. They started the war with 44 pieces of artillery and finished with 66; yet, General Estigarribia told me that for months at a time the artillery was silent for lack of ammunition.

Paraguayan leaders are also united in denying that they received any large-scale aid from Argentina. They assert that the Buenos Aires government facilitated them no loan (although there were some short-term transactions with Argentine banks), or supplied them with any munitions. However, when the League embargo was on, Argentine officials are reported to have shut their eyes to transit of European shipments up the Paraná River. The Paraguayan army included a so-called Argentine regiment, but this was recruited in the Argentine province of Formosa, which is largely populated by Paraguayans. An Argentine military mission was stationed at Asuncion when the war broke out, but this was promptly withdrawn. The Paraguayan army had the help of a few foreign officers, including a number of White Russians, but only a handful of Argentines. These Paraguayan denials, however, have not served to convince some foreign observers of the entire absence of Argentine assistance. Proof of this cooperation is lacking, but suspicion lingers. I pass these facts and figures on to you, for what they are worth in our present state of knowledge.

It is largely true that Paraguay is a country of no statistics and few definite facts. What you learn is always approximate. ~~SEE 2 MEMOS.~~ more or less. Written sources are few, and verbal statements need to be checked and re-checked. For example, take the rise in the cost of living which the Chaco War and inflation have brought to Paraguay. A leading lawyer told me that since 1932 it had gone up three times, reporting that he had to send his servant to market with 600 Paraguayan pesos now instead of 200.

Then I came upon the manager of a foreign bank wrestling in his office with a sheet of prices; the salary of his Paraguayan employees shifts with the price level. He ventured with some caution that the cost of living had gone up between 300 and 400 percent. Then I talked with a group at the National Confederation of Labor who asserted that the rise was 600 percent. I put it down as a Paraguayan fact that the increase had been at least three-fold.

But wages have lagged behind, and consequently there is some ground for discontent. The common laborer in town makes about 150 Paraguayan pesos a day, in the country about 100 (respectively 50 and 35 cents in U.S. currency). Wage figures furnished by labor leaders indicate a general rise of from 200 to 250 percent from 1932 to the present. The labor movement claims some 25,000 members. The strongest unions are found among the port workers and in building construction, packing houses, textile and shoe factories, and on the railroads and street-cars. In 1931 the labor unions were dissolved by the Guggiari government, but with the accession of Colonel Franco in 1936, they came out again into the open; the National Confederation of Labor was formed, and some gains were made. Leaders now advocate a moderate policy and "democratic" tendencies, and play down socialist and communist ideas, which in the past had won some ground.

Nonetheless, the danger of "communism" is cited by the military as justification for the present dictatorial government. It serves equally well those Paraguayans - chiefly army officers and war veterans - who think of themselves as fascist, and who organized the "Frente de Guerra". One colonel told me, "The officers are fascist principally because they are opposed to communism, which is the worst type of dictatorship; and in the past communist ideas have been strong among the masses." The "Frente de Guerra" has attacked both old parties, criticizes "sloppy" democracy, and argues for nationalism and dictatorship. Opinions differ widely as to how much real influence it has. Aside from the "Frente," it does not appear that Nazi and fascist influences have made much dent. Some of the newspapers carry Italian and German propaganda; both nationalities run schools in Asuncion, but chiefly for their own children, rather than the Paraguayans. The Franco government ordered 36 airplanes from Italy - Caproni bombers and Fiat fighters. The first shipment recently reached Asuncion, but has been held in the customs until Paraguay was ready to make payment. But now that the Chaco war is over, the government does not need the planes, and is reported to be shopping around to find a customer for these unwanted goods.

The most interesting foreign influence in Paraguay is that of Argentina. There is no doubt that this "backwoods" republic, which has been frontier country for three centuries, falls within Argentina's economic empire. But this is not due primarily to

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heavy investments of Buenos Aires capital. Argentines are the largest landholders in the Chaco, but at that the worth of their vast tracts probably does not exceed \$5,000,000. Argentine capital is also reported in the railroads, and in the street-cars of the capital. It also controls the Mihanovitch line, owning the most important steamer fleet which links Asuncion with Buenos Aires. And it is through control of communications that Argentina has what some Paraguayans feels is a strangle-hold on their economic life. For most of Paraguay's foreign trade goes down the river, the greater part of it on Mihanovitch boats, and much of it is transhipped at Buenos Aires. If Argentina closes its ports, as happened a year ago when yellow fever was reported in Paraguay, this inland republic is cut off from the world. Hence, the authorities at Asuncion are playing with the idea of an outlet through Brazil, either by road via Iguassu to open up to tourist traffic the famous falls there; or by extending the Concepcion-Borqueta railroad line to the northeast to meet a similar projected line on the Brazilian side. But appealing as these projects look on the map, their economic utility is highly dubious. I must, however, say a word for the Iguassu Falls, which the guidebook reports are higher than Niagara and half again as wide. I flew over them on my way from Sao Paulo to Asuncion, and they are worth going a long way to see.

In addition to military dominance and some economic dislocation, the war has bequeathed Paraguay a new outlook on the future. Captain Bossano, Minister of War and graduate of M.I.T. at Boston said to me: "Now a shadow of thirty years has been lifted. In the past we have had our thoughts centered on a war which we knew we would have to fight sometime. But now we can look ahead to constructive endeavors." A professor reviewing the results of the war declared: "It changed our national morale from that of a defeated nation which believed it could do nothing - the heritage of the Five Years War - to that of a victorious people with growing assurance and self-confidence." Paraguay is talking of reconstruction. It recognizes it has to start almost from scratch. In a conversation with ex-President Ayala here in Buenos Aires, he told me that a 1935 survey of Paraguay's 130,000 farmers revealed that they possessed only 5,000 steel plows. The seed commonly used is old and run down. New seed, new implements would multiply production and economic wealth. Given peace and the help of a little foreign capital, Paraguay's leaders hope that they face toward a future of growth and promise.

September 26, 1938

The President called me at 10:30 last night and asked me to find out whether there was any change in the movements of any Italian or German liners out of the ordinary.

Called Admiral Waesche and he reports, this morning, that there are no changes in the regular movements. He will continue to watch them and if there are any changes he will advise me at once.

Instructed Waesche to have a cutter ready so she can go on 24 hours notice.

September 26, 1938

HM, Jr called Miss Le Hand at 4:30 and said, "The President asked me what would he have to do if he wanted to intern German and Italian boats. Please tell him that a proclamation is ready and all he has to do is sign it. It goes back to the Act of June 15, 1917, and he declares that our foreign relations are threatened, etc."



TREASURY DEPARTMENT

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PROCUREMENT DIVISION

WASHINGTON

September 26, 1938

OFFICE OF THE DIRECTOR

CONFIDENTIAL

MEMO. TO THE SECRETARY:

Re: Attorney General's Special Committee as to what could or should be done to control prices under absolute neutrality of our own country in event of disturbance in Europe.

The above committee was called to meet in the Department of Justice at 2:30 P.M. this afternoon.

Present:	Golden Bell	Justice	Mr. Neenan	Commerce
	James W. Morris	"	C. J. Peoples	Procurement Division
	Alexander Holtzhoff	"		
	Dr. Ezekiel	Agriculture		
	Mr. Appleby	"		

It appears that a report submitted by Mr. Bell, Mr. Morris and Mr. Holtzhoff to the Attorney General was submitted by the latter to the President who wished the committee to continue, and to explore the problem in more specific detail.

It appears that the committee is in general of the same opinion as to the advisability of indirect price control as well as direct price control when the latter can be exercised under existing agencies.

After much discussion it was decided that Mr. Morris was to contact various agencies as to the functions that each could contribute or exercise, and as to any additional members.

Specifically it appears the President is not convinced that prices of some commodities would not rise, and specifically desires a recommendation from the Department of Justice as to:

1. What can the President do, without declaring an emergency, with respect to the control of prices; and
2. What can the President do by declaring a National emergency.

The committee is to meet again next Monday at 2:00 P.M. at the Department of Justice.

Attached is copy of memorandum from the Director of Procurement on this question, submitted to the Department of Justice Committee.

C. J. Peoples
 Director of Procurement

A. The Objective: The objective is the question of price control through indirect methods or directed methods. Price control for peace time application aimed to prevent the skyrocketing of prices.

The necessity for drafting such a plan immediately arises by reason of the present critical European situation. Should war break out in Europe, European belligerents would undoubtedly endeavor to obtain in large quantities a great variety of products from this country. These products would comprise not only items required directly and indirectly for war purposes, but also a great many that they normally produce themselves but which they would cease to produce because of the diversion of normal producing capacity to the manufacture of munitions indispensable to their war efforts. Such a situation developed rapidly during the period, 1914 to 1916. The resulting expansion of our foreign market caused violent increases in demand for our products, a skyrocketing of prices, and a disruption of not only our price structure, but of our entire national economy. The international situation now may prove to be identical to that of the summer of 1914.

The orders of European belligerents, as well as of those who normally are supplied by those belligerents, may again flood this country to such an extent as to exceed our present normal capacity to produce. In any such eventuality we must be prepared to avert a disruption of our national price structure, with its inevitable ill effects upon our whole national economy. The plan below is an attempt to suggest a means to this end.

B. Postulates:

1. In the event of immediate war in Europe, this country will assume a status of neutrality.
2. Any system of price control which may now be installed must be of such a character to be sufficiently flexible for immediate and smooth conversion to wartime application.
3. Any system of price control imposed must be such as to merit the whole-hearted cooperation of industry, labor, and the public.

C. Principles:

1. When inventories and capacity to produce exceed demand, a system of minimum price control is applicable, i.e., a figure below which the price of a given commodity is not permitted to fall. The application of this principle is suited to periods of depression. Outstanding examples of it are embodied in the functioning of the N.R.A. and of the administration of the present agricultural surpluses. This principle is not applicable to the present problem, as it pertains to the control of skyrocketing of prices with its attendant disruption of the national economy.
2. When demand exceeds inventories and capacity to produce, price control of another nature is required. Under these conditions one of at least two means of control are available. First, for a given commodity, a definite fixed price may be set, or second, a maximum price may be established above which the price of that commodity would not be permitted to climb. This is the objective with which the present problem is concerned.

(a) The second of the alternatives just cited, namely, the maximum price beyond which the price of a given commodity would not be permitted to rise, is to be preferred for the following reasons:

(1) A definite fixed price is in effect a minimum as well as a maximum price and, as shown above, the minimum price principle is not applicable to the problem before us.

(2) Fixation of definite fixed prices presumes a fineness or perfection of administration not practically attainable.

(3) The establishment of workable fixed prices would require an array of administrative accountants, which in turn would make the method too unwieldy for prompt and effective administration.

(4) Lack of flexibility in price range below an upper limit would favor the low-cost, large-scale producer, and would tend to prevent the full cooperation of the small and marginal producers.

(5) Any tendency toward discouraging the small-volume producer would make the Government's position in peacetime extremely vulnerable to attack by unsympathetic elements - which in turn would tend to impair the effectiveness of the means of attaining the prescribed objective.

On the other hand, a system of maximum price control:

(1) allows the forces of supply and demand to function elastically below upper limits.

(2) provides elastic means of control with upper limits established through trial and error, bringing in all production considered desirable and consistent with the prescribed objective, i.e., the prevention of skyrocketing of prices.

(3) was tried and found effective during the World War.

D. Scope of application:

The volume of work necessary and the staff required to extend price control to all materials and commodities make such a plan impracticable of application. For this reason alone price control should be restricted as much as possible. It is likely that control of the prices of basic materials and commodities at source of production will suffice. In any case, unnecessary control must be avoided.

It is believed that peacetime price control, at least initially, should be further restricted to items involved in foreign trade. If sufficient control can be exercised by our Government over the volume and distribution to American producers of foreign orders, it may be practicable to permit an upward price differential for foreign orders over and above that prescribed for domestic consumption. With properly vested authority, this may even comprise a strong weapon for keeping prices in proper bounds. In any case, however, large volumes of foreign orders would make mandatory the imposition of price control over the items they involve. Large foreign demand for these items would create domestic scarcity, and if uncontrolled, prices would rise rapidly.

It may be necessary soon to extend price control to items other than those involved in foreign trade. The effect of large volume foreign business would soon be reflected in increased public purchasing power, which of itself would create additional demand and hence tend to raise the general level of prices.

Incidentally, it must be borne in mind that the existing neutrality legislation limits the scope of products that may be exported to nations at war or to nations declared by the President to be belligerents. A further limiting factor is the prohibition against credit or loans which may be granted domestically to finance sales to nations now in debt to the United States.

The extent to which foreign orders should be encouraged by price differentials or otherwise is debatable. Rapid productive expansion beyond domestic peacetime needs would be desirable if we were drawn into the conflict; World War experience has proved that it would have disastrous repercussions if we were not.

As has already been indicated, one of the sources of foreign orders may be expected to be those for whom belligerents or potential belligerents have acted as suppliers, but whose productive capacity is now or may be preempted for war production.

Expansion of our own productive capacity over and above our normal peacetime ability to consume should be gauged to a considerable degree by our probable ability to hold a substantial amount of this newly acquired foreign trade with neutrals.

Some measure of aggressive action might even be desirable as a means of utilizing present idle capacity and of furnishing useful work for the present millions of our unemployed.

It must be borne in mind, however, that the peacetime mission of price control is the maintenance of stable domestic prices and that only in war time or when war is imminent does the paramount consideration become one of bringing into production the last indispensable unit required for the war effort and for essential civilian consumption. Until it is evident that we will ourselves become a belligerent, and subject to the above reference to increased foreign trade possibilities, production to meet maximum peacetime requirements should be the happy medium for which to strive in the system of price control adopted.

E. Type of Control:

Price control should be constructed primarily upon the principle of voluntary cooperation of all concerned. Arbitrary measures of duress normally are distasteful to American standards. In view of the limited direct means of enforcement at present available, control of a voluntary cooperative nature is mandatory in peacetime. In wartime, such cooperation is indispensable for the maintenance of public support of the war effort, without which maximum prosecution thereof cannot be attained.

F. Means of Control:

1. Agricultural Products: Governmental agencies now in being are, in effect, at the present time controlling the prices of a number of agricultural products. This control is of the minimum price type, since supply of these products considerably exceeds the demand for them. War abroad undoubtedly would create a market for the present surpluses; would likely eliminate these surpluses, and render unnecessary the type of control now exercised. The Government thereupon would be relieved of the necessity of acting in its present capacity as a corporation to buy and sell these products, but might continue to utilize its existing machinery to set upper limits of agricultural prices as the emphasis is shifted from minimum to maximum price control.

2. Industrial Control: Control of the prices of industrial output, both extractive and manufacturing, is quite another matter. It is believed that the

normal means of doing business should here also be adhered to as closely as possible. The setting up of a governmental corporation to buy industrial products from the producer and to sell them to a foreign belligerent, however, is not recommended. Such a departure from the normal means of conducting international trade appears entirely unnecessary and, in all likelihood, would entail most undesirable repercussions. It would set up an expensive temporary bureaucracy difficult subsequently to eliminate, and its administration might involve us politically from an international standpoint.

Here again it is believed desirable to utilize for price control purposes the framework which is now actually in existence, augmented as may be found necessary - such augmentations being made in a manner to fit into the projected wartime organization for the mobilization of American industry.

Here also must be considered the fact that at present, compulsory means of enforcement are now largely non-existent, and that voluntary cooperation of industry must be relied upon.

The following means of price control in peacetime is therefore suggested:

(a) Direct Means:

(1) Trade Associations: We have at present trade associations for nearly all industries. The potential value of these associations in policing the members within their own organizations was demonstrated during the World War. It was again demonstrated during the days of the NRA, which, incidentally, served to revitalize and expand these associations as component parts of our industrial structure. Their framework is now available for peacetime and wartime application of price control.

(2) Commodity Committees: Commodity Committees composed of representatives of industry, of the Government, and of the public, could be set up in each industry to parallel trade association alignments. These Commodity Committees could be used to determine fair maximum prices for the voluntary application of the trade associations. One policy forming Price Control Authority to coordinate the work of the commodity committees could be established in Washington.

(3) Foreign Purchasing Agents: It is believed that the State Department through diplomatic negotiations could induce each foreign belligerent to establish within the United States a centralized purchasing agent. The J. P. Morgan Company acted in this capacity before we entered the World War. The desire of foreign belligerents to obtain and maintain the good-will of our National Administration, and the fact that otherwise inevitable high prices and other ill effects of unrestricted competition could thereby be avoided, should furnish the incentive to accomplish this end. Our Government could appoint advisor-observers to act as liaison agents among the foreign belligerent purchasing agents, our own government, commodity committees and trade associations, thus making available full information to the policy forming committee in Washington and to the Administration for the determination of price control policies. Any additional administrative or legislative measures necessary to make price control measures more effective would thereby be brought to light.

(4) Export Quotas: Export quotas could be used as a brake by the Administration on excessive exports. The records of our various fact-finding agencies, such as embodied in the Departments of Commerce, Labor and Interior, could be used to determine when the brakes should be applied.

(b) Indirect Means:

(1) Financial: It is a well recognized economic fact that the contraction and expansion of credit have a very definite indirect effect upon business activity, and hence upon the national price structure. Such a means of control is now exercised by such Government or Government controlled agencies as the Securities and Exchange Commission, the Reconstruction Finance Corporation, the Federal Reserve System and even the Treasury Department itself. The Securities and Exchange Commission, for example, controls the issuance of commercial securities; the Federal Reserve System sets rediscount rates, prescribes reserve balance requirements of member banks, and enters into open market transactions to stabilize credit; the structure of the Reconstruction Finance Corporation is available to make loans to prevent undesirable business failures; and the Treasury Department regulates the issuance of long and short term public securities. All of the functions of these agencies can be coordinated indirectly to support the direct means of controlling prices.

(2) Numerous other indirect but nevertheless powerful means of enlisting the cooperation of industry in a price control program are available. Wages of labor, for instance, constitute a great portion of the costs of production, which, together with a reasonable profit, comprise the base upon which the price structure must be constructed. The Government has assumed an important position in the determination of labor wages. The determination of export quotas by the Government, previously mentioned, comprise another indirect method of enlisting the cooperation of industry in price control matters. Excess profit taxes now imposed and the threat of increasing them could also be employed for this purpose. The power of the purse in public grants of money is still another potent weapon for obtaining industrial cooperation. In fact, the Government now has so much of our national economy under review and so many indirect means of compelling the cooperation of industry with its policies that it can exercise powers tantamount to coercive action in making price control measures effective.

G. Application of the Means of Control:

The fact that the Government has adequate direct and indirect means of enlisting national compliance in a system of peacetime price control is of little consequence if a proper organization is not set up for the timely application of control. Only when such powers are at the disposal of one authority can control become effective. It is for this reason that the above organization, with the central Price Control Code Authority superimposed upon all of the organization's component parts, is suggested.

It can be safely forecasted that the proposed organization will prove to be imperfect, and that mistakes will be made in constructing and in administering it. This is the price one must pay for any new undertaking. The really important consideration, however, if disturbed conditions abroad should culminate in a European war, is to get this price control mechanism functioning, and, through trial and error during the initial period of peacetime experimentation, discover its weaknesses and take remedial action to correct them. The remedial

action required may prove to be either administrative or legislative in nature, but if the organization is non-existent when prices begin to skyrocket, the damage to our national economy will be incurred before the mechanism to control it can be made operative. To maintain the stability of our price structure, timely action by a control agency is imperative. Almost anyone knows when prices get out of line. The important factor is to have the organization to control them ready to function before prices become exorbitant.

In placing any price control mechanism in operation, we must not lose sight of the force of public opinion. The temper of the people is in times of peace different from the attitude of the public in times of war. In wartime emergency measures are expected. In peacetime the people must be education to recognize the necessity for such measures as price control. To this end appropriate publicity must be used to explain the necessity for price control measures, and the people must understand that price control, in the event of European war, is not only necessary to maintain our own economic stability, but may even be a means, properly controlled, for helping us to avoid being drawn into the conflict.

H. Transition from Peace to War: This organization suggested can be readily adapted to wartime use. The Trade associations can be used as war service committees now projected in the Industrial Mobilization Plan; the Commodity Committees can be employed in identical capacities as a part of the projected War Resources Administration; the Advisor-Observers to the foreign belligerent purchasing agents can form the nucleus of the projected War Trade Board; export quotas can be supplemented by export licenses, and the Federal Reserve System, the R.F.C. and the S.E.C. can continue to perform in wartime the identical functions they perform in times of peace.

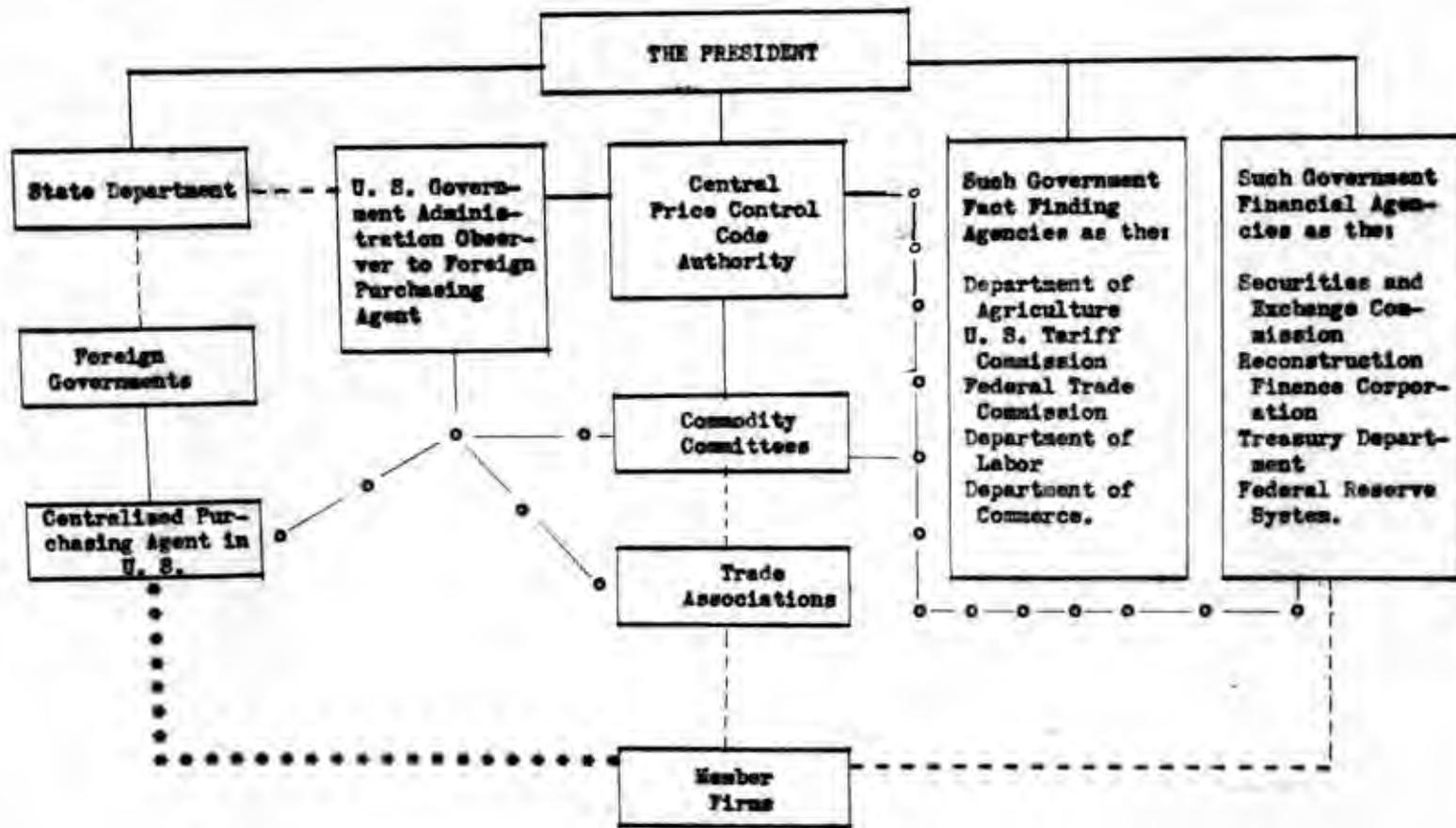
W. J. [Signature]
 Senior Colonel (EC) USA
 Director of Procurement

9/19/38

- _____ Direct Control
- Indirect Control
- Flow of Orders
- o----- Liaison

ORGANIZATION

FUNCTIONAL CONTROL OF PRICES



TREASURY DEPARTMENT

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INTER OFFICE COMMUNICATION

CONFIDENTIAL

DATE September 26, 1938

TO Secretary Morgenthau
FROM Mr. Haas
Subject: The Business Situation,
Week ending September 24, 1938.

Conclusions

(1) The renewed fear of a general European war has brought an unpredictable factor into the foreground of the business picture, overshadowing all other influences. Until the outcome of the present crisis is determined one way or the other, a discussion of the business outlook in this country can only be based on hypothetical reasoning. Even assuming a peaceful solution of the Czechoslovakian problem, however, the business prospect would remain decidedly uncertain, owing to underlying weak features in the current situation. In the event of a war outbreak, the initial depressing effect might later be offset by increased business due to war orders and rising prices, unless prevented by the strict application of neutrality legislation.

(2) The chief points of underlying weakness, which persist despite surface indications of good business, are: (a) Deflationary pressure from abroad, only part of which is traceable to the war crisis, which is tending to depress commodity prices, and thereby to raise the possibility that inventory liquidation may again become a factor in holding back production; (b) a relatively unfavorable level of new orders, despite an upturn this week; (c) the prospect of continued tension over the situation in East-central Europe, regardless of the immediate solution of the Czechoslovakian problem.

(3) Continuing its upward trend, business activity has improved somewhat further during the past week, with greater than seasonal gains in steel activity and power production. An encouraging upturn in new orders is reported, particularly from the U. S. Steel Corporation and from textile companies. In the steel trade generally, however, orders during September so far are reported as disappointing, and the fall upturn in automobile production is slow in getting under way. The September index of industrial production is expected by the Federal Reserve Board to be "above 90", as compared with the August figure (revised) of 88.

Secretary Morgenthau - 2

Foreign influences continue depressing

Apart from the effect of war threats, which have tended to support prices for a number of speculative commodities, the influence of the weak foreign situation apparently continues to be an obstacle to recovery in this country through its deflationary effect on prices. This influence, as reflected in the weakening of sterling exchange, (See Chart 1), and other European currencies, seems to be attributable only in part to the current war crisis. In part it reflects a deterioration in business abroad and other factors. To the extent that commodity prices abroad may be stimulated by war demands, and to the extent that mobilization of industry abroad for war purposes may reduce competition in our foreign trade, weakness in foreign currencies would not have their normal depressing effect on prices in this country.

Evidence of deterioration in the European business situation appears in the weekly cabled reports to the New York Cotton Exchange on the cotton textile situation. During the week ended September 12, Great Britain cabled that yarn and cloth business was continuing to decline, prices were very unsatisfactory, and machinery activity in the mills was falling. France continued to report stocks of goods at mills heavy, sales light, and mill curtailment extensive. Switzerland reported trade almost stagnant, and Belgium reported new business very small.

The failure of commodity prices to continue to improve with the rising trend of business -- instead, the BLS all-commodity index in August again turned downward to a new low -- appears the most unfavorable feature of the present situation. In this respect the situation does not conform to the trends in other recent recovery periods, but resembles more nearly the false upturns in the spring of 1931 and the fall of 1932.

Aside from the effect of weakness in commodity prices in restraining new buying, the possibility arises that it may again bring the inventory situation into prominence as a weak feature of the business picture. While inventories, according to our estimates, have been reduced to a point where they should provide no material handicap to business recovery if prices improved as business expanded, declining prices might result in a renewed movement to liquidate inventories. Furthermore, a tendency to build up inventories in anticipation of improved demand has again become apparent, particularly in the steel industry. This has been due in part to the current hand-to-mouth buying policy of steel consumers, which requires the steel mills to have adequate stocks on hand to guarantee prompt delivery.

Secretary Morgenthau - 3

The steel situation

An upturn in orders of the U. S. Steel Corporation to the equivalent of 48 per cent of capacity, as compared with 37 per cent last week, places them slightly above the previous highs of the year. (See Chart 2.) If continued at that level, they would apparently justify the current rate of activity in the industry, which is estimated this week at 47.5 per cent of capacity, representing a new high for the season.

Reports from the steel trade, however, make no mention of any material improvement in orders recently, which suggests that the increase in U. S. Steel orders this week may be due to an isolated large order. The Iron Age says that "Disappointingly slow improvement in new business during September tends to make the trade cautious in its expectations for the near future."

Reports from Pittsburgh mention that orders during the past week were a shade larger than a week ago, while for the Chicago district, second in importance, it is stated that "A lack of interest seemingly has developed for which there is no apparent reason. Sales last week were from 15 to 20 per cent less to just slightly better than the previous week. Orders are still confined to present needs."

A reduction in prices of rails and track materials this week may stimulate some buying by the railroads. The reaffirming of steel prices on other products for fourth quarter delivery was anticipated, and is not expected to affect orders. Pig iron prices, on the other hand, have been increased by \$1 a ton, recovering part of the \$4 cut made last June.

Greatest hope for steel demand continues to center on the automobile industry, from which some increase in orders recently has been reported. Most companies, with the main exception of Ford, are now producing 1939 models. The progress on new models, however, has been disappointingly slow, suggesting that the factories are proceeding cautiously in their production plans. Labor troubles have also been a factor. Whereas a short time ago it was believed that the fall upturn would get under way two weeks earlier than last year, it now appears that little or no advance over last year will be made. (See Chart 3.)

Secretary Morgenthau - 4

New orders improve

An upturn in new orders during the third week of September, partly seasonal in nature, has carried our weekly total index back to the level of the last week in July. (See Chart 4.) The upturn in U. S. Steel orders previously mentioned was an important factor in the rise, but other orders have also shown some improvement. This is particularly true of orders for cotton textiles and building materials, which normally improve during September.

The increase in orders so far is not sufficient, in our opinion, to maintain business activity at present levels. It might be possible, however, for the deficiency to be remedied over the next month or two by a marked improvement in demand for automobile steel, building materials and textile products.

Current business news

The New York Times weekly business index for the week ended September 17 more than recovered its drop of the previous week, rising 1.4 points to a new high of 85.9. While the adjusted indexes for automobile production, cotton mill activity, and miscellaneous carloadings declined, these were more than offset by increases in the indexes for steel, power, and lumber production and "all other" carloadings.

Barron's adjusted weekly index, on the other hand, declined to 60.2 from 61.5 in the preceding week, after levelling out for three weeks. This index differs from the New York Times index in that weekly petroleum output and coal production are added, while lumber production is excluded.

Department store sales during the week ended September 17, affected by unfavorable weather, were 12.5 per cent below the comparable week last year. This compares with a decline of only 2.7 per cent during the first week of September, which was the most favorable comparison of any week in recent months.

The construction industry continues to stand out as a bright spot in the business picture. While the F. W. Dodge data on residential awards for the first half of September are not yet available, the Engineering News Record figures for heavy construction awards for the week ended September 22 were the highest since the week of June 25, 1937, representing an increase of 95 per cent above last year. Awards for public construction were 177 per cent above last year, but those for private construction were 35 per cent below. Mortgages selected for appraisal by the FHA during the week ended September 17 were the highest for any single week under the program, with 60 per cent covering homes to be constructed.

STERLING EXCHANGE AND PRICES OF COMMODITY FUTURES

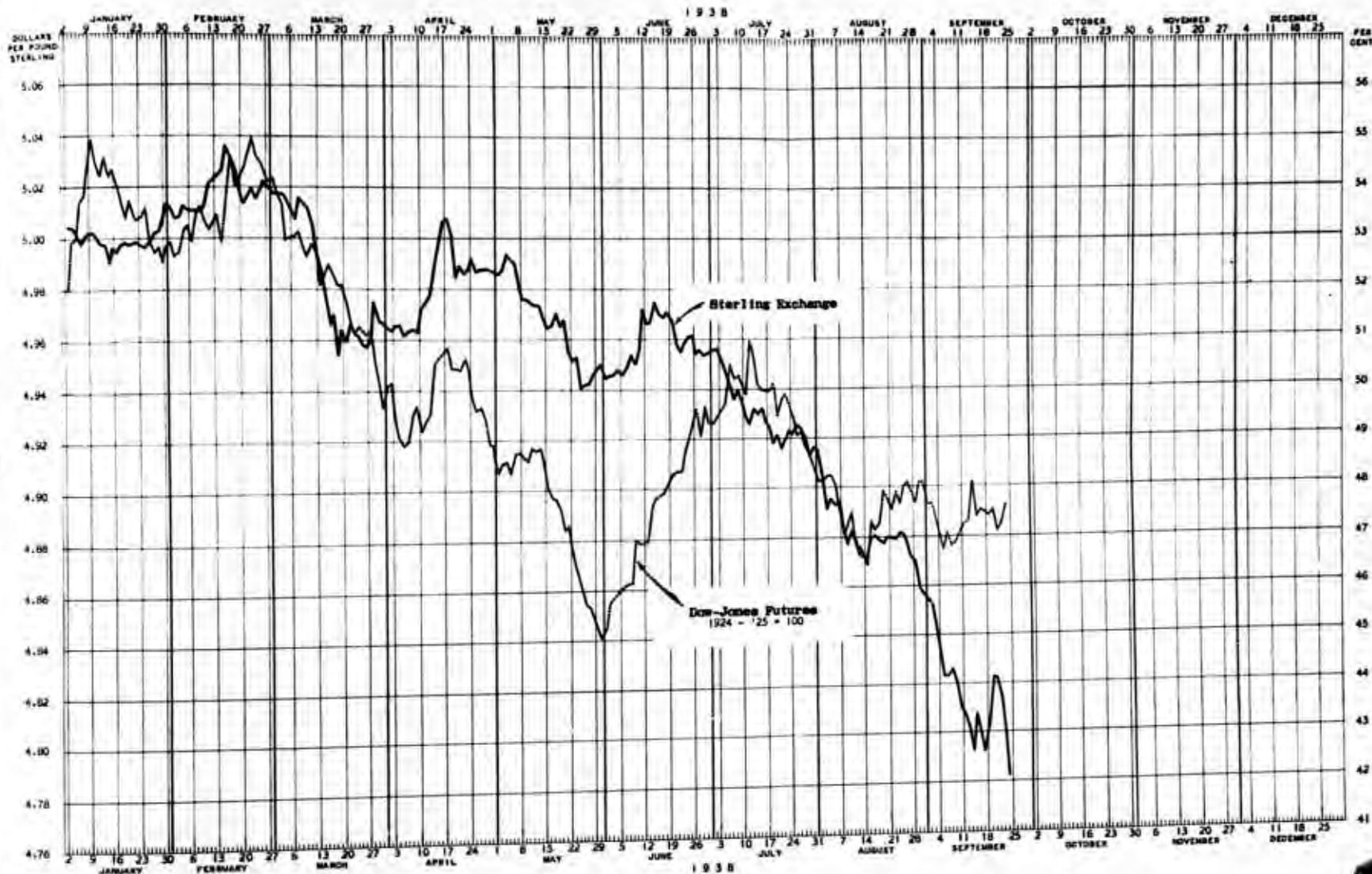
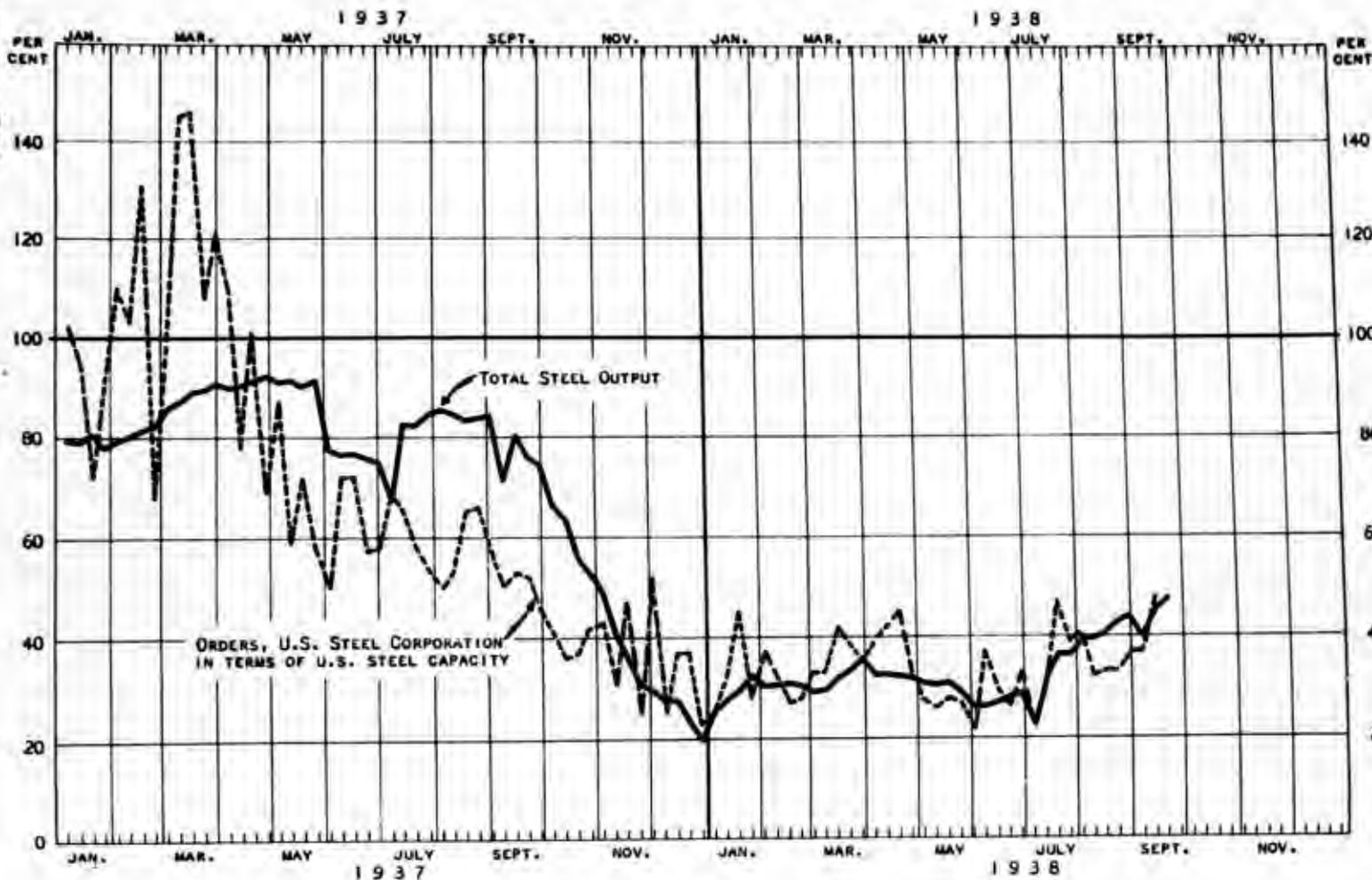


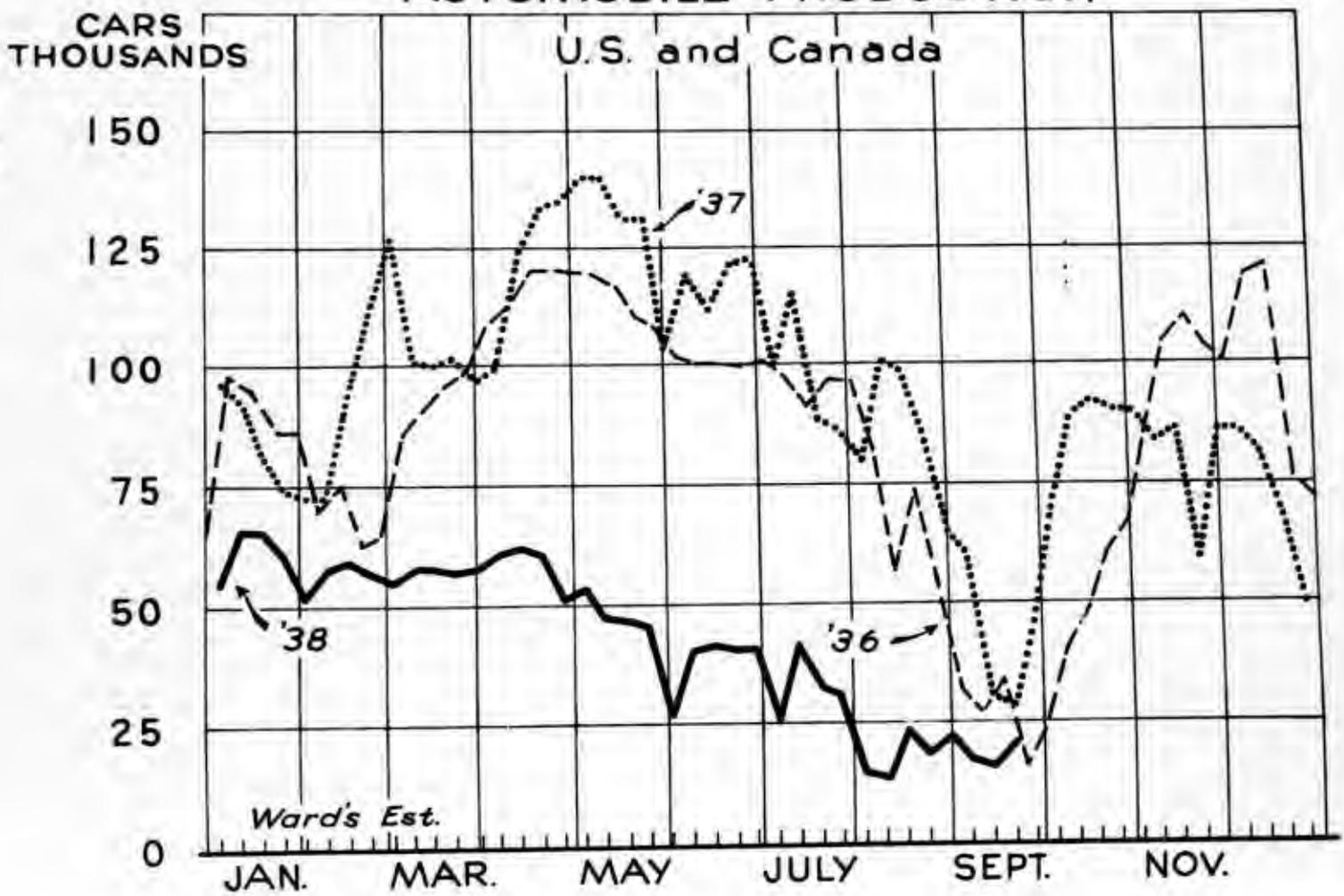
Chart 2
Confidential

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

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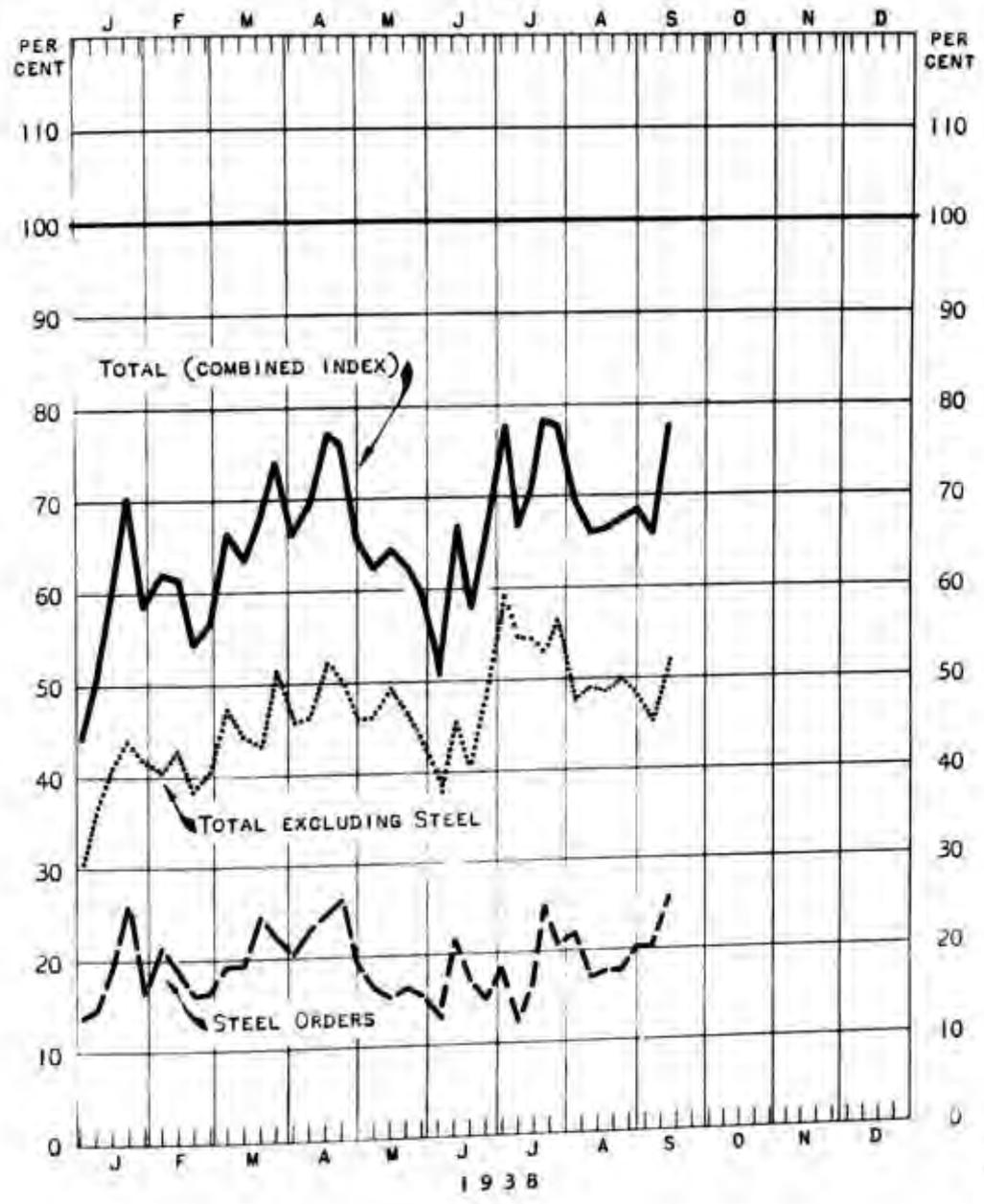


AUTOMOBILE PRODUCTION



INDICES OF NEW ORDERS 1936 = 100

1938



Paris, October 3, 1938.

Dear Mr. Secretary:

For your records, I have pleasure in transmitting herewith three memoranda covering recent conversations.

Faithfully yours,



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

Enclosures:

- 911
1. Memorandum dated ~~August 30~~, 1938.
 2. Memorandum dated September 8, 1938.
 3. Memorandum dated September 26, 1938.

9/1

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Paris, ~~August 30~~, 1938.

M E M O R A N D U M

Secretary Morgenthau called me at 4 p.m. today from Washington. He instructed me to telephone my friends in Central Banks in the Netherlands, Belgium, Switzerland and Sweden. He wanted me discreetly to find out what they thought of the general situation, of chances for trouble in Czechoslovakia and also what they thought of sterling breaking below 4.86. The Secretary said it was then 10 o'clock with him and it was urgent that my report be telephoned back within two hours, that is, before 6 o'clock Paris time.

I put in calls for the various Central Banks and succeeded in obtaining the information which was incorporated in my 1371, dated 6 p.m. today. I had been able to telephone the contents of this message to Secretary Morgenthau at 5.50 p.m. The cablegram covered practically everything of value which I obtained from my friends, but the following notes should be put down to complete the record.

Governor Janssen of the National Bank of Belgium was interested to know whether there had actually been any negotiations between the British and ourselves in regard to altering the rates in one or both currencies. I told him that Secretary Morgenthau had not even gone to London on his recent European visit, lest such a visit might be connected with the trade negotiations, and that

I . . .

I was aware he had carried on no negotiations while in Europe in regard to the sterling-dollar rate.

When I talked with the Deputy Governor of the Bank of Sweden, this gentleman seemed more nervous than any of the other Central Bankers with whom I spoke. He also was anxious to know whether the Americans had been negotiating with the British in regard to changing currency rates, and I replied to him as I had to Governor Janssen. He told me that Governor Rooth was due back at the Bank on Thursday, September 1.

President Bachmann of the Swiss National Bank referred to Secretary Morgenthau's visit to Switzerland and stated that he would have liked to have called very much on the Secretary but had hesitated to do this lest it might embarrass the latter. I explained very frankly to Bachmann that Secretary Morgenthau had traveled in Switzerland only as a tourist; had made no calls on either Swiss or American officials lest rumors might arise; and had not even visited the B.I.S. in Basel. President Bachmann asked if it would be possible for me to visit him in Zurich before the October meeting of the B.I.S.

When I told Secretary Morgenthau that the Swedish Central Bank Deputy Governor seemed particularly concerned over the situation and that his Bank was selling sterling against dollars, the Secretary let me know that the Swedish Central Bank had asked him yesterday to sell

1 million . . .

1 million pounds sterling at the best rate the New York market would pay, and that the American Stabilization Fund had itself taken this amount.

The Secretary asked what the French press reaction had been to his statement in New York. I told him that the Agence Economique in particular had carried this in detail and that other papers had given it favorable attention. I also referred to his farewell remarks upon improved conditions in the French provinces made as he was sailing from Havre and told him that one paper had written quite a story on this interview. The Secretary let me understand that he had a purpose in mind in picturing the French situation encouragingly. He asked me to send him all clippings. I told the Secretary that after Rueff had returned from London he had told me last Friday that he had found the British Treasury people interested in fitting in with the American plan if, after study and consultation by and between the Banks of England and of France, this plan was found to offer some real assistance to France. I reported that Rueff had not yet let me know the results of such consultations. The Secretary understood that there was plenty of other problems to think about today.

The Secretary was most appreciative of the promptness with which the opinions of the several Central Bank Governors had been obtained and communicated to him.



M E M O R A N D U M

At 4.30 p.m. on September 6, Secretary Morgenthau telephoned me at the Embassy. He asked that I do a little telephoning to my friends and ascertain their opinion as to trouble possibly breaking out in Europe during the remainder of this week. He asked that I call him back, Washington time, at 11 a.m., Wednesday September 7. He told me that he had to make a decision in regard to his September financing and wanted the best available opinion as to what the chances were of real trouble breaking out in Europe within the present week.

I gave the Secretary a full account of the interview which I had just had at the Ministry of Finance with Rueff. When the Secretary asked if I was going to cable this I told him that the matter had not entered any record of the Embassy and that it might be preferable not to make the final chapter official. It was agreed, therefore, that I should prepare a letter yet that evening for mailing on the Normandie the following morning. This was done in my personal letter to the Secretary dated September 6.

On September 7, I telephoned or saw a number of my central and private banking contacts. At 4.30 p.m. I put in a call for Secretary Morgenthau for 5 o'clock, which was accepted at that hour. When I

got . . .

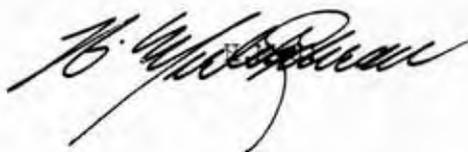
got on the line three different times I was told by the American central that the Secretary wished to speak with the Ambassador and not to me. When I insisted that I was putting in the call for the Secretary under instructions from him, I was finally informed at 6 p.m. that the Secretary was no longer available but would call me back at my apartment at 7.30 p.m.

When the Secretary got connection with me at my home at 7.30 p.m. I explained my efforts to reach him earlier in the evening. He said he had put in a call for the Ambassador but had been informed that the Ambassador was at the races and had been asked whether he desired to speak with the Ambassador's secretary. He had replied that he did not want to speak with the Ambassador's secretary and had cancelled the call. I remarked that the central had evidently cancelled my call as well as his which was, of course, a misunderstanding. I hoped I was not too late with my information. He said that such was not the case and asked me to give him a full report. I gave him a detailed statement as incorporated in my cablegram 1405, dated September 7, 1938, 6 p.m., which I had already prepared but did not file until after the Secretary requested it in our conversation by telephone. After I had quoted my various friends, the Secretary asked me what my own opinion was. I told him that I was convinced there would be no serious trouble the remainder of this week

on . . .

- 3 -

on this side and that he could safely go ahead with his
loan in so far as Europe was concerned.

A handwritten signature in cursive script, appearing to read "W. W. R. R. R. R. R.", is written in the center of the page.

Paris, September 26, 1938.

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M E M O R A N D U M

Rueff telephoned me yesterday, Sunday, evening between 5 and 6 o'clock. He told me that he expected to see Minister of Finance Marchandau after the latter came out of the Cabinet meeting which was then in session, and asked that I come over to the Ministry at 7.15 p.m.

When Rueff received me at 7.20 p.m. he told me that in the present situation it was necessary for France to preserve her gold stocks for military reasons. He handed me the attached memorandum dated September 25. He said that no decision had yet been taken to carry out the measure suggested in the memorandum, that is, that of having the Stabilization Fund restrict its giving of foreign exchange to those parties who could justify their requests on commercial or tourist grounds. He recalled that such a measure had been used at certain times in the past without great efficacy. He said that he just wanted to inform us, through courtesy under the Tripartite, that such a step was under consideration. He agreed that I should transmit the text of the memorandum in strict confidence to Secretary Morgenthau, and said that he would let me know promptly if and when France definitely decided to institute the plan under consideration. In the meantime he wanted us to know the plan and give consideration to cooperating with the French Ministry of Finance on our own American market.

When . . .

When I asked Rueff if the rate of 179 francs to the pound would be maintained if the abovementioned procedure should be resorted to, he said that such foreign exchange as the Bank of France gave for the Stabilization Fund's account would be within the 179 limit, but that if the demand for such exchange greatly exceeded the amount which the Fund would be ready to give, there would presumably develop a black market and a second rate. Rueff said that no decision would be taken until the market had been observed after its opening on Monday morning. He said that the Fund had been under considerable pressure last week, but still had an important amount of gold, and that the franc had held up well in London and New York on Saturday.

Rueff had not yet seen the communiqué which had been issued following the Cabinet meeting but he was not hopeless in regard to the international political situation. He received Rowe Dutton, Finance Counselor of the British Embassy, to give him the same information which he gave me. I shook hands with Rowe Dutton in the waiting room but had no further conversation with him.

While I was waiting to see Rueff I exchanged a few remarks with his assistant, Couve de Murville. The latter was convinced that there was nothing to do but impose exchange control if war should break out.

After leaving the Ministry of Finance I came to the Embassy, but was informed by the door man that

there . . .

there was no code clerk on duty. I then proceeded to my home and at 8 o'clock put in a long distance call for Secretary Morgenthau at Washington.

At 8.45 I got communication with Secretary Morgenthau at his farm, Beacon 211. I told him of my meeting with Rueff and read him an English translation of the note which I had made and which the Secretary took down verbatim. It was agreed that I should cable this message at once to Washington, to which city the Secretary was returning by airplane within an hour and a half, and that I should also tell the Ambassador and Butterworth of my conversation. The Secretary asked what was new, and particularly whether anyone had the text of the German demands on Czechoslovakia. I gave him what news I had, and told him that I understood the text of the ultimatum had been cabled by our Embassy in London. He said that he would see all the Paris messages when he arrived in Washington. I let him know that the British had been given a notice similar to ours.

After talking with the Secretary I telephoned Mr. Murray, and met him in the Embassy Code Room around 9 o'clock and prepared my cablegram No. 1582, of that hour, incorporating therein the translation of Rueff's note. While in the Code Room I telephoned to Counselor Wilson and summarized my message, since I learned from Mr. Murray that the Ambassador was at Chantilly. Mr. Wilson said that he was preparing a cablegram on the cabinet meeting and would tell the Ambassador about my

message . . .

message when he telephoned to him to get his approval for his cablegram under preparation. Mr. Wilson did not think it necessary or advisable for me to telephone the Ambassador and give too much of the details of the note over the telephone.

At 10.30 I put in a telephone call for Mr. Butterworth at his home, Langham 2257, London. At 10.45 I was told that no one answered at that number so I cancelled the call. Shortly after my arrival at my home, Mr. Butterworth got me by telephone. He was still at the Chancery and there had been no one to answer the phone at his home. Secretary Morgenthau had, however, been in conversation with him and mentioned my message. I read Butterworth the English text of the note. He said the French and British officials were still in session at 11 o'clock when he talked with me. It was understood that I should telephone Butterworth if and when the French Ministry of Finance informed me that it would put into effect the procedure discussed in the note. At 2.30 a.m. this morning, Secretary Morgenthau telephoned me at my home. He stated that he had returned to Washington and had discussed my message with everyone including the President. Fels and Moffat had shown him all of the State Department messages on the European situation. He asked me to telephone Rueff at once and let him know that the Secretary of the Treasury was entirely willing and glad to cooperate fully along the lines suggested.

If . . .

If the French decided to go ahead with their plan, the Secretary asked that we be informed as early as possible. He insisted that I telephone Rueff yet during the night thinking that this assurance might make the latter happier. The Secretary told me to call him whenever I received the French notice even though it might be during the night hours at Washington, since American cooperative steps could only be taken through direct instruction from the Secretary himself. In answer to the Secretary's inquiry, I told him that I had nothing further than he did on the situation, except that Butterworth had told me that the British and French officials were still in conference at a little after 11 p.m.

At 2.40 I telephoned Rueff's home, Littré 26-01, but obtained no response. At 2.45 I telephoned the Ministry of Finance, but could get no answer. Consequently, I did not call again until 9 o'clock this morning when Rueff's home told me that he had already left for the Ministry of Finance. I reached him there at 9.30 after failing to find him on a call at 9.15. I told him that I had communicated his note by telephone to Secretary Morgenthau early in the evening and that the latter had proceeded by airplane from his farm in New York where I first talked with him to Washington where he discussed the matter and called me back late in the night. I told Rueff that the Secretary of the Treasury said that he would be willing to cooperate fully in
the . . .

- 6 -

the sense desired and only requested that the French give us as early notice as possible if and when they decide to put their plan into operation. Rueff thanked me warmly. He said that there was nothing new this morning and again assured me that he would promptly give me any news on the situation as soon as available.

B. M. G.
H.M.G.