

DIARY

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## GROUP MEETING

October 21, 1938.  
9:30 A. M.

Present: Mr. Oliphant  
Mr. Gaston  
Mr. Haas  
Mr. Taylor  
Mr. Hanes  
Mr. Upham  
Mr. White  
Mr. Viner  
Mr. Lochhead  
Mr. Gibbons  
Mr. McReynolds  
Mrs. Klotz

H.M.Jr: Herbert, do you want to change those blinds for me?

Gaston: Yes. Is it right that Dr. Benes is coming to Chicago?

Viner: Uh huh.

H.M.Jr: Fine. I congratulate you.

This, I understand, has been written at the request of Guy Helvering. See that gets a copy of it. I have only got that one. Just attach a copy of it. He just asked for it.

McReynolds: I'll look at it, and see.

H.M.Jr: What?

McReynolds: I'll look at it, and see.

H.M.Jr: Anything else?

McReynolds: Just a minute; the General Motors has been putting on a Parade of Progress in a hundred twenty-seven cities, quite a scientific show; they're going to put it on, starting next week, here. It will be on this open plot back here at the corner. Their men were in yesterday evening to see me, and I called Herbert. They are offering to give to the

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Treasury a free showing, before the show opens - get a chance to go through it - lots of scientific history, scientific development to it - and if you would care to go see it, they would give us a preliminary showing.

H.M.Jr: No; no, my price is higher than that.

McReynolds: So I'll .....

H.M.Jr: No thanks, not for myself. No. Thanks very much. Anything else?

McReynolds: I've got nothing but a couple White House letters here you asked me to talk about; no hurry about it.

H.M.Jr: Yeah. Dan?

Bell: I have nothing this morning.

H.M.Jr: (Nods to Mr. Lochhead.)

Lochhead: The exchanges are all quiet.

H.M.Jr: Dan, could you give me - let me have it Monday - how much is the United States Government doing in the way of Public Works, for the last of my message, which do not show up in the Budget?

Bell: Just the Government - Federal?

H.M.Jr: Federal. I mean, use the - as an example, Straus' organization. Huh?

Bell: Uh huh.

H.M.Jr: How many things like that are we doing; how much does it amount to, in dollars? Huh?

Bell: Yes sir.

H.M.Jr: Make it part of that other thing I want. And how many of the things are we doing could we throw into that category? And, for instance, why do they, in the case of Pennsylvania, make the toll higher, rather than doing something else? And it isn't - who decides whether there should be a levy to produce this thing, or whether there shouldn't?

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- Bell: Well, that Pennsylvania thing came under a corporation up there especially set up by the legislature, and was a Public Works program.
- Lochhead: Out to get some P. W. A. funds which is outside of the regular state government, because of limitations put in the Constitution from that state.
- H.M.Jr: Well, is that - is that a good model?
- Bell: About the only way to handle it. I shouldn't think so, no.
- H.M.Jr: You see what I am thinking about; are there others which are better? Could we throw the thing into things which could be financed, and well - ah - I guess - is Bolder Dam, is that - is that - is that a good example?
- Bell: Well, Bolder Dam was an excellent project. The contracts were all signed before a spade was ever stuck in the ground, and the revenue was assured to pay the Government back their hundred and sixty million dollar investment, and it still is a good project, but what I am afraid, before it is over, the rates now applying in the Bolder project will be changed to comply with Bonneville and some of the others that are not so good, and we won't get our money back.
- H.M.Jr: What about the Southern Water District? Is that the transmission line from Bolder Dam? What was that that the R. F. C. sold sixty - sixty-five million dollars, and they pledged to hold the Southern California ....?
- Bell: That was another thing.
- H.M.Jr: What was that? It did show the transmission, or something.
- Bell: That was the power company, I think.
- H.M.Jr: How much are we doing, of the things that do not appear in the Budget, and how many - what sort of things could we do in the way of Public Work lines which could be thrown in that category, which would not show up in the Budget?

Bell: It will require a little study.

H.M.Jr: As to what we are doing now wouldn't require it.

Bell: I think I can have something on it.

H.M.Jr: Thanks.  
(Nods to Mr. White.)

White: We've got something here with reference to the sterling rate as applies to the negotiations with the English, but I presume you want to postpone that until later in the day.

H.M.Jr: That is right.  
(Nods to Mr. Gibbons.)

Gibbons: (Nods "Nothing.")

H.M.Jr: You're very solemn; you're not worried about the New York State election?

Gibbons: I don't think there is going to be any election up there, is the way I feel. That was a funny thing I asked about the other day - those two lawyers that's running - are they still taking different sides? Ah - you know, your ....

Oliphant: Eddie? No, you're mistaken about Eddie.

Gibbons: The other fellow told me .....

Oliphant: I'll tell you sometime what he told me - if Lehman ran against him.

H.M.Jr: You fellows are a little beyond me.

Gibbons: Incidentally, Bob Wagner is certainly having a terrible time getting any funds - people that will contribute to the Democratic party.

H.M.Jr: On Section two-eleven?

Gibbons: I am telling you about what - personally, it is funny - I mean, people contribute to the party - Labor Relations Act.

H.M.Jr: Be sure. You're on that ..... (speaking low)  
You (Mr. Viner) want to give us a little pure economics?

Viner: It's gotten a little adulterated of late - New Deal stuff. I am not even sure of that now, whether my memory's straight.

White: Get it a little adulterated; it will be useful.

H.M.Jr: I read your two memoranda last night, Cy; as far as I could read, it seems you are doing everything you can as far as the West Coast situation is concerned. You're sitting tight.

Upham: I have a tentative draft of a letter following up to one of the banks, which I'd like to refer to these .....

H.M.Jr: If you get that, it will be fine. (Some words not understood.)

Upham: O. K.

Hanes: (Hands H.M.Jr. a letter.) Got that thing on the German situation.

H.M.Jr: (Looks at memo after talking low to Mrs. Klotz.)

Hanes: The last paragraph will tell you he's just making an exception in this case; it will not have to divulge the names to pay the tax.

H.M.Jr: And it's all done?

Hanes: All done.

H.M.Jr: I'm not used to such service. Thank you very much; that's very nice; thank you very much. What else, John?

Hanes: That's all I've got. I've got the first draft of that letter which you want to write, which I'd like to take up with you.

H.M.Jr: I'm going into this meeting with the economists at ten, and may be able to come up for air this afternoon; I'll see.

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White: We've got in fine shape that contract we have drawn.

Hanes: I haven't been over there yet.

H.M.Jr: Mac, talking with John Hanes about Phil Young,....

McReynolds: He dropped in this morning.

H.M.Jr: Oh, I'm sorry..... I told him he could pay him whatever is necessary in order to get him. We thought you'd have to pay him five.

McReynolds: Yes.

H.M.Jr: You go to Hanes about that. Is that right?

Hanes: (Nods "Yes.")

H.M.Jr: Or am I going too fast?

Hanes: No, that's all right with me.

H.M.Jr: Isn't that what you want?

Hanes: Didn't hear you.

H.M.Jr: I told Mac you talked to me about Phil Young, and it's all right with me to pay him enough to get him.

Hanes: Good.

H.M.Jr: Huh?

Hanes: Good.

H.M.Jr: You thought that five would do it.

Hanes: I don't guarantee that, because I haven't talked to him about it; he said he wouldn't come for the price he's talked to Mac about. He didn't want to change for that price.

H.M.Jr: Was Duffield satisfied?

McReynolds: Oh yes; he's ready to come, just as soon as .... probably the first of November.

H.M.Jr: And you explained the salary to him.

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McReynolds: Yes.

H.M.Jr: Anything else?

Hanes: No.

H.M.Jr: Wayne?

Taylor: The Peruvian man is coming in at three o'clock this afternoon for his first conversation.

H.M.Jr: Good.

Taylor: Have you got any particular idea about it - or just listen?

H.M.Jr: No, no idea. What do they call their money?

White: Sol.

H.M.Jr: Yeah. I haven't got a "sol."

Taylor: We're also going to be asked, within the next couple of days ....

H.M.Jr: Yes.

Taylor: .... to name a three-man mission, to go to Cuba.

H.M.Jr: Well, now, let's talk about that with these people at ten o'clock; let's talk to them about this whole business; I want to talk to them about South America as well as sterling. Bring that up, see?

Taylor: Sumner Welles told me that yesterday, that it was coming, and he wanted particularly for us to send the best we have.

H.M.Jr: He told me about it a couple weeks ago, but I don't know - I'd like to get these men's advice, and maybe out of this group we can get somebody to go down there. Jake looks as though he might like a couple of weeks in Havana.

Viner: As long as it's in the winter time.

Taylor: It might be more than two weeks.

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Gaston: Jake gets too much publicity when he's left alone, and I think he might have to have some help.

Viner: With your help, Herbert, fine. Say, I ought to charge the Treasury for a secretary to answer all the letters people write asking me for jobs here.

H.M.Jr: Ah - well, that's .....

Viner: Or maybe you will give them all jobs, I don't know which.

H.M.Jr: I'm sorry; the W. P. A. rolls are full. Wayne, anything else?

Taylor: (Nods "No.")

H.M.Jr: George?

Haas: I have nothing this morning.

H.M.Jr: Herbert?

Gaston: Duffield told me that Hogate hoped that this thing could be put on the basis of a loan, and I told him, of course, a loan of his services would not be; I told him, of course that couldn't be done.

H.M.Jr: A loan? What do you mean? A loan of his services?

Gaston: Yes.

H.M.Jr: No.

Gaston: I told him that, of course, we couldn't do anything like that.

H.M.Jr: No.

Gaston: I did something rather unusual yesterday. I asked the Washington Times not to print a story which is perfectly true, and they agreed not to print it. We have been getting shipments of raw opium for storage supply. They had an accident down in the railroad yard; a couple cars were ditched, and one of them was our car of raw opium, and some of the railroad men talked pretty freely about it, and the Times had pictures and were prepared to run a

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story. Harry Anslinger thought it would be very dangerous to print it, and they agreed not to print it.

Gibbons: How much opium was in it? How much of a quantity?

Gaston: I don't know; it was a pretty large quantity - a carload of opium.

H.M.Jr: Do they always ship it that way?

Gaston: They seemed to have been shipping it that way for sometime, and nobody learned about it; it's been coming in here very quietly.

H.M.Jr: Does it go to our vaults?

Gaston: Yes. It's in part for ordinary reserve, and it's in part for military supply.

Viner: (Talking to Mr. Upham.)

H.M.Jr: What does Jake say?

Upham: Getting ready for a new session of Congress.

H.M.Jr: Is that what he said?

Upham: Yes.

H.M.Jr: Why should we? They're "dopes" already. (Laughter)  
All right.

Can I thank you (Mr. Gaston) and Cyril for the follow-up you've done on one Mr. Kiplinger? I hear he's reformed.

Gaston: Thank you, Mr. Upham.

H.M.Jr: I say "follow-up" because I claim an hour and a quarter with that fellow myself. Believe me, I never talked to anybody the way I talked to him.

Gaston: I think that ~~thing~~ that Shelton brought up to us was pretty much of a feeler; I don't think he really intended to print it.

H.M.Jr: Anything else?

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Gaston: Nothing else.

H.M.Jr: (Nods to Mr. Oliphant.)

Oliphant: (Nods "Nothing.")

H.M.Jr: Let's see, ten o'clock, we have this meeting.  
All right.

Friday  
October 21, 1938  
12:12 p.m.

HMJr: Hello.

Operator: Speaker Bankhead.

HMJr: Thank you.

O: Go ahead.

HMJr: Hello.

Speaker  
Bankhead: Hello.

HMJr: Henry Morgenthau, Jr.

B: Mr. Secretary, this is W. B. Bankhead.

HMJr: How do you do, sir.

B: I'm all right. How have you been?

HMJr: Oh, I've been better and worse.

B: Yeah. I called you up about a matter that our people down here in Birmingham and all over this section have been very much interested in. Ah - It relates to the location of the regional office involved in your decentralization of the Bureau of Internal Revenue.

HMJr: Oh yes.

B: Now, when this program was first announced, Mr. Secretary, they - Louisiana and Mississippi, Tennessee, Alabama, Georgia and Florida were the states they said were going to be involved.

HMJr: Yes.

B: And the Chamber of Commerce at Birmingham and a lot of other civic organizations in this area were very anxious to get that ah - headquarters located in Birmingham.

HMJr: Yes.

B: Now, ah - I've received in- - we've received information that since the original states were layed out that ah - in fact I have a letter from

- 2 -

Mr. Hanes about it.

HMJr:

Yes.

B:

Who is Acting Secretary. - That Louisiana and Mississippi have been cut off of that list and that they were now thinking about putting that office in Atlanta. Well now, very casually, Mr. Secretary, Atlanta has just about got everything - every regional headquarter in this Administration.

HMJr:

Yes.

B:

And our people over here in Alabama - and I share in it - have gotten pretty sensitive about it.

HMJr:

I see.

B:

We don't think it's fair to us. And I'm asking you to see if you can't re - have that matter reconsidered and let the original geographical division stand and consider Birmingham for that assignment.

HMJr:

Well, I'll be very glad to look into it and I - and I'll - and find out just where -

B:

I think it could be done and we ah - we people over here in Alabama feel like we're - and Birmingham - that we're entitled to some of those things.

HMJr:

Yeah. Well -

B:

We don't have to be - ah - you know, we go along over here in Alabama.

HMJr:

I know you do. (Laughingly)

B:

Atlanta has just practically gotten everything. Of course I don't blame them but ah - it's a fact that practically all of the regional headquarters of any importance under this Administration in this area have been put in Atlanta.

HMJr:

Right.

B:

And my people, the Senators Hill and Senator Bankhead and all of us can't understand why we don't get a look-in every now and then.

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HMJr: Well, you're willing to leave the Federal Prison there, aren't you?

B: Huh?

HMJr: You're willing to let them have the Federal Prison?

B: Federal Prison?

HMJr: Yes. At Atlanta.

B: (Laughs) Yes. All right. That's there too you know.

HMJr: All right. Well, give -

B: But now, Henry, listen -

HMJr: Yeah.

B: I'm deeply interested in this.

HMJr: Well, give me a chance.

B: I'm appealing to you - I don't ask for many favors -

HMJr: I know. Very few.

B: - from this Administration. And I feel like that we ought to have a reconsideration of this.

HMJr: Well, I can assure you if it's just a question of flipping a coin you'll get it.

B: Well, I - I'll appreciate that very much. And Louisiana and Mississippi could be retained in there and Birmingham would be right square in the center of that area.

HMJr: Well -

B: Physically and everything else.

HMJr: If it's<sup>just</sup>/a question of tossing a coin I'm for you.

B: What's that?

HMJr: If it's just a question of - if it's a tossing a coin - if it's a matter of close decision, you see, - where it should go, I'm for you.

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B: Well. Well now you - you talk to Mr. Hanes about it, he's been handling the matter. I want you to do that for me.

HMJr: I'll do it today.

B: Well, I want you to.

HMJr: I'll do it today and ah - I'll go right into it. I'll be glad to.

B: And will you let me hear from you?

HMJr: I certainly will.

B: Thanks verymuch. And - and good luck.

HMJr: Thank you. Same to you.

October 21, 1938

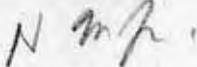
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My dear Mr. Secretary:

Thank you for your confidential letter of October 5th.

I shall appreciate your making available to me any additional information you may receive on the activities of Japanese-owned fishing boats in Mexican waters.

Sincerely yours,



(Signed) H. Morgenthau, Jr.

The Honorable  
The Secretary of the Navy.

October 21, 1938

My dear Mr. Secretary:

Thank you for your confidential letter of October 5th.

I shall appreciate your making available to me any additional information you may receive on the activities of Japanese-owned fishing boats in Mexican waters.

Sincerely yours,

(Signed) E. Morgenthau, Jr.

The Honorable

The Secretary of the Navy.

17 Home

THE SECRETARY OF THE NAVY  
WASHINGTON

(SC)AB-5(1)/EF37.

5 October 1938

CONFIDENTIAL

Sir:

The enclosures, which are copies of reports received from a source believed to be reliable, are forwarded for information.

In this connection, it has been further reported that the Japanese population on the Pacific Coast of Mexico was increasing rapidly, that Japanese owned tuna boats from San Pedro and San Diego were leaving these ports with skeleton crews, stopping in Mexico to man their boats with recently arrived Japanese, would bring these men to San Diego as members of their crews and there obtain seamen cards for them to land. These Japanese would then disappear and the same boat would again leave with a skeleton crew to pick up more Japanese in Mexico. The American consuls in Guaymas and Ensenada, Mexico, have endeavored to stop this practice by refusing to visa the crew manifest, but the situation still exists.

Respectfully,

*Claude Swanson*

The Honorable,

The Secretary of Treasury.

Enclosures: (3)

CONFIDENTIAL

*to be ans,  
AH*

Los Angeles, California  
January 11, 1938

I have been at Guaymas, Sonora, Mexico, since about April of 1933, engaging in the fishing industry, together with my associate, an American citizen. I am also an American citizen. In our fishing operations, we have used American capital and American vessels, and have conducted our fishing operations in the Gulf of California, basing at Guaymas. During the last few years, we have concentrated upon the catching of shrimp, and we were the first persons to produce and ship shrimp from these waters in commercial quantities. This we were only able to do after the expenditure of large sums of money in the development of nets for deep sea fishing of shrimp. Before we commenced our shrimp operations, a small quantity of shrimp had been produced by Mexican fishermen, using canoes, fishing in the lagoons for only a short period each year. Our success soon attracted the attention of the Japanese.

First, I will attempt to give some history as to the operations of the Japanese up to 1936, when their real invasion of the waters of the Gulf of California began.

In 1931, a large Japanese vessel came into the Gulf, and dropped off six small sampans, each of about 25 feet in length, and using 10 horse power Japanese Bolindo engines. They went into Guaymas, and stated that they wished to work with Mexican labor as fishermen. These fishermen were placed aboard small boats, but were not used, as the Japanese did any work that was to be done. The boats went up and down both Coasts of the Gulf, doing very little fishing. Had they caught any shrimp, they would have had no means of getting it to any market, as they had no ice on board, and even so, the holds on each of these boats would only hold less than a ton of shrimp with ice. They checked both Coasts as far North as the North end of Tiberon Island, taking special interest in a reef of 15 fathoms that lies midway between the south end of Tiberon Island and the North end of San Pedro Martir Island, a place where it is most unusual to find shrimp. It was at about this time that the Mexican Government became suspicious of the actions of the boats, and sent soldiers overland from Guaymas to Kino Bay, a distance of ninety miles, and on the pretext of not being immigrated properly, the Japanese were brought back to Guaymas, deported to Japan, and the boats confiscated.

In 1931 or 1932, the Japanese made another attempt at fishing, basing on Topolobampo, Sinaloa, using an old steam schooner called the "Marta Buner", once an American bottom, but at that time under the Mexican Flag. This expedition was headed by a Japanese

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by the name of Shin Shibata, who lives in Long Beach, California. He has conducted many expeditions in Mexico, all of which have failed as far as fishing is concerned, but regardless of the number of failures, he never seems to be financially embarrassed. This may be due by reason of his being financed by Japanese or illicit operation. The expedition of the "Marta Buner" was a failure.

In February, 1934, three very well-dressed Japanese came to Guaymas, and stated they wanted to hire a small boat to investigate fishing conditions in the Gulf of California. The Mexican that was placed aboard the boat to operate it, was instructed to observe everything that was being done by the Japanese. Two days after this boat left Guaymas, the writer was fishing on an American boat at a place called the "Tastiota" Lagoon, about fifty miles North of Guaymas, and about ten o'clock A.M. of the third morning, the small boat carrying the Japanese was seen to come out of a small bay called "San Pedro Bay" about ten miles South of Tastiota. San Pedro Bay is one of the very few fresh water holes between Guaymas and Kino Bay. Although we were fishing at the time, and despite the fact that the Japanese stated they wished to investigate fishing conditions they were not interested enough to stop and observe our operations, but proceeded towards the middle of the Gulf and passed on to the North. When this small boat returned, after a two weeks' trip, the Mexican Captain reported that the Japanese did not fish, and made no attempt to determine and locate fishing grounds, but did nothing but check water holes, taking soundings, and take many pictures, both movies and stills.

In the Fall of the year 1936, the Mitsui Company, which is the well-known Japanese corporation, whose attention had been attracted to shrimp fishing operations, sent the aforementioned Mr. Shin Shibata to Guaymas, Mexico, as their representative to undertake fishing operations for them. At first, they used American boats, obtained from San Pedro, California, and there was quite an influx of Japanese into Guaymas, but due to the opposition of the Mexican citizens, a great many of these Japanese left, although a considerable number remained. The Japanese were unable, at the beginning, to catch shrimp, because they were unaware of the fishing grounds, and did not have the proper nets. They attempted by bribery to have our employees divulge information to them, and were able to copy our nets and boards.

The few shrimp that were caught were in very poor condition, and when the same reached the United States by rail, were not fit for human consumption. This expedition was a failure.

When Mr. Shin Shibata and the Mitsui Company first arrived at Guaymas, they were accompanied by two Mexicans - one, a General Iturbe, and Mr. Valdes, both being Mexican Government

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officials representing the Department of Economy of the Mexican Government. These two men, and the Japanese did their utmost to cause us trouble, hoping that we would leave Mexico. They passed out a great deal of propaganda about how the Japanese would help the Mexican fishermen.

During the year 1935, a Mexican citizen named A. Anaya, who was employed by the Japanese, was given a concession by the Mexican Government to explore the Coasts of Mexico, to gather information concerning depths, currents, temperatures, topographic and fishing conditions, spawning grounds of different species, and to educate Mexican fishermen in modern methods of fishing. Mr. Anaya was really employed by the large Japanese Kyodo Company, and shortly after, the Japanese vessel "Minato Maru", a steel vessel of about 500 tons, appeared at Mazatlan, which was to be the base of their operations. Immediately, Japanese propaganda was commenced by giving neckties and various other gifts to the populace, and making many promises regarding the future welfare of Mexico regarding her fishing. The crew of the Minato Maru appeared to be well disciplined, leading one to believe that they were probably trained along Naval lines. The Minato Maru made one trip South to Cape Corrientes, and one North to the Colorado River, taking soundings, with both lead line and sonic depth finder.

About this time, two Japanese citizens were placed in the Department of Fisheries of the Mexican Government at Mexico City, and are still there. The Kyodo Company apparently has been able to gain the confidence, by one method or another, of some Mexican officials. The propaganda of the Japanese to teach the Mexican fishermen how to fish, was merely a sham, for they did not employ any Mexican fishermen, and were unable to catch shrimp at the beginning themselves. By their agreement with the Mexican Government of "exploration", they evaded the payment of exportation and exportation taxes. About the same time, another Japanese vessel of the same size as the Minato Maru was sent to the East Coast of Mexico.

The Minato Maru finally confined her operations to a shrimp bed about 15 miles long near Mocopule Island. In the beginning, the Minato Maru was entirely unable to catch shrimp and all that she obtained was purchased from Mexican fishermen. At this same time, the Mitsui Company was operating out of Guaymas, and there appeared to be some friction between the Mitsui and the Kyodo Company, neither of whom had been successful at that time. Apparently, some deal had been made in Japan, whereby the waters of the Gulf of California were divided between these two companies.

In January of 1936, the Captain of the Minato Maru, named Imamura, and a Japanese named Fukuno, the latter of whom I believe

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resides in San Diego, came to Los Angeles in an attempt to enter into a transaction with us. They admitted that their shrimp fishing operations had been a failure and very costly. At first, they stated they wished to purchase shrimp from us, leaving the Minate Maru in Mexican waters to be loaded with our shrimp there. However, the price they offered was way below the cost of production, and we could not accept their offer, nor would we have done so if we could. Their next proposition was that they supply us with small Japanese boats which we would operate for them. We, of course, refused such a proposition. In our fishing operations, we have used fishing vessels much smaller than the Minate Maru, and more in number, for this is the logical way to obtain shrimp. The Japanese admitted that our methods were correct, and that theirs were wrong, and their boast that they would teach Mexican fishermen how to fish is laughable, as we taught the Japanese how to fish - that is, they copied our procedure. At this conference, these two Japanese, seeing that they could not enter into a transaction with us, politely informed us that they felt very sorry for us, indicating that they would drive us out of Mexico.

We have been approached many times by different Japanese on the pretext, on their part, that they desired to buy shrimp from us, but it was evident that all they were seeking was information concerning our methods of fishing.

Shortly after the above meeting in January, 1936, the Mitsui Company and the Kyodo Company evidently made some agreement between themselves, and in March, 1936, several small Japanese boats came into Guaymas, flying the Japanese flag, which boats belong, we believe to the Kyodo Company.

An incident occurred in February, 1936, that is worth repeating. One of our vessels, the Theodore Foss, came to anchor in the evening in the fishing grounds South of Guaymas. The Minate Maru came very close alongside, hailed our Captain, and asked him by what right he had to be there, and demanded that he come aboard the Minate Maru with his ship's papers. Of course, our Captain refused to do so.

The Minate Maru left Mexico in the summer of 1937 for Japan, taking back with her several Mexicans.

In the Fall of 1937, the Minate Maru returned from Japan and is now in the Gulf of California, together with two large Japanese ships of about the same size as the Minate Maru, and five smaller Japanese ships about 80 feet long. Contrary to their promises to the Mexican Government, the larger vessels had no Mexican fishermen aboard, and the smaller vessels carried very few.

Another of their understandings with the Mexican Government was that they would not ship any shrimp out of Mexico, merely doing exploring work. However, they are now catching hundreds of tons of shrimp, to the knowledge of the Mexican Government, who in no way seem to protest. We have been informed that the Japanese have been compensating Mexican officials.

The present method of operation of the Japanese is as follows: The larger vessels stay on the fishing grounds and fish for shrimp. The smaller vessels do the same and the shrimp which they catch are put aboard the larger vessels. Also, these smaller vessels put in at Guaymas for ice, oil and provisions and bring shrimp into Guaymas, which is shipped to Los Angeles by rail. One of the larger vessels, generally the Minate Maru, leaves the Gulf for San Pedro about every two or three months. She last arrived in San Pedro about the middle of December, with 300 tons of shrimp on board. For any shrimp sold in the United States, the Mitsui Company acts as the sole agent for the Kyodo Company. The shrimp brought by boat is generally packed in boxes and frozen, which boxes are marked "product of Japan". In her first trip of the season, which was in the Fall of 1937, she unloaded considerable shrimp for the United States market in San Pedro. However, on this last trip, all the shrimp which she had on board was trans-shipped to Japan. We have information that another one of the large Japanese vessels is due to arrive shortly in San Pedro with a load of shrimp. The shrimp that is shipped from Guaymas by rail is not frozen, but is packed in ice.

We are not certain how much shrimp the Japanese have sent into our United States markets through Los Angeles since the Fall of 1937, but we believe the same to be several hundred tons. They are now working out their threat to drive us out of Mexico so that they may have a total and complete monopoly of the shrimp fishing industry. This they are doing by actually dumping so much shrimp in the markets in Los Angeles that they have driven the price down way below our costs and their costs of production. Regardless of any fair price that we may put upon shrimp which we send to Los Angeles, the Japanese immediately cut our price, and when we meet their price, they immediately again lower their own price, until the sales price is below the cost of production.

The Captain of the Minate Maru has a salary of 200 yen per month, which is approximately \$68.00 and the members of the crew have a salary of 40 yen, or \$11.00 per month. These salaries are far below any wages paid on American fishing vessels. This cheap labor, coupled with cheap food, consisting mostly of rice and fish, which is served to the crew, is far below the standards of living which any decent American would desire to maintain.

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The Japanese are willing to sell below cost, as above stated, in order that they can, in this manner, cause us to leave Mexico. The Japanese companies have huge financial resources, and we believe are backed by the Japanese Government, and they are as ruthless in economic warfare as in their military operations. They are deliberately cheating the Mexican Government, and carrying on insidious propaganda. We pay our labor decent living wages, both in fishing, and in the repair of our vessels. Should the tactics of the Japanese compel us to withdraw from our fishing operations, the American labor which we hire would be unemployed. We have endeavored to build up a sound business, using honest methods, and paying labor well, and it seems unbelievable that the Japanese can come some 8000 miles, and in what is virtually American waters, drive out American industry. Were American fisheries to operate in Japanese waters, everyone knows what the result would be. We feel that the American Government should support American fisheries and drive out this unscrupulous Japanese competition which is now appearing from the Bering Sea, South.

While we believe that our Naval authorities can draw better conclusions as to the Naval and military dangers involved by having these large Japanese vessels operating in such close proximity to our shores, we wish to call particular attention to the fact that while these vessels are probably not large enough to take active part in any Naval engagement or the destruction of commerce, yet they are so equipped with high-powered radio that they can disseminate information as to the movement of ships and otherwise, which would be of the utmost value. While it may seem fantastic, yet these vessels could act as mother ships to submarines, and lend them great help. It is rather odd and strange that the Japanese have become so interested in the location of fresh water holes, in the depths of the water, and the location of safe anchorages, if they are only interested in fishing.

While the above dates may not be exact, the facts are correct, and we have continually made reports to the American Consul at Guaymas of all of the Japanese activities, as far as the same have come to our knowledge, and we believe that the American Consul has made official reports concerning the same. While it may be, for diplomatic reasons, that the American Government would hesitate to make representations to the Mexican Government, which would be the easiest, quickest way to remove the Japanese, if so, it is necessary for American labor to take such action as they may deem fit in order to preserve American industry and American fisheries from the invasion of cheap foreign labor operated by unscrupulous foreign corporations. Were we the only American fisheries now being harmed by this Japanese invasion, it might be said that our protest was a selfish

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one, but when it is considered that the Japanese have invaded our fisheries in other respects and at other places, it becomes necessary that we be protected. When it can be said that we are in competition with the whole Japanese Government, it becomes self-evident that each individual American fishery can no longer fight its own battles, and that we must have protection. If it is the desire of America that American industry and American fisheries perish, such a result will surely happen, and in the not far future. The magnitude of the situation makes it impossible for us alone to solve the problem. If the American Government lends no assistance, there is only one body of people sufficiently large to combat the situation, and that body is organized labor, because no individual group is large enough.

We need not quote statistics as to the number of men employed in American fisheries, the value of the products, and the harm which is being done by arrogant, unscrupulous Japanese methods.

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(TRANSLATION)  
LFB

PROJECTED DECREE OF FISHING IN TERRITORIAL AND EXTRA-  
TERRITORIAL WATERS

Whereas, 1. - The products of the sea constitute a national resource, which by themselves should contribute to the nutrition of the Mexican people for their strength and development, and performing today in territorial and extraterritorial waters, fishing under primitive methods, the lack of these products makes, if not impossible, it very difficult to acquire them; until now they are regarded as food for the privileged persons, since among the proletariat there are not the elements necessary to acquire this food so appreciated by all civilized peoples.

Whereas, 2. - It is the obligation of the Government to bring about reduction in price and increase consumption of marine products, and to accomplish this it is necessary to teach the native fishermen the new method in fishing, training them in the handling of same and showing them objectively the procedure and results that up to the present time have been accomplished in modern fishing.

Whereas, 3 - It is imperative to continue the work of ocean investigation and studies to determine the production zones and protect the various marine species, at the same time form with the students of the Institute and school of Forest Conservation and Fish and Game, adequate personnel, including the construction of fishing boats through the establishment of necessary ship-yards,

THE CONGRESS OF THE UNITED MEXICAN STATES DECREES:

ARTICLE 1. - The executive Dept. of the Government will be empowered to create a stock company in position to fish largely the marine products, procuring at the same time a price reduction in the country and also the teaching of modern fishing methods, - its handiwork and the construction of fishing boats.

ARTICLE 2. The objective of the Corporation will be:

(a) Fishing in general in territorial and extraterritorial waters, excepting that of reserved areas and also of marine species reserved to native fishermen grouped in the cooperatives.

(b) To effect explorations and exploitations in territorial and extraterritorial waters.

(c) To establish packing and refrigerating plants, fixed and floating, as auxiliaries of these.

(d) To effect all kinds of operations pertaining to fishing.

(e) To foment the inversion of Mexican capital into the fishing industry.

(f) To continue works of investigation and scientific studies to determine zones of propagation and adequate procedure of the protection of the various marine species, proportioning such studies to the Federal Government.

(g) To supply the fishermen's Cooperatives with boats and fishing equipment for their work financing them and buying their products.

(h) Industrialization in general of the edible marine products without losing sight of the manufacture of fertilizer for agriculture utilizing species of low market or commercial value, and the offal of same.

(i) To teach the native fishermen the different systems of modern fishing as well as to the students of the Institute and School of Forestry Conservation and Fish and Game.

(j) The construction of fishing boats to reduce hunting, establishing for this the necessary ship yards.

(k) Employ in the crew of the boats one-third Mexican fishermen and as these become schooled in the management of modern systems employed in fishing, thus losing their character of apprentices, to substitute for foreign fishermen so they can occupy positions in the fishing crews on the boats of the Company.

(l) To supply markets of the country, at reduced prices, Marine products, fresh, refrigerated, salted and dried at prices within the reach of the working classes - putting out propaganda to open new markets in the Interior.

(m) To make use of fishing boats with refrigerating plants equipped for trawling and smaller boats to 80 tons each, equipped with nets easy to handle; a boat of less tonnage will be used especially for research and to teach Mexican fishermen.

(n) Boats to which the previous paragraph has referred will be proportioned by the shareholders of Series B, to the Company in the nature of renting and will be held and considered as Mexican, the Company being privileged to buy them and acquire others as required for fishing purposes.

ARTICLE 5. - This will be a stock Company through registered shares in Series A and B.

Shares in Series A will be subscribed to by the Federal Government, will represent 55% of the Company's capital, will be absolutely unchangeable.

Shares of Series B can be subscribed to and acquired by foreigners when they represent a maximum of 70% and the 30% as a minimum to be subscribed by Mexicans.

ARTICLE 4. - The capital stock will be \$500,000.00 to be subscribed to in the following form: The Government presents to the Corporation concessions for Marine fishing granted to the Company and cash in the amount of \$125,000.00.

Thereof, up to the amount of \$500,000.00 will be contributed by the subscribers and holders of shares of Series B.

ARTICLE 5. - The majority of the members of the Administrative Council will be designated for representation to the Government - one being appointed by the Secretary of the Treasury and Public Credit, another by the Secretary of National Economy and two by the Autonomous Department of Forestry and Fish and Game.

ARTICLE 6. - The capital stock, if necessities or circumstances of business require, can be increased to another \$500,000.00 that will be distributed proportionally by the members, but the Government will continue with 55% representation, this increase in capital stock with only the obligation of contributing a 27 $\frac{1}{2}$ %, as the other 27 $\frac{1}{2}$ % will be considered as increase in value of the authority or concession for fishing.

ARTICLE 7. - The Federal Government will represent in the Assemblies the number of votes equivalent to 55% of the Corporation's capital and approval of the Federal Government as stipulated by the shares, will be necessary to determine the following matters:

- (a) License to contract with individuals or private companies for fishing and exploitation of determined species.
- (b) Building of ship yards and construction of fishing boats by contractors.
- (c) Measures designed to regulate the interior market of the products in the fisheries branch or restrictions in exploitations.

ARTICLE 8. - The Administrative Council will be made up of seven members, of which the Federal Government will appoint four, at any time being privileged to revoke appointments and name other members.

The remainder will be designated by majority vote of the share holders present of Series B and unanimous vote of the Government Councils will be necessary when it has to deal with deciding upon some of the points mentioned in Article 7.

ARTICLE 9. - Formal contract of the Corporation will determine the proportions in which the profits will be distributed, on the basis as follows:

I - In the first place a certain percentage to be set aside for reserve fund.

II - In the second place a definite amount will be destined for the acquisition of boats or fishing equipment and refrigerating or packing plants and vehicles of transport.

III - Then the necessary quantity will be applied to cover the shares of Series A. Interests as appearing on formal contract.

IV - In the third place a certain percentage will be distributed among the directors, employees and workmen of the Company.

V - After payment of the above, the interests of Series B will be covered, and

VI - If there be a closing of accounts the additional interests will be apportioned to the shares of Series A and B.

ARTICLE 10 - The Federal Government will agree to the condition of the Company as established in the formal contract and in accordance with special agreements, subsidies that compensate the Company, if same fulfills each and every one of the obligations imposed by this Decree and those designated in the respective contracts.

ARTICLE 11 - The Company agrees and will fulfill all laws in force regarding fishing and those that might be dictated in the future including Decrees and bulletins that might affect it.

ARTICLE 12 - The executive Branch of the Government through the Secretary of the Treasury and Public Credit of the National Economic and Autonomous Department of Forestry and Fish and Game, is empowered to subscribe to and stipulate in the contract and statutes all clauses and stipulations convenient for the best enforcement of this Decree, and each one of the Secretaries and Departments mentioned will exercise attributes which, to the State they correspond as share holders of the Company. The Department of Forestry and of Fish and Game, will choose technical heads Founders of the Company.

Mexico D. F. December 15, 1937  
PRESIDENT OF THE UNITED MEXICAN STATES

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LAZARO CARDENAS.

CHIEF OF THE  
DEPARTMENT OF FORESTRY AND FISH & GAME

.....  
MIQUEL A. DE QUEVEDO

## PUBLIC WORKS ADMINISTRATION APPROPRIATION ACT OF 1938

## Breakdown by Departments and Agencies

<u>Department and Agency</u>	<u>Amount</u>	
<b>Agriculture</b>		
Agricultural Economics	\$ 3,360,400	
Agricultural Engineering	15,100	
Beltsville Research Center	3,492,671	
Entomology and Plant Quarantine	<u>400,000</u>	
Total Agriculture		\$ 7,868,171
<b>Commerce</b>		
Coast and Geodetic Survey	2,050,500	
Fisheries	1,090,350	
Lighthouses	<u>3,670,150</u>	
Total Commerce		6,811,000
<b>Interior</b>		
The Bonneville Project	10,750,000	
Geological Survey	2,690,000	
Indian Affairs	5,313,000	
Mines	597,000	
National Park Service (Phy. Imp.)	2,212,000	
National Park Service (Roads & Trails)	90,500	
Reclamation	<u>31,750,000</u>	
Total Interior		53,402,500
<b>Justice</b>		
Prisons	<u>14,085,000</u>	
Total Justice		14,085,000
<b>Navy</b>		
Yards and Docks	<u>36,154,000</u> ✓	
Total Navy		36,154,000
<b>Treasury</b>		
Coast Guard	7,987,433	
Public Health Service	<u>3,490,000</u>	
Total Treasury		11,477,433
<b>War</b>		
Corps of Engineers (Rivers & Harbors)	600,000	
Corps of Engineers (Flood Control)	3,000,000	
Quartermaster Corps	<u>49,283,400</u> ✓	
Total War		52,883,400
<b>Independent Offices</b>		
Veterans Administration	<u>13,268,200</u>	
Total Independent Offices		<u>13,268,200</u>
Grand Total -		\$ 195,949,704

October 11, 1938

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Handed to be in Oct 21. by Barlow

Approved  
10-21-38



Department	EMPLOYMENT BY WAR AND NAVY DEPARTMENTS ON W.P.A. AND P.W.A. PROJECTS		
	W.P.A.	P.W.A.	Total
War . . . . .	23,287	3,326	26,613
Navy . . . . .	23,416	3,435	26,851
Total. . .	46,703	6,761	53,464

## EXPENDITURES FOR PUBLIC WORKS FOR THE FISCAL YEARS 1936 TO 1939

(In Millions of Dollars)

	1936	1937	1938	Estimated 1939
<b>Paid from regular annual appropriations:</b>				
Public Highways	\$ 29	\$ 90	\$ 152	\$ 190
Tennessee Valley Authority	21	42	42	41
Reclamation	15	16	40	50
Rivers and harbors, improvement	7	74	89)	170
Flood Control	28	26	39)	60
Public Buildings	15	34	61	50
United States Maritime Commission <sup>1/</sup>	a/12	a/ 6	1	50
Rural Electrification Administration	-	1	11	50
Other (Army housing, naval shore stations, etc.)	16	38	45	45
<b>Total regular</b>	<b>119</b>	<b>315</b>	<b>480</b>	<b>656</b>
<b>Paid from emergency appropriations:</b>				
Public Highways	215	260	85	45
Tennessee Valley Authority	28	-	-	-
Reclamation	35	36	26	11
Rivers and harbors, improvement	143	75	10)	5
Flood Control	9	20	24)	5
Public Buildings	53	42	16	10
Emergency housing	25	51	43	-
Rural Electrification Administration	1	8	5	-
Public Works Administration:				
Loans to public bodies	a/36	a/21	a/38	70
Grants to public bodies, including administration	234	273	190	355
Other (Army housing, naval shore stations, etc.)	59	63	56	54
<b>Total emergency</b>	<b>766</b>	<b>807</b>	<b>417</b>	<b>555</b>
<b>Grand Total</b>	<b>885</b>	<b>1,122</b>	<b>897</b>	<b>1,211</b>

<sup>a/</sup>  
<sup>1/</sup> Excess of credits, deduct.  
Includes Shipping Board.

1939 EXPENDITURES - FEDERAL AND LOCAL

(In millions)

	Federal	Local	Total
W. P. A. . . . .	\$2,135 <i>ll</i>	\$400	\$2,535
P. W. A. . . . .	500	500	1,000
General public works . . . .	550	200 x	750
C. C. C. . . . .	275	--	275
Emergency public works . . .	200	--	200
Total . . . . .	\$3,660	\$1,100	\$4,760

x Highways, etc.

11. Includes \$500 million from March 1<sup>st</sup> to June 30, 1939.

CONSTRUCTION, REPAIRS, IMPROVEMENTS, ETC.  
(Outside Budget)  
(Continued)

Agency	Type of Work	Limitation	Obligations Incurred	Balance of Funds Available	Remarks	
Home Owners' Loan Corp.	Advances for Repairs	Indefinite	Own Property - 1938 -	\$21,700,000	Estimated 1939 - \$25,000,000 250,000	-
			Borrowers' Property 1938	304,000		
					Approximately same amount in each year.	
Federal Saving and Loan Association	Home Financing	Indefinite	1938 - New Construction	\$95,500,000	Approximately same amount expected each year.	See below.
			Home Purchasing	83,000,000		
			Refinancing	73,000,000		
			Reconditioning	17,500,000		
			Other	<u>23,000,000</u>		
			Total	292,000,000		

E: The Federal Government has about \$500,000,000 invested in the Home Loan Banks, The Federal Saving and Loan Insurance Corporation and in stock of Loan Associations (both insured and non-insured). The above figures cover insured institutions only. These represent about 25% in loans and deposits of the total Associations in the System.

CONSTRUCTION, REPAIRS, IMPROVEMENTS, ETC.  
(Outside Budget)

SUMMARY

Agency	Type of Work	Limitation	Obligations Incurred 9/30/38	Balance of Funds Available	Remarks
Federal Housing Admin.					
Title I	Modernization Loans	\$500,000,000 to 1,000,000,000	\$669,236,187	a/ \$25,000,000 to 50,000,000	Loans running \$20,000,000 per month
	Insurance of Modernization Loans	\$100,000,000 (to cover losses)	\$ 95,000,000 (Reserve)	a/ \$ 5,000,000 (Plus releases)	Losses to date \$18,000,000
Title II	Insurance of Construction Loans	Outstanding balance of insured mortgages limited to \$2,000,000,000 or 3,000,000,000 (with approval of President)	New construction \$ 693,449,116 Existing " 745,038,901 <u>1,438,538,017</u> Estimated Repayments ..... 102,991,536 Net ..... <u>1,335,546,481</u>	\$664,453,519	Appears that 2,000,000,000 authorization will be exhausted by 6/30/39. After 6/30/39 only new construction and renewals are insurable.
Electricity Administration	Generating Plants, Transmission Lines and Wiring	\$146,340,000 (R.F.C.Funds) (\$3,660,000 expired 6/30/37)	\$58,600,000	\$87,740,000	\$70,000,000 of \$87,774,000 subject to approval of the President.
Public Housing Administration	Slum clearance and low cost housing	\$800,000,000	\$202,000,000	\$598,000,000	Obligating at rate of \$1,000,000 per day.

Estimated. As loans are paid off in excess of 90% (80% if insured for 20%) the unused portion of the insurance becomes available to cover new loans.

CONSTRUCTION, REPAIRS, IMPROVEMENTS, ETC.  
(Outside Budget)  
(Continued)

Agency	Type of Work	Limitation	Loans Authorized	Amount Disbursed	Repayments and other reductions	Unpaid Balance	Remarks
<b>F. C. -</b>							
Self-Liquidating Loans (Sewers, Bridges, Highways, etc.)	New Construction Loans	No limitation other than R.F.C.'s general limitation as to amount and expiration date.	\$451,105,736 (since 1932)	\$316,117,507	\$123,990,638	\$192,526,869	Approximately \$400,000,000 authorized before P.W.A. began. New authorizations include Pennsylvania Toll Highway for which \$26,100,000 is P.W.A. and \$35,000,000 is R.F.C. funds.
Repair of damage, Earthquake, Flood, etc. (Known as First Earthquake Loan)	Loans for repair of damage during 1933	\$20,000,000 expires Dec. 31, 1933	8,529,108 (during 1933)	8,529,108	7,719,510	809,598	No more loans being made.
Repair of damage, Earthquake, Flood, etc. (Known as Second Earthquake Loan)	Loans for repair of damage during 1935-1936	\$30,000,000 expires Jan. 23, 1939	3,470,447 (since 1934)	3,470,447	1,729,393	1,741,054	No more loans being made.
Disaster Loans - Repair of damage, Earthquake, Flood, Tornado, etc.	Loans for repair of damage.	\$20,000,000 expires Dec. 31, 1938	8,062,365 (since 1937)	7,280,673	1,328,688	5,951,985	Expect 3 or 4 million will be authorized for hurricane damage.
Loans to business enterprises	Improvement and repair loans	No limitation other than R.F.C.'s general limitation as to amount and expiration date.	7,992,241 (since 1937)	7,992,241	Information not readily available	Information not readily available	Expect \$8,000,000 will be authorized during remainder of 1939 fiscal year.
	Construction Loans	"	15,285,890 (since 1934)	15,285,890	"	"	Expect \$15,000,000 will be authorized during remainder of 1939 fiscal year.
Railroad Loans	Improvement, repair and construction loans.	Included in a section covering railroad loans for various purposes limited to \$350,000,000 plus.	90,062,651 (since 1932)	90,062,651	"	"	Difficult to estimate. <i>See attached</i> Have at present one conditional authorized loan of \$2,483,600.
<b>F. C. Mortgage Co. -</b>							
	New construction	No limitation other than \$100,000,000 capital and R.F.C.'s general limitation as to amount and expiration date.	16,996,066 (since 1933)	3,768,000	1,094,702	2,673,298	Expect loans will run along at the rate of 5 to 6 million a year.

October 21, 1938

The President called me on Friday, October 21, at 12:45.

I read the attached statistics to the President and he said, "Things are going up too fast," and I said, "I don't agree with you, Mr. President. They can't go up too fast," and his reply was, "Well, it is nice to have them go up now just before election."

The President then said that Bullitt wanted to talk to me; that he wanted to come to Washington to see me and was bringing Monnet with him. He said that he read the three-page memorandum which I gave him on Tuesday and that we need not worry about the part that has to do with exchange difficulties.

The President then put Bullitt on the telephone and I told him that I would be glad to see him and Monnet sometime over the week-end, but that I did not know what arrangements Mrs. Morgenthau had made and after talking to her I would send him a wire. Attached is a copy of the telegram which I sent Bullitt later in the day. *see pg 38*

Copy

N.Y. Times Weekly Business Index

	<u>Weight</u>	<u>Oct. 15 Wk.</u>	<u>Change</u>
Automobile Production	.03	65.9	up 14.5
Steel Ingot "	.10	73.5	up 6.4
Electric Power "	.49	95.2	up 1.9
Lumber "	.06	74.7	off .4
Miscellaneous Carloadings	.19	77.0	up 3.1
All Other "	.08	88.6	up 1.7
Cotton Mill Production	.05		

On basis of available data, NYT index of business activity  
in Oct. 15 wk. rose 2.7.

Next wk.:

NYT index of auto production in Oct. 22 wk. rose to 85.4  
from 65.9. up 19.15.

October 21, 1938

TELEGRAM (VIA WHITE HOUSE WIRE)

HON. WILLIAM C. BULLITT

HYDE PARK NEW YORK

I WILL BE VERY GLAD TO HAVE YOU AND YOUR FRIEND COME  
FOR SUPPER TOMORROW SATURDAY NIGHT AT EIGHT O'CLOCK  
BEST REGARDS

HENRY MORGENTHAU JR

October 21, 1938

Harry White gave me the attached memorandum with reference to the French Government's establishing airplane factories in Canada and why we should not help finance them, and I gave a copy of it to the President when I saw him at Hyde Park on Tuesday.

I did not leave the first sheet of the attached memorandum with the President, because it had Harry White's name on it and I did not want to put Harry on the spot. I did not want Bullitt to go after him. Harry's name did not appear on the other pages of the memorandum.

I also gave the President a copy of White's memo "British comments on Sterling."

C O P Y

October 18, 1938.

To: Secretary Morgenthau  
From: Mr. White

The proposal that France build large plane factories in Canada has merit only under the assumption that France cannot (for technical reasons which I would not know) produce all the planes she needs at home during the next few years.

Possibly Mr. Bullitt is in possession of information indicating that is so.

However, on economic grounds the proposal has very little merit. If the only or chief consideration is one of finance, it seems that France would be most unwise to attempt to develop a source of supply for planes in Canada rather than at home.

*M. White*  
Left a copy of  
this with G. H. R. at  
Hyde Park  
*AM*

## Copy

PROPOSAL THAT THE FRENCH GOVERNMENT ESTABLISH IN CANADA AIRPLANE PLANTS CAPABLE OF CONSTRUCTING SEVERAL THOUSAND PLANES A YEAR.

Conclusion.

The plan has some advantages but these appear at first examination to be much outweighed by the disadvantages:

A. The possible advantages of the plan are as follows:

1. The French Government would have an important source of supply located three thousand miles away from Germany and Italy.
2. France might be able to increase her supply of planes more rapidly by utilizing trained skilled labor of United States and Canada. Were France dependent on the output of foreign owned plants she might not be able to get as many as she would wish, and/or the cost might be higher. Were she to depend on the United States for supplies, those supplies might be stopped in time of war by the application of our "Neutrality Act".
3. It is possible that France might be able to obtain through borrowing abroad a portion of the foreign exchange necessary to construct the plants.

B. The value to France of these advantages is quite uncertain:

1. Inaccessibility of the plant to foreign bombing planes would be an advantage only in war time. But that is the very time when speed, ease, and certainty of delivery of planes becomes important. For France to depend on a source of supply in a foreign country three thousand miles away for so large a proportion of a vital war need would seem to be unwise from a military point of view.

(a) Ocean transportation of three thousand miles in war time has its hazards; submarines, mines, air attacks, sabotage, spy activities, etc.

(b) Planes manufactured in Canada would be subject to assumption control by the Canadian (or British) government. France would be giving another important

- 2 -

hostage to Britain. Canada might decide, in the event of war, that she prefers not to have within her borders an area which might attract the enemy's bombing planes. Wishing to remain "neutral" Canada might place an embargo on the export of planes to France. Or in the event of a world war she might decide she needs all the airplane plant capacity available to turn out planes needed for her own protection.

All possibilities considered it would seem that despite her proximity to Germany and Italy, France would have a more dependable supply of planes in war time were they produced at home.

2. Plants with an output of the magnitude proposed would require a large number of trained workers. Where would they come from? The United States itself will absorb all available skilled workers for a long time to come if it embarks on a large program of its own. In fact, there is probably a scarcity of that type of labor now. Large plants built in Canada would greatly accentuate the scarcity, drive up wages still further and complicate our own plane program. Bottle necks of all kinds would develop which would serve only to accentuate price mal-adjustments here.

France would do better, it would seem, to train her own personnel and develop a large scale organization at home.

It is possible that France feels she cannot develop a large scale equipment at home quickly enough, and is afraid to contract for future purchases in the United States both because of the Neutrality Act, and because of the possible interference with production schedule and models by Army and Navy authorities.

This possible interference with a supply from the United States constitutes the chief advantage for attempting to establish factories in Canada as against dependence upon the United States plants. Were the sole alternatives open to France either United States or Canadian sources of supply, the latter might be a little more certain so long as the Neutrality Act remains in force. The importance of that disadvantage is somewhat reduced by the probability that the Act will be modified, or that it would not be permitted to interfere with shipments to France were France to be attacked.

- 3 -

3. France may be able to finance construction of the plants through flotation of foreign loans. Whether Americans could participate directly in such a loan without violating the Johnson Act is not certain, but even if it be assumed that the foreign capital for setting up the plants would be forthcoming from Americans and/or Frenchmen, the chief cost of foreign exchange would remain. The planes produced would have to be paid for with foreign exchange.

The gold holdings of France are already deemed low, and her balance of payments is already heavily unfavorable. Were France to purchase from abroad several thousand planes a year, the increased pressure on the franc might easily be enough to cause it to depreciate much further.

The suggestion has been made that France would be able to finance the construction with French capital that has already left the country (i.e.-flight capital). This is doubtful and even were it true the advantages accruing therefrom are not important. Frenchmen who now prefer to keep their funds outside of France would probably hesitate to invest in any securities which could in the event of war be very easily identified and taken over by the French Government. In any case, the item of expense that is most important to the French government from the foreign exchange aspect is the purchase of the planes and not the cost of the plants.

C. Other disadvantages of the proposal are:

1. For the French people the venture might involve a heavy loss. The expenditure of several billion francs a year at home (especially when financed largely through borrowing) would mean a substantial increase in employment and business activity. Were, however, that amount spent abroad unemployment at home would not decrease and might even increase. Much depends on how the money was raised and on the repercussions on the franc.

2. For the United States the construction and utilization of such a large airplane factory would have some disadvantages difficult to evaluate.

- 4 -

(a) It would compete with any large program that might be undertaken by this government, and would add to wage and price maladjustments in the airplane and allied fields.

(b) Large plants in Canada might in the hands of a victorious enemy (or of a Great Britain realigned with Germany or Japan in a desperate attempt to save the Empire) constitute a threat to our safety. Possibly, too, important French plane factories near our border would slightly increase the danger of our becoming involved in a European war.

October 12, 1938

Secretary Morgenthau

Mr. White

Subject: British press comments in regard to the sterling-dollar exchange rate.

Summary

1. Toward the end of June, when the sterling-dollar rate was approximately \$4.95, comments appeared in the British press suggesting that sterling was overvalued, but these comments emphasized that the rate had been stable and was expected to continue to be so.
2. During the latter half of July, mention of sterling overvaluation became more frequent. At the same time the hope was expressed that the sterling-dollar rate would be permitted to fall to \$4.86 in the event that the two currencies were formally stabilized, as it was widely rumored they might be.

Several weeks later it was frequently stated that this adjustment to \$4.86 was not enough to correct the overvaluation of sterling but it was generally supposed that the United States would not permit a fall in the sterling-dollar rate below \$4.86 and it was considered better, in view of the international political situation, to lose gold rather than antagonize the United States.

3. About the middle of August, when the sterling-dollar rate was approximately \$4.88, several financial writers took the position that sterling was destined to go below \$4.86 and that the United States would soon become reconciled to this. Press comments were generally to the effect that sterling should be allowed to fall in terms of dollars about as far as the United States would permit.

About this time it came to be accepted that the benefits of a lower sterling-dollar rate would outweigh the adverse effects of an accelerated short-term capital outflow such as might result if sterling were allowed to go below \$4.86.

Secretary Morgenthau - 2

4. During September (sterling below \$4.86): Approval widely expressed at the breaking through of the traditional parity rate, which had been regarded as an important psychological barrier to the needed correction of overvalued sterling.

Figures from \$4.10 to \$4.70 were mentioned as possible appropriate equilibrium points for the dollar-sterling rate.

(Incidentally for the first time there appeared statements that sterling was considerably overvalued in terms of several sterling bloc currencies.)

5. During October, attempt to justify fluctuations in sterling because of the critical period but approval of the lower levels. (Press and periodicals for October not yet available except the cable quotations.)

Intimation that an adjustment of the dollar-sterling rate will not suffice to correct Britain's weakened economic situation and a new note.

The item in the London Times of October 12, 1938, taken together with Keynes' statement of a few days earlier, may be the harbinger of an altered commercial policy in recognition of the weakened British economic status as a consequence of the Munich episode. The item of October 13 introduces for the first time a note of hopelessness in Britain's monetary position in the near future.

HDWilra  
10/13/38

Secretary Morgenthau - 2

June 24, 1938 (\$4.961) - The Financial News

Present sterling-dollar rate is stable and can be maintained in the future - although there is an intimation that sterling is overvalued.

June 25, 1938 (\$4.962) - The Statist

Sterling-dollar rate is stable but sterling may prove to be undervalued if prices rise in United States as a result of the pump-priming program.

July 5, 1938 (\$4.948) - The Financial News

Sterling-dollar rate is stable. However, sterling is overvalued, and a small steady loss of gold will be necessary to support the prevailing rate.

".....For the first time since sterling was depreciated, there is now no major maladjustment between the chief currencies. For the last three years the sterling-dollar rate has been very stable; its fluctuations have had an amplitude in the whole period of only 2 percent. Thus, although in objective terms the dollar is still undervalued in relation to sterling, the existing rate is one which has been effectively stable and which seems unlikely to change in the near future. Moreover, the latest franc depreciation has finally removed the overvaluation of the franc. There is thus no distortion in the structure of the sterling-dollar-franc triangle, and that structure could, in all but the most sensational circumstances, be maintained. In fact, we are already in a period of de facto stabilization."

"Immediate outlook suggests that dollar will for some time remain in the vicinity of gold export point to the United States." — but "in the long run the outlook for the dollar may be unfavorably affected by the implications of the pump-priming program."

".....In other words, the dollar, in view of our own adverse balance and that of many sterling area countries, seems once more to be undervalued against sterling. That does not mean that any fall below the present rate is to be expected, but a steady trickle of gold to support sterling."

Secretary Harganham - 3

July 7, 1938 (\$4.936) - The Financial News

If stabilization were to be effected, rate should be set at \$4.866 to correct overvaluation of sterling which has appeared in recent months.

July 9, 1938 (\$4.936) - The Economist

Capital movements may be masking a real overvaluation of sterling.

July 9, 1938 (\$4.936) - The Statist

If British and American currencies were stabilized - in accordance with rumors - \$4.866 would likely meet with approval by United States and British authorities.

".....If stabilization should come about, the old parity of 4.86-2/3 again seems a reasonable level. It is well known that at the time of the Tripartite Agreement our own authorities had a figure of about 4.80 in mind, and, in view of the American trade surplus the dollar has been manifestly undervalued in recent months....."

"It is, however, possible that these movements of international 'hot money' into gold, and the consequent gold operations of the Exchange Equalization Account are masking what would otherwise be a steady drain of gold from our reserves occasioned by our passive balances of payments."

"If stabilization were embarked upon, it seems not unlikely that the old parity of 4.86-2/3 would now meet with the approval both of the American authorities and our own. This would imply an appreciation not only in the dollar but in the sterling price of gold.

"On current account, however, the dollar is again demonstrably undervalued against sterling. The balance of probabilities thus favors an improvement in the dollar....."

Secretary Morgenthau - 4

July 11, 1938 (\$4.928) - The Financial Times

A sterling-dollar rate of \$4.60 would be justifiable but \$4.866 would be a compromise between the economic equilibrium and the political requirements of the United States.

July 13, 1938 (\$4.932) - The Financial News

Our export surplus proves sterling is overvalued.

July 16, 1938 (\$4.927) - The Economist

\$4.86 may be a "more natural" level than \$4.92.

".....the old parity of \$4.866 would today imply an overvalued pound. On this basis \$4.60 would be 'about right'.

"This suggests that even the recent recovery in the dollar leaves the pound still overvalued. A rate of \$4.866 would, in fact, be a compromise rate, reflecting both the influence of capital movements and also the desire of Washington not to compromise a lower rate for sterling. Quite possibly it was the rate which has formed the basis of this year's trade negotiations, and if a new monetary agreement is envisaged rumour is probably correct in forecasting the adoption of that rate. Certainly we ought not to accept a higher rate, and Washington would probably not agree to a lower rate. Even if no fresh agreement is in view, sufficient has been said to suggest that if economic forces alone were operative the pound would naturally gravitate downwards, and it looks as if recent rates had been artificially high. For these reasons the long-term view, as well as the short-term view, favors a firmer tendency of the dollar, but with \$4.866 as the bottom limit of any further depreciation."

"The huge American export surplus for the first five months of this year (amounting to \$544,000,000, as compared with a deficit of \$126,000,000 for the corresponding months of 1937) is taken as a clear indication that on current account the dollar is undervalued at any rate approaching \$5.00 to the £."

"It is intimated that on purely economic grounds sterling at \$4.866 may be a more natural level than \$4.90."

Secretary Mergenthau - 5

July 19, 1938 (\$4.918) - The Financial News

Undervaluation of dollar is bringing pressure on the pound by inducing capital flow to United States.

July 20, 1938 (\$4.921) - The Financial News

Sterling-dollar rate should fall considerably before the Exchange Account undertakes to support sterling by selling gold.

July 22, 1938 (\$4.919) - The Financial News

Weakness of sterling is due to general expectation that sterling-dollar rate will fall to \$4.86.

August 4, 1938 (\$4.895) - The Manchester Guardian

Weakness of sterling, exclusive of capital movements, is directly attributable to rearmament program.

"Market quarters suspect that continental quarters with large sterling balances are becoming alive to the manifest undervaluation of the dollar in relation to sterling, and foreseeing a prolonged period of pressure on the pound, are already removing funds from London to New York."

".....It is reasonable that the Exchange Account should release gold to effect the movement of capital, but only if the dollar is in equilibrium on income account. And that can only be when the dollar rate stands considerably lower than it does today."

"That sterling is weak in terms of dollars is due to the fact that, while the number of those who seriously believe in a joint sterling-dollar devaluation is small, there are more people who consider it possible that the rate may eventually be adjusted to 4.86. This accounts for the early covering of seasonal dollar requirements by produce merchants from whom a difference of one percent is of some importance. The weakness of sterling is thus immediately based on a seasonal factor."

"With the large adverse balance of payments now presumably being incurred by this country, a certain quantity of gold withdrawals is fully to be expected as soon as the masking of this by foreign acquisitions of sterling ceases. And as long as we accept this adverse balance as part of the order of things, necessitated by the rearmament program, gold withdrawals can be viewed in the same way."

August 4, 1938 (\$4,895) - The London Times

Pressure on sterling is temporary and will be relieved as business recovery proceeds in United States.

August 6, 1938 (\$4,895) - The Economist

If sterling and dollar currencies are stabilized, it is likely that the rate will be fixed at \$4.866. Improvement in world conditions will strengthen sterling.

".....There are reasons for thinking that in part at least the relatively favorable foreign trade experience of the United States has been the result of transient influences. In any case until last year an export surplus was a normal feature of American economy. Notwithstanding the adverse trade balance of this country is tending to decrease, and if one takes the balance of trade of the wider sterling area, as one should to take the real measure of the economic pressure on sterling, the principal factor in the deterioration has been the trade slump in the United States itself, which will pass with the progress of recovery in the United States. As for the influence of rearmament, large though the British expenditure, actual and prospective, may seem, the expenditure on relief and capital works in the United States is more formidable still, and if it does not immediately reflect itself in an inflation of imports it will do so no doubt in due course as it did from 1935 onwards. There is certainly no indication of other than a purely temporary shifting of the balance of economic power in between sterling and the dollar. That there has been any shift at all is because these days the cyclical movements of trade in different countries no longer coincide. The United States moved first into 'recession' and is apparently moving first out of it."

".....These rumors for a stabilization of currencies of Tripartite alignment have in their turn drawn attention to the overvaluation of sterling. There is little or no belief in an early devaluation of the dollar in terms of gold, but in conventional circles there is certainly a belief in the likelihood of a return to the traditional sterling-dollar parity of \$4.86-2/3 as a preliminary to any stabilization agree-

Secretary Morgenthau - 7

"It is well-known that there is always a time-lag between the exports and imports of the primary-producing countries..... This possibility that the exchange stringency of these countries due to the time-lag is beginning to pass away is of some importance to the outlook for sterling. Most of the countries concerned are members of the sterling area, and any change in conditions which helps these currencies will pro tanto help sterling as well, although the reduction in the primary producers' imports is unfortunately likely to connote a reduction in the United Kingdom's exports."

August 6, 1936 (44.894) - The Statist

Overvaluation of sterling, in terms of dollars, will be accentuated in coming months, although it should be recognized that "an enormous short-term bull position in dollars has been built up."

".....An unquestionably more potent influence during the past week has been the growing conviction that sterling is overvalued in relation to the United States dollar and that this overvaluation will become more and more apparent as the autumn approaches." .....

The weight behind this conviction of the overvaluation of sterling is derived from such concrete evidence as the revolutionary change in the U. S. balance of payments over the past twelve months, and from the belief that this tendency will be accentuated in the immediate future by the bountiful grain harvest in the United States and in the more indeterminate future by the effect of accelerated rearmament on the balance of payments of the sterling area as a whole."

".....The one important qualification that should be made to the view that a further appreciation of the dollar is inevitable derives from the fact that an enormous short-term bull position in dollars has been built up over the past month by foreign exchange dealers. There can be few institutions transacting foreign exchange business on an important scale which are not at the moment running long positions in dollars."

August 9, 1938 (84,883) - The Financial Times

Sterling declined to return to \$4.86 by mid-September, but if there is stabilization of currencies, the sterling rate may go lower.

August 10, 1938 (84,883) - The Evening Standard

Economic forces probably require \$4.50 rate.

August 13, 1938 (84,872) - The Statist

The view is gaining ground that it is inevitable that sterling will fall below \$4.866.

".....For long the Continent has been concerned of the overvaluation of sterling in terms of the dollar."

"The several devaluations and disvaluations by British, French and American officials have failed to remove the impression that the pound is devalued for its old parity level and that an all-round devaluation is probable. It is now said that mid-September may be the time for this latter event."

"To what level the currencies are to be lowered is not mentioned in fact, it is almost impossible to state what is the true parity between the dollar, sterling and the franc."

"Towards 4.50. The view has often been attributed to our authorities that the \$5.00 to the pound rate seriously overvalues our currency, and that a rate nearer 4.50 is more in keeping with the true situation. Accordingly, while our authorities are probably anxious to prevent a too sudden devaluation in the pound against the dollar, over the longer period they may well take the view that somewhat force must cause the dollar rate to move towards 4.50. Their recent actions suggest that this is the case."

".....Just one, then, suppose that the traditional parity does not possess this backing, and that the view is spreading that it may well be swept aside by the forces that are pulling down sterling in terms of the dollar? It is unquestionable that such a view is gaining ground. The approach of the autumn season and the steady widening of the deficit on the visible balances of British trade lend it some circumstantial support....."

".....Perhaps the retreat from that stabilist's support August 2/3 had become inevitable by reason of the adjustments in the balance of payments

August 17, 1938 (94.881) - The Financial News

British authorities face alternative of losing gold or allowing sterling rate to fall to about \$4.50. In order to maintain cordial relations with United States it may be better to accept a sterling rate of \$4.86 even though this involves the loss of considerable gold.

"The evidence is not conclusive; for international financial statistics do not permit exact calculations. But there is at any rate a strong presumption, backed up by the actual pressure on the pound, that sterling is overvalued. In this position, the authorities have three long-term alternatives. They may initiate a deflationary drive to reduce prices and costs here, hoping in the meantime that American industrial recovery will make the necessary adjustment less than would otherwise be necessary. This must evidently be impracticable.....The authorities are, therefore, left with two alternatives, both unpleasant. They may allow gold to be withdrawn in order to maintain the international advantages of the Tripartite Agreement. Or they may allow sterling to fall to, say, 4.50, at the expense of a certain strain upon Anglo-American economic relations and a possible currency war.

"The depreciation of sterling would certainly be the line of least resistance - provided it were possible to persuade the American authorities of its necessity, and to achieve it within the framework of the Tripartite Agreement. But if the Americans insisted on the maintenance of the old dollar parity, we should be most unwise to destroy the Agreement and to attempt to alter the rate by force. At present, beyond all question, the attainment of the closest possible relations with the United States must be the corner-stone of our international policy. The maintenance of the 4.87 rate might be costly, but in the long run it would be less expensive than a breach in Anglo-American relations. In other words, in order to maintain the Tripartite Agreement, we should be prepared to lose gold. As a long-term policy, of course, this plan is hardly practicable.

Secretary Morgenthau - 10

August 20, 1938 (24.890) The Statist

sterling is said to be overvalued in terms of both the franc and the dollar.

August 26, 1938 (24.877) - The Financial News

The Tripartite Agreement prevents correction of sterling's overvaluation but political solidarity of United Kingdom and United States is more important than correcting overvaluation. American views on proper exchange rates are rigid.

"As far as the three currencies of the Tripartite Agreement are concerned, it is evident that sterling is palpably overvalued in terms of the French franc and that any exchange weakness of the latter currency is due not to normal monetary purchasing power factors, but to inherent distrust in the currency. As regards the dollar, recent experience in the exchange market strongly supports the view that sterling is also overvalued in that direction."

".....the Tripartite Agreement still prevents the overvaluation of sterling against the dollar from being corrected. In the near future, this country's adherence to the agreement is likely to be tested to the uttermost, for there is little doubt that the defence of sterling at its present dollar value will entail the loss of further large quantities of gold. No doubt it is true that currency depreciation is not the best means of correcting our adverse balance at a time when large imports of materials are needed for rearmament. The best course may well be to continue financing our import surplus by drawing on our overseas investments and, if necessary, a large part of our gold reserve. Even if that were not so, it might be worth while to suffer considerable inconvenience rather than to break away from the agreement, since the latter affords a means of preserving the political solidarity of the democratic nations. But it may seem regrettable, to some, that American views on exchange rates are relatively rigid, and that the securing of the political benefits of the agreement should, consequently, be a matter left so largely to this country."

August 29, 1936 (44-570) - The Financial News

The fall in sterling rate has not been enough to correct overvaluation of sterling.

August 31, 1936 (44-577) - The Financial News

After summarizing the sources of the current selling movement, the position is taken that sterling should be allowed to depreciate about as far as United States Treasury will permit. The United States Treasury is criticized for the "rigid views" on exchange questions.

".....The view was gaining ground that, despite the heavy decline of the past month or two, the overvaluation of sterling against the dollar has not yet been remedied and that the authorities will thus in the long run be forced to permit a further substantial depreciation."

".....Undoubtedly, the counter course in the long run is to allow sterling to decline in order that our deficit may be paid for by increased exports. If our monetary authorities come to this conclusion (and there is reason to suppose that they too consider sterling grossly overvalued) the initiative passes to the American authorities.....Should our own Exchange Account cease to support sterling, the Americans could always counter that policy by themselves buying sterling. That sterling they would expect to convert, however, into gold withdrawn from the British fund, and in the last resort this country could retaliate by refusing this facility. Any such currency war would be deplorable in the extreme, and yesterday's statement by the U. S. Treasury holds out a welcome hope that America is at least prepared to modify her rigid views on exchange questions. One may well ask, indeed, why it should be left to this country alone to shoulder the burden of maintaining the triggerless pact. That agreement is undoubtedly of immense value as an expression of political harmony between the six democratic Powers which adhere to it, but those political benefits are shared equally with the other participants including the United States, which in the past has profited in addition by a persistent undervaluation of the dollar vis a vis sterling and the franc."

September 1, 1938 (\$4.854) - The Financial Times

British translation that \$4.86 is proper rate should be destroyed.

September 1, 1938 (\$4.854) - The Financial Times

Economically justifiable rate is about \$4.10. France is undervalued against both dollars and sterling.

September 3, 1938 (\$4.842) - The Economist

Trade balance of sterling area has been shifting unfavorably. Less gold would have been lost by pegging rate at old parity. Int. such a policy would have been unwise probably. Fall in sterling rate below \$4.86 is not an unfair competitive depreciation.

"Many people believed that if [sterling exchange] would never be permitted to fall below that level \$4.86-2/3. Apart from the psychological factor, they could produce no argument in favor of their view. More than one prominent banker expressed the opinion yesterday that the sooner we tried to forget the level of \$4.86-2/3 the better. Sentiment among, they contended, surrounded that old parity with a halo."

"The theoretical position today thus appears to be roughly as follows:

1. The pound is overvalued by not quite 15 percent against the dollar.
2. The dollar is overvalued by 15 percent against the franc.
3. The pound is overvalued by 30 percent against the franc.

These calculations are based upon price indices alone, and ignore the many imponderables which affect these calculations and which probably mean that the franc is less undervalued than these figures suggest."

".....No doubt there is some solid commercial justification for the recent strength of the dollar. It is evident, for example, in the fact that the visible trade balance of the United States yielded an export surplus..... while both the British and, as far as it can be calculated, the sterling area's, trade balances have been shifting appreciably in the other direction....."

".....This figure \$4.86-2/3 once passed, there is no obvious rallying-point, no obvious rate to limit the riot of imagination that can be resorted to in viewing the possible extent of a further depreciation of sterling. There is probably substance in the opinion generally heard in the foreign exchange market

Secretary Kerguelan - 13

this week that it would have cost the Exchange Equalization Account less to hold the rate above \$4.86-2/3 than it has cost to hold it above \$4.85. But this alone provides no adequate criticism of the policy actually followed by the authorities. They are better able to judge of the character of the selling to which sterling has been subjected, and to decide from this and from its weight whether the occasion calls for pegging a outrage or for the exercise of the more normal function of the Account, namely that of 'ironing out' fluctuations."

".....And in any case, this week's fall in the pound sterling has neither been due to movements of British capital nor has it been engineered by the British authorities. In no sense is it an unfairly competitive depreciation....."

September 3, 1938 (\$4.85-1/4) - The Statist

Letting sterling fall below \$4.866 was an excellent move. The benefits of a lower exchange rate outweigh the adverse effects of short-term capital outflow. There is no long-term speculation against sterling.

".....The Account has in fact filled its traditional role of smoothing fluctuations and has refused to oppose a trend which, by its recent persistence and by the massive operations to which it has already led, gives every indication of being fundamental. There have been suggestions in the market that the authorities, by allowing the dollar rate to move beyond 4.86-2/3, have let the 'bottom fall out of the market'. There is no great evidence to support the suggestion. Admittedly the passing of this level was a psychological factor of some importance and undoubtedly helped to swell the volume of offerings of sterling on Tuesday. But the operations of the Account must clearly be guided by something more than day-to-day considerations of this kind or even by regard for psychological influences. Psychology has to be translated into actual exchange operations before it becomes an effective market factor. It might in this particular instance help to drive more foreign capital away from London than

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would otherwise have gone but this is a consideration on which the decision to hold sterling at what may be a definitely overvalued level should not depend.

".....But there is no long-term speculation against sterling such as there has been and such as still persists against the franc. From that quarter the Exchange Equalization Account need fear nothing."

September 6, 1938 (\$4.823) - The Financial Times

Appropriate value of sterling is now about \$4.60 but since future developments indicate a strengthening of sterling the proper stabilization rate is \$4.70.

".....the pound might be held to be overvalued by some 10 percent and therefore bound, say, for a point in the neighborhood of \$4.40. If the hoped-for trade revival in the United States materializes, prices there should respond quickly, especially under the inflationary impetus of "pump-priming"......British currency, moreover, will benefit as and when the import demands of rearmament diminish. Such probabilities lend powerful support to the views of those authorities who limit their expectation of sterling's fall to, say, the neighborhood of \$4.70."

September 9, 1938 (\$4.820) - The Times

Overvaluation of sterling against sterling- bloc currencies more apparent than overvaluation against dollar.

"The economic evidence of a recent overvaluation of sterling points to an overvaluation as against the currencies of sterling- bloc members with more certainty than it does to an overvaluation as against the dollar. In the circumstances, the present signs of a wider adhesion to the sterling pivot cannot be an entirely welcome compliment."

September 10, 1936 (64-811) - The Economist

Fall of sterling below \$4.86 is not  
compelling in fact it is necessary to  
achieve equilibrium of international pay-  
ments on current account.

September 17, 1936 (64-811) - The Economist

Sterling is overvalued but, since it is  
impossible to say what the correct value  
should be, stabilization is not desirable.  
Authorities should pursue an elastic and  
flexibly opportunistic policy.

"It must not be thought that the weakness of  
sterling is entirely due to capital movements. The  
pound is also weak for ordinary commercial reasons.  
.....If it is true to say that the immediate result  
of the Ypartite Agreement and the franc devalu-  
tion of October, 1936, was to establish a fair degree  
of equilibrium round the pound-dollar-franc triangle,  
then subsequent exchange and price movements in the  
three countries have overvalued the pound against  
both the other currencies. It has indeed been over-  
valued against the dollar ever since American prices  
began to fall in the autumn of 1937. As a long-term  
view, therefore, and quite apart from the immediate  
pressure on the pound (4.86-8/7) has ceased to be an  
appropriate rate. On this argument, the pound's de-  
cline below that rate is not competitive depreciation,  
but quite the reverse.....

"At a very rough guess, we could stand a total  
loss to the United States of \$150 million....."

".....In times of recession, particularly in the  
opening stages, the ordinary producer is hit worst by  
a fall in his prices, whereas the manufacturer finds  
that he is unable to reduce his prices and so is un-  
able to sell his goods. The present overvaluation of  
sterling against the dollar is, so far as England is  
concerned, nothing more than a particular though ster-  
ling symptom of this general disease, and so must be  
regarded as one of the necessary and automatic conse-  
quences of the world recession. The extent to which  
sterling is overvalued is difficult to define. It de-  
pends whether it is thought best to measure British  
manufactured goods prices against American primary  
product prices or against those of American manufac-  
tured goods; or whether it is thought best to attempt  
a compromise between the two categories of American

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prices, which differ fundamentally from each other.  
 ".....We must, therefore, pursue an elastic and, indeed, a frankly opportunist exchange policy."

September 20, 1938 (84.823) - The Financial News

If capital flows back to England, authorities should not permit sterling-dollar rate to return to \$4.86.

"For this reason, it would be wise to keep sterling at a level at which it is not unduly vulnerable. Having allowed it to decline below 4.86, the authorities may as well keep it under that level. To allow it to rise above its old parity would serve little useful purpose; for the figure of 4.86 has by now ceased to possess any 'mystic' quality, and no psychological factor, consequently, would tend to facilitate its defence at its historical parity."

October 1, 1938 (84.823) - The Statist

Recent action of authorities in allowing sterling-dollar rate to fluctuate widely is justifiable.

".....The tactics of the Exchange Account in allowing these wide movements in rates have met with no real criticism in quarters best placed to appreciate the task that faced the authorities on the critical days of this week. With the outlook so uncertain and threatening there would have been no justification for holding the sterling-dollar rate in the face of the overwhelming volume of sales of sterling which reached the market."

September 12, 1938 (64-75) - The Times

The present decline in sterling has been viewed for the most part with approval and the Exchange authorities have made no great effort to check the decline. Arguments demands of the United Kingdom are likely to increase costs and raise British export prices. Also, there is the possibility that the United Kingdom may lose some of its export trade in Southwestern Europe. However, a fall in sterling against the dollar alone is not a sure for sterling overvaluation because exports of the United States and other countries with currencies linked to the dollar do not compete with United Kingdom's exports in several of her most important markets.

"The removal weakness of sterling since the sharp post crisis recovery has been widely viewed in the city with a complacency not wholly distinguishable from well-willed pleasure. It has not escaped notice that no great effort has been made by the authorities to check the movement..... Those who are encouraged by the evidence that sterling has been and is overvalued - and they are in a majority - see in this movement a possible adjustment of the exchange value of sterling in accordance with our real commercial needs..... It certainly seems probable enough that the demands of expanded rearmament will tend to increase rather than lower the costs and prices of British goods relatively to those of our competitors. And the desirability of a lower rate for sterling is thus likely to increase rather than diminish during the next year or two. It is also necessary to reckon with the possibility of the loss of some of our trade with Southwestern Europe in favor of Germany although admittedly the total volume of such trade has in recent years been small.

"Unfortunately however it is unduly optimistic to feel that a fall in sterling against the dollar automatically an easy cure for any existing overvaluation of the pound. The relief provided by a decline in the dollar rate is economically more apparent than real for the United States together with other areas whose currency is based on the dollar is of only limited importance as a market for or competitor of British exports. So far as it goes the relief provided is welcome and valuable. But it must be remembered that the great bulk of British overseas trade is in relation to competitors and markets whose currencies are either within the sterling bloc or can for practical purposes be aligned with it..... The only currency against which even passive depreciation is possible is the dollar and only a very limited and partial corrective for any overvaluation can be obtained in that way. The absence of any natural corrective in the sphere of the exch-

Secretary Morgenthau - 18

rates is indeed a very real problem and one which could not find any practical solution if solution proved necessary except by negotiation between members of the sterling bloc. Whether the problem will become pressing or not at an early date may depend very largely on the domestic effects of the anticipated expansion of the armament program."

October 13, 1938 (84-73-1/2) - The Times

The best policy for the Exchange Fund to pursue - so long as the persistent pressure on sterling continues - is that of orderly retreat, "especially as at the present time Washington seems inclined to view a fall in sterling with equanimity." The alternative policies of determined pegging of the rate, or allowing the rate to fall rapidly to a much lower level are much more dangerous.

".....if the westward flow of funds proves as persistent as at present seems likely the policy of gradual retreat might naturally prove somewhat expensive in terms of the loss of gold involved. The market is inclined to feel that it can take advantage of the authorities policy of gradual recession - an attitude which has found its reflection in an appreciable amount of speculative bear selling of sterling during the past few days. It is difficult to see, however, what new policy the control could logically pursue. It would appear on the face of it that the flight into dollars is of a kind which would not be easily checked either by a determined effort to peg the rate or by allowing sterling to fall rapidly to a materially lower level. The latter policy has certain obvious attractions, especially as at the present time Washington seems inclined to view a fall in sterling with equanimity. But there are serious objections to adopting such a line, partly because there is no real guide as to what sort of level if any would check the demand for dollars, and partly because it is very conceivable that a rapid decline might in any circumstances merely aggravate a flight which is based on apprehensions of an essentially vague kind. In view of the rapidity with which the flight to the dollar was renewed after the Munich Agreement it may well be thought that it is impossible to calculate any particular point at which it can be

Secretary Morgenthau - 19

checked or exhausted without some new favorable development in the European political sphere. If that should prove to be so a policy aiming at an orderly decline in sterling - if decline should be necessary - may for the time being be the most reasonable and effective."

Friday  
October 21, 1938  
2:37 p.m.

HMJr: Hello.

Operator: George Harrison. Go ahead.

HMJr: Hello.

George  
Harrison: Hello, Henry

HMJr: Hello, George.

H: How are you, sir?

HMJr: George - hello?

H: Yes.

HMJr: Have you been following this R.F.C. note issue  
of Monday?

H: Yes.

HMJr: How - what interest coupon do you think it ought  
to have?

H: Well, I had a session this morning - about an hour -  
with ah - Sproul and Matteson,-

HMJr: Yeah.

H: - both of whom have been talking to banks and dealers  
and everybody else trying to get their views.

HMJr: Yeah.

H: Ah - our - our unanimous opinion is -

HMJr: Yeah.

H: - that is we feared -

HMJr: Yeah.

H: - that it would be wise to put out a three year note -  
November to November -

HMJr: Yeah.

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H: - at 7/8ths -

HMJr: Yeah.

H: - without any allowance for interest adjustment.

HMJr: Well that's what they seem to think down here.

H: I think that's a clean cut thing to do and it gives you about a fair price.

HMJr: Ah -

H: Now the - the three year June ones are selling at par 16 to 18.

HMJr: Yeah.

H: We think that the November one would probably sell at - being a little longer maturity - at par 13 to 15.

HMJr: Yeah.

H: If you made it 3/4ths for three years it would be awfully thin ; it would be just slightly over par on a mathematical basis - not allowing for anything else.

HMJr: But at 7/8ths - comfortable?

H: 7/8ths, we think, is very reasonable.

HMJr: Who -

H: There is one bank who owns a big block of the - ah - who suggested it ought to be one percent.

HMJr: Huh. - What bank was that?

H: That was the Chase.

HMJr: I see.

H: They own forty million of them.

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HMJr: Greedy - greedy -

H: But Green is ah - he's a - he's a flippant sort of fellow who likes to trade and I think he sort of was smart;- he said to go up a cent or even 1 and 1/8th.

HMJr: Yeah.

H: But that doesn't make any sense.

HMJr: Well, George - ah - who'll be in the bank tomorrow?

H: What's that?

HMJr: Who'll be there tomorrow if I want to talk?

H: Well, I - I had planned to go on up to New Haven to the ball game but I'd just as soon stay here.

HMJr: That's all right. Will ah - what's his name be there?

H: What's that?

HMJr: Sproul?

H: Ah - Matteson will be the best one for you to talk to I think but - ah - I'll stay around myself, Henry, I'm not particularly anxious to go.

HMJr: No, I don't want you to do that. I just want somebody there ah - to give us the final say around eleven o'clock or so.

H: Yes. Well I think - I think Matteson will be the best one for you to talk to.

HMJr: You do?

H: And I'll have him call you if you'll let me.

HMJr: Well, I won't - I may be at home, I don't know - ah -

H: Uh huh.

HMJr: But I'll be here in town.

H: Well, if I'm not here would you talk to Matteson?

- 4 -

HMJr: Sure.

H: All right. If it's a very good day and if everything is quiet here I may go up unless you want me to stay.

HMJr: No, no. No, I don't think it's important enough.

H: No. And I don't either, really.

HMJr: No. No, everybody's been telling me - well I haven't checked except around the -

H: Well, we - we've - I went over it very thoroughly and - from all its aspects and I think that's your best bet.

HMJr: I talked to Burgess - that's the only person I've talked to - outside of the Treasury.

H: Well, ah -

HMJr: Burgess said 7/8ths.

H: He - he thought you could do anything. He said even if you went four or five years. But I think it would be a great mistake to go out beyond the -

HMJr: No.

H: - the life of the corporation.

HMJr: Well. - Oh, I don't want to do that. Well, unless there's something happens tomorrow it'll be three year - 7/8ths.

H: First rate. And no interest allowance.

HMJr: No interest allowance.

H: That's right.

HMJr: Right.

H: First rate.

HMJr: Thank you, George.

H: Goodbye.

Friday  
October 21, 1938  
4:50 p.m.

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HMJr: Cy.

C. B.  
Upham: Yes.

HMJr: What Mr. Jones was here for was to plead with me that if Mr. Herbert Fleishhacker would hand in his resignation now - that we would let him - accept it but ah - not make him resign until the first of January.

U: That is effective January 1?

HMJr: Yeah. Now I said nothing. So then he said that Sam Husbands has an application for a twelve million dollar loan.

U: Yes. Preferred stock.

HMJr: Yeah. And I said, "Have you told Upham about it?" He said, "No." So I said, "Well, tell Upham about it."

U: Yeah. Well Husbands is coming tomorrow at nine-thirty.

HMJr: So ah - he's coming to see you tomorrow morning.

U: Yes, sir.

HMJr: O.K.

U: Thank you.

HMJr: Goodbye.

U: Goodbye.

## RE POSSIBLE CHINESE AGREEMENT

October 21, 1938.

4:00 p.m.

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

H.M.Jr: You (Hanes) said you wanted a meeting on China.

Hanes: I only wanted to show you the two versions. One is rather more full than the other one. This is the draft of the letter for you to send to the President. Do you want to go over those two letters?

H.M.Jr: No, I'm all in.

Hanes: All right. Well, somebody will have to say which one you want, as between the two. They both contain the same facts.

Oliphant: I think the shorter one is the better.

Hanes: I shortened the letter up by taking out the first part of it, which only goes to say, "As you are fully aware, from an economic standpoint, China's plight at the moment is desperate" - goes on to tell how we can help China, and so forth, which I thought was not getting to the point. So I went straight to the point in the second draft, which says, in effect, "Here's the program we have planned, and ways and means of getting 21 million dollars quickly into the hands of the Chinese Government."

H.M.Jr: If you gentlemen will be patient for one minute, I'll just read it.

Let me take home - let me take this thing home.

Hanes: Better take both of them, see which one you like better.

H.M.Jr: This is the one that you like the better.

Hanes: Well, that's mine. I took the - Mr. Oliphant wrote the other one. I just cut out the part that told about - which was superfluous, and which he already is familiar with, by the way.

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H.M.Jr: All right.

Hanes: Incidentally, this second copy here is corrected for three years. First copy has not been corrected for three years.

H.M.Jr: For three years is how much money?

Hanes: Is 21 - is 43 million 600 thousand dollars.

H.M.Jr: For three years?

Hanes: For three years. Not the entire amount, but half of that for the immediate down payment, or 21 million. The accurate figure is here.

White: They only get 21 million loan altogether on that, don't they?

Hanes: They get - the total, if the oil is purchased for 12 cents a pound - the cost of three years' supply will be 43 million 200 thousand dollars.

H.M.Jr: Yes, so half of that - and a half of that would be ....

Hanes: And a half of that would be 21 million 600 thousand, which would be the down payment.

Oliphant: The total amount of credit extended.

Hanes: 21 million.

White: Do you feel the five year is out? Five year is out?

H.M.Jr: For this purpose, yes.

White: Yes.

H.M.Jr: I want to, if I can, establish the principle.

White: If this works, they have some tin they're ready to talk on.

H.M.Jr: Exactly.

White: Also pig bristles.

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- H.M.Jr: Well now, as to this Tientsin silver - is that what it is? - Mr. Hull says - I gather he feels we should keep out of it, is that right?
- Lochhead: He didn't say. They've changed it there so that we wouldn't admit here specifically - I mean we don't state specifically that we haven't got an interest in there, because technically we might have an interest in it.
- Taylor: The reason - in other words, the reason he wants to word that that way is because they're a little worried about why the British asked them the question, and they would like to be able to answer about like that, which is that it has no specific interest.
- H.M.Jr: I realize when my brain isn't clicking; it isn't clicking now. I'm just going to call all bets off.

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Will be present:

Burgess  
Williams  
Warren  
Viner  
Riefler  
Hansen

Will not be present

Stewart

RE STERLING EXCHANGE RATE

October 21, 1938.  
10:00 p.m.

Present: Mr. Taylor  
Mr. White  
Mr. Lochhead  
Mr. Viner  
Mr. Riefler  
Mr. Goldenweiser  
Mr. Williams  
Mr. Burgess  
Mr. Walter Stewart  
Mr. Robert Warren  
Mr. Feis

H.M.Jr: The reason I asked you gentlemen to come down was this. We've got - oh, a number of things, I think. When you were here last time, we decided to deposit gold, and I think that was a good move. I haven't had any complaints. Federal Reserve Board hasn't said anything, and it was well accepted. I don't know whether - I'm just going to throw out - anybody wants to bring that up or anything else.

I'm bothered considerably about sterling. We always talk here confidentially. We've got this British trade treaty which is in the works. I'm told the thing was figured at 4.90. Sterling roughly is 4.75. They've got this clause in, which is - you can invoke the thing if devaluation takes place. The suggestion has been made that instead of leaving it that way we might put in a floor, say that if sterling should go to X point, why, the trade treaty would be cancelled, the theory being that it would be much easier for me and for the President, I think, if we had a floor to the thing, in case it went through to a certain point at which point we determined it would be to our disadvantage; because there are some people unkind enough to say that they're going to hold sterling where it is until the trade treaty is signed, then watch her go through to the floor. Why not put in a floor before?

And I want to say that on sterling I haven't said anything publicly, because certainly while the British press doesn't reflect this in any way, the British Treasury has done everything possible ....

(Feis comes in)

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Hello. Come in, sit down.

.... everything possible to defend the pound. I mean they've spent as much as 60 million dollars in one day.

I'll repeat what I said, which I want particularly, Herbert Feis to hear. I say - I'm talking about what we - I'm talking about sterling. Don't you want to come up here, Herbert?

Feis: I've never known anyone who gets down to business promptly three minutes after the hour. He's already talking on the subject which he is supposed to talk about. I've never heard of anything like that before.

H.M.Jr: Well, you see, in the Treasury we ask intelligent people over, and we don't like to waste their time.

I want to go back. The sterling thing is up; I'd like these people to talk about it. When they were down last time we decided we'd deposit the gold certificates; that decision was made. I think the thing has worked out very well. We're depositing about five percent, ten percent, more every time. I think that's worked out all right for the present.

And the other thing - told them we always talk here confidentially - I think the trade treaty is worked out on a theoretical basis of 4.90, and sterling is now around 4.75. I say some people have been unkind enough to suggest that they'll hold it there until the trade treaty is signed, and then they'll let the thing drop. And therefore, I'm raising the thought of the possibility of suggesting to the President that we put a floor in, a price at which, in case it should drop, why, automatically the thing would be off. It certainly would be much easier for me if there was a floor, a price at which we felt it would be unfair. Then I wouldn't have to have all these arguments to invoke this thing. See? I'm raising that thing at this time.

I mean just for argument's sake say that if sterling went through 4.50 that would be the signal at which the trade treaty would be - would have to be reexamined;

-3-

I don't know how you describe it technically - instead of having that very difficult sentence in on exchange, which would mean that Mr. Hull and I would have a head-on collision as to how to interpret that clause.

The present clause - we can get that clause. Have you (White) got that clause?

White: Yes.

H.M.Jr: It's very short. Just read it out loud, Harry.

White: The clause I was about to hand you is the one I thought you might wish to substitute. The clause that's in there - I'm sorry, I haven't it; I thought I had it. I have the clause which they suggested and which we turned down.

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

White: And I've got the one which we're suggesting. But the actual one I haven't got. But I can get it for you in a minute.

Oliphant: You can state the substance of it.

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

White: Yes, I can state the substance of it: that when there shall occur a wide variation which shall be regarded as inimical to the interests of either party, the clause shall be invoked which permits the reexamination of the trade agreement with a view possibly to reformulation or a cessation.

H.M.Jr: Well, get the exact wording. We got that, and the other thing I'd like you people to discuss is this: this whole question of possible financial assistance through government loans to Central and South America. Everybody's talking about what we're going to do with this 14 billion dollars worth of gold, and I'd like to know why it wouldn't be a good thing if Congress would authorize the President that if he felt that the Monroe Doctrine was being undermined in any Central or South American country, he could be authorized to make a governmental loan to that country, or to assist them in

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their finances. We have right now before us the question of State Department sending a mission down to Cuba. Now, you people know what the situation is in Brazil, where they've got all these foreign exchange troubles, haven't got enough foreign exchange, American business men have to wait indefinitely for their money. If the United States Government openly and aboveboard, let's say, should loan Brazil a hundred million dollars for 20 years at three percent, something like that, why, it would put Brazil on her feet. And I personally lean very strongly - I don't know what better use we could make of our money than if we should loan it to countries in Central and South America.

I mean I don't want to take these devious ways of doing it through some backdoor method. I'd like to - that's what we did in - what was the country where we did it with J. G. White?

Feis: Haiti.

H.M.Jr: Haiti. But I'd much rather do it openly and aboveboard.

And now I asked White to prepare a little stuff so that you fellows could shoot at it. Then after we get through we'll follow the regular routine. People can bring up anything that's bothering you that's my responsibility. So if you don't mind first taking some of my worries, then I'll be glad to take some of yours.

Go ahead, Harry.

White: Prepared a hurried memorandum which has four sub-headings.

"1. What currencies followed sterling down?" - to indicate that the problem is not merely one of dollar versus sterling, but dollar versus most of the important currencies. And we have supporting data so they can see at a glance just what currencies have followed sterling, which have exceeded and which haven't.

And the second question asked is: "Does the total economic situation justify a lower sterling rate with reference to the dollar than \$4.86?" And I've indicated all the possible reasons that might be advanced in justification of that position.

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The third question gives some information as "pertinent to the above claims" that would help you to arrive at an evaluation of those claims briefly.

Fourth question is "What can we do about it?" indicating three or four possibilities.

The last question is "Should we do anything about it?"

I have copies of this memorandum that I can distribute, or would you prefer that I just read it out?

H.M.Jr: I think it would help them if you distribute it.

White: I'm sure I haven't got enough. Didn't have time to do it.

H.M.Jr: Look over each other's shoulders.

I say he's (Burgess) - I don't know how they let him in. Do you (Feis) think it's all right, letting this banker in here?

Feis: Yes, I guess it's all right.

White: We didn't have time to make more; we've only got three carbons.

H.M.Jr: Well ....

White: We'll spread them around.

H.M.Jr: Spread them around.

White: I have the original. Would you like to read it?

H.M.Jr: You're going to read it. I'll listen.

White: "Appended is a table indicating the percentage change in rates of exchange from August 1, 1938 to October 17, 1938" - to the most recent. I haven't many copies of those tables, but they do indicate that most of the important countries either went right along with sterling or exceeded the sterling rate.

"It will be noted that most of the currencies have depreciated during that period at least as much as or

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more than sterling. The important exceptions are Belgium, the Netherlands, Canada and Switzerland. Of these only Belgium did not decline at all." The others showed declines varying from a half to a little more than one percent.

"In evaluating the effects of the depreciation of sterling it is therefore essential to bear in mind that most currencies drop with sterling and a decline in sterling really involves the appreciation of the dollar in terms of most currencies. This makes a decline in sterling more important for the United States and less important to England.

"2. Does the total economic situation justify a lower sterling rate with reference to the dollar than \$4.86?

"The following reasons might be advanced as justification for a lower sterling rate." Most of them have been advanced in one form or another by the British press and semi-official statements.

"(a) England has been experiencing an adverse balance of payments exclusive of capital movements of substantial proportions while we on the other hand have been gaining a large amount of gold exclusive of capital movements.

"(b) British exports are dropping while her rearmament program calls for sustained imports" - thereby indicating that the situation might grow worse so far as the balance of payments is concerned.

"(c) England no longer has a balanced budget and her rearmament program combined with the possibility of a deepening recession will still further unbalance her budget.

"(d) England cannot afford to lose much gold through an adverse balance of payments on non-capital account because she is the resting place for a large amount of short-term capital. She therefore needs to conserve her gold supply to make her less vulnerable in the event of a flight from sterling.

"(e) England must reserve its gold stock as part of her national defense program.

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"(f) In her efforts to prevent sterling from weakening England has already given up, she claims, large sums of gold.

"(g) Since the recession in England is concentrated largely in her export industries any improvement in her international competitive position is an important means of checking the recession" - in England.

"(h) England is now faced with more powerful competition from one of her chief competitors - Germany. Britain thus must take strong and, if necessary, unusual measures to protect and even increase her share of the world's export trade."

Those are the claims that are advanced. Now the question of evaluating those claims would be one of the things that I presume you'd want to discuss in some detail today.

But here is some of the factual information that might be helpful:

"(a) Great Britain's unfavorable balance of payments on non-capital items is large and has been increasing during the past three years. Our estimate for the first six months runs around £50 million and probably somewhat less than that for the second half. For the year as a whole her 'unfavorable' balance may be as much as one-half billion dollars." We've got some more detailed data available here when you want to go into it further.

"In contrast, our 'favorable' balance on non-capital items is about \$1 billion a year. This balance is due chiefly to a low level of imports accompanying our recession, and a relatively high level of exports sustained in part by the foreign armaments consumption and by the return to an export surplus in agricultural products.

"(b) United Kingdom exports in the third quarter are 17 percent less than the comparable period of the previous year." This relates to their claim that their exports are declining. They had a 17 percent decline in the third quarter, a 14 percent decline in the second quarter, and a 2 percent decline in the first quarter, as compared to the previous year, which shows that their ....

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H.M.Jr: Excuse me, Harry - 2, 14, and 17?

White: 17 the last quarter, 14 the second, and ....

H.M.Jr: Start the first quarter. I can't follow you.

White: 2 percent, then the second quarter 14 percent, then the next 17 percent, as compared with the comparable quarters of the previous year. In other words, their exports are declining.

"Our exports, however, show an even greater decline. The first quarter showed a 16 percent increase compared with 1937, whereas the second quarter showed a 7 percent drop" - that is, we went from a 16 percent increase to a 7 percent drop - "and in the third quarter there has been an 18 percent drop" - compared to last year.

"(c) The" - with reference to the claim that their balance - their budget is unbalanced and will become more so - "The United States deficit for this fiscal year will be in the neighborhood of \$4 billion. The estimated deficit for Great Britain is the amount of the National Defense Loan raised during this fiscal year - less than..." - don't know exactly how much, but unquestionably less than a half billion dollars, between probably three hundred and four hundred million.

"No matter what basis.." - with respect to increased armaments - "no matter what basis of comparison is employed, it seems likely at the moment that our expenditures on armaments during the next couple of years will be greater than those of Great Britain." - ...selecting any basis of comparison that you think is significant.

"(d) We do not know how much gold the British Equalization Fund has lost in the last few months. We estimate that the Fund probably lost no more than \$300 million and possibly much less." I haven't checked that figure wholly with Archie, and it will be subject to substantial modification in the last couple weeks.

Lochhead: I've been trying to check on the last few weeks. Of course this is a guess - you realize we can't get figures - but I think it's nearer five to six hundred

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million.

White: The losses in the last couple weeks have been very heavy.

"It must be remembered that a substantial portion of the outflow of gold from London consisted of gold belonging to other countries and newly-mined gold. England has about \$2,700,000,000 in the Bank of England and at least another billion in the Equalization Account."

Or that may be a couple hundred million less. The figures of their gold losses we tried to interpret from the point of view of what we have gained and what other countries have lost, and guess on what they lost in the hoards, as a basis of these estimates as to what the Equalization Fund has lost. I think six is high, but three is probably low.

"We have no figures indicating the amount of foreign short-term capital left in England but certainly the 'hottest' portion of that capital must have left London during the past few months.

"(e) There can be no doubt England must conserve part of her gold stock for a national defense program. The question is - how much is a reasonable amount? As a practical question the limiting factor will not be the amount of gold she needs for war purposes, but something in excess of that."

These are not attempts to meet their claims - there's more discussion that we have on each one of them - but it's merely certain factual observations.

"4. What can we do about it? Possible moves which we may take, listed in order of severity" - beginning with the least severe and increasing:

"(a) We can request the British to consult with us on any further proposed variation - downward variation in the sterling rate, in accordance with the terms and spirit of the Tripartite Accord.

"(b) If the British fail to agree to the consultations, or if the outcome is unsatisfactory we can announce the termination of the Tripartite Accord." That is, if the criteria, or criterion, which they supply to us as a

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basis of their movements of sterling is, after discussion and consultation, unsatisfactory to us, we might say that they're taking a competitive advantage which is in violation of both the spirit and the letter of the Tripartite Accord.

"(c) We could use the proposed United States-United Kingdom trade agreement as a lever to prevent further substantial depreciation of sterling by insisting that a general provision be included which would terminate the agreement if the sterling rate declined by more than a stated percentage (possibly 5 percent) from the rate pertaining on April 22, 1938, the date on which active negotiations began." That would mean at about \$4.71.

There is another suggestion which is all prepared - something like that, but stated in the exact terms, which I can read after this, if you like.

"(d) We can raise the dollar buying and selling price of gold." Or there's another: you can raise just the selling price and leave the buying price where it is. The effects of that we'd have to discuss as a possibility.

"(e) Use of the Stabilization Fund to prevent sterling depreciation and, if necessary to carry out this program, ask Congress for an increase in the size of the Stabilization Fund." That "e" is practically out, for various reasons.

Now the next question, and the important question, is "Should we do anything about it?" And in an attempt to answer that we will have to consider: "To what extent will our export trade be affected?" We did receive estimates prepared by the Commercial Attache in London in which he went into very considerable detail, indicating "that a decline in sterling to \$4.40 would result in a loss in our exports to the United Kingdom and other sterling countries (which is only a part of the loss to our exports) as being \$150 million per year based on 1936 trade figures, and \$100 million if sterling drops to \$4.60."

I'd say offhand that the assumptions on which those conclusions rest are subject to a wide degree of both

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modification, question and interpretation. Any attempt to estimate the exact amount of trade that you would lose if sterling drops to a certain figure, is almost love's labor lost; you won't get very far without subjecting your conclusion to all sorts of reasonable questioning.

"This estimate to be complete should be increased by the loss in trade resulting from depreciation of non-sterling currencies, and the loss in trade in non-sterling markets. Only 40 percent of our exports go to sterling countries." Even that estimate did not take into consideration the trade effects that would result from the decline in other currencies that will go with sterling.

"(b) Our domestic markets will be subject to intensified competition from imports.

"(c) The consequences upon domestic business conditions of adjustments in the export and import trade volume and character."

Those briefly are probably some of the things you want to talk about. I can only plead that we didn't have much time to throw it together.

H.M.Jr: Did all right in a short time. All right, gentlemen, where do you want to start?

White: I now have that clause, if you want to read it.

H.M.Jr: Fine.

White: Did you want that clause?

H.M.Jr: Please.

White: The clause as it is at present in the general provision in the contemplated trade agreement between the United States of America and the United Kingdom, states as follows: "If a wide variation should occur in the rate of exchange between the currencies of the United States of America and the United Kingdom, and if either high contracting party should consider the variation so substantial as to prejudice the industries or commerce of the territories of that high contracting party, such high contracting party shall be free to

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propose negotiations for the modification of this agreement, and if agreement is not reached within 30 days after the receipt of such proposal, the high contracting party making the proposal shall be free to terminate the agreement in its entirety on giving 30 days' notice in writing to that effect."

So the key words are "If a wide variation should occur" and "if either party should consider the variation so substantial as to prejudice its industries or commerce."

Viner: And the 60 days.

White: Well, the 60 days is for notice.

H.M.Jr: What did the British suggest last June or July? They made some suggestion.

White: "Without prejudice to the question whether a variation of more than ten percent in the rate of exchange between the currencies of the United Kingdom and the United States obtaining on the day of signature of the agreement would constitute a wide variation for the purposes of Article 13, it is understood that no variation of that amount or less shall be so regarded." In other words, on the date of signature - let's assume today: \$4.76 - a variation of ten percent up or down from that, or less, would not be regarded as a wide variation, without saying that a variation of more than that would be; but at least a variation of ten percent or less would not be. That was their proposal submitted ....

H.M.Jr: But if it went 11 percent, it doesn't mean ....

White: That's right.

H.M.Jr: It does not mean that all bets are off.

White: Merely means you can reconsider it at that point, if you wish to.

H.M.Jr: That wouldn't help me any.

White: But anything of ten percent or less you would not be in a position to consider a wide variation.

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Viner: Ten percent from date of signature, not from date the negotiations begin.

White: And that makes a substantial difference, because it was four ninety-three or -four, I think, when the concessions were offered and it's now four seventy-six.

There's another clause which has been suggested as a possible basis for discussion here if you like, to replace that with, if it is felt that some floor is called for.

"For the purposes of Article 18 (which I read before the last one; that's the article that's now in there) a variation in the dollar-pound sterling rate of three percent or more either way from the rate of \$4.86 to the pound sterling shall be deemed to be a wide variation, and if for five consecutive business days the dollar-pound sterling rate of exchange varies by six percent or more from the rate of \$4.86 to the pound sterling, the agreement shall be terminated in its entirety 30 days after the expiration of such five-day period." That's a three percent variation from par; would bring it around \$4.72, which would be regarded as a wide variation and thereafter pave the way for discussions. A six percent variation would be \$4.57.

H.M.Jr: Six percent?

White: Would be 4.57. It would be automatically terminated at 4.57. At 4.72 would be the area in which you could begin negotiations; those figures are just tentative.

H.M.Jr: But the six percent would be 4.52?

White: 4.57.

Gold'r: Would you mind reading that again, this last one?

White: This is supposed to be in addition to and would not be made public; this would go as part of the secret minutes or whatever it is.

Feis: (Nods no)

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- White: No? You mean that no such thing is possible, you don't have any understandings outside of written agreements in international affairs. Well, in that event it might have to be modified, if the State Department persists in that view.
- "For the purposes of Article 18, a variation in the dollar-pound sterling rate..." - incidentally, the British asked that their ten percent rate should not appear in the agreement; when they offered it, they asked that it be understood and appear in the minutes and not in the agreement; but probably they (American State Department) pursue different tactics.
- Viner: Listen, Harry, if they operate on the rate - we tie ourselves to gold and they operate through gold, and let's assume that as a result of their operations, or of conditions, the sterling rate goes up to five five; then they can terminate the agreement.
- White: That's right.
- H.M.Jr: Even though they have taken the initiative.
- White: Well, I don't see how you can - you have to have a two-way clause. That isn't a grave danger. But they would be justified if, in wanting to reconsider....
- Viner: Supposing we raise the price of gold. I mean let's take it the other way. Suppose we by Presidential action raise the price of gold.
- White: You raise an interesting question, important question, which will have to be discussed here. It is clear that at present any alteration in the rate is practically British-determined. They can determine the rate and we can't, except indirectly.
- Viner: By changing the price of gold.
- H.M.Jr: That's right.
- Viner: Therefore, one might take the position that since we're the passive agents, we need some protection of that kind.

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Let's assume that a clause like that is desirable. You ought to put it in general terms, so it takes care of the direction of the initiative, so it doesn't indicate by its form that we expect them to depreciate and there is no question of our doing it.

H.M.Jr: Well ....

White: Shall I repeat that?

Gold'r: I'd like to hear it, because I missed one or two of the points - if you don't mind, Mr. Secretary.

H.M.Jr: Sure.

White: "For the purposes of Article 13, a variation in the dollar-pound sterling rate of three percent or more either way.." - these figures are just tentative - "from the rate of \$4.86 to the pound sterling shall be deemed to be a wide variation" - this is explaining and defining wide variation in the exchange - "and if for five consecutive business days the dollar-pound sterling rate of exchange varies by six percent or more from the rate of \$4.86 to the pound sterling, the agreement shall be terminated in its entirety 30 days after the expiration of such five-day period." Unquestionably this will have to be modified and changed to make ....

Viner: See, my point is this. Supposing sterling rises again because of market conditions to 5.05 or 5.10, or whatever the precise point is; that would automatically terminate the agreement. We certainly don't want that; they mightn't want that. Yet both parties would be bound to it. And the importer who is anxious to know what the rates would be at a certain time, finds us saying, reading that literally, that when sterling goes up - automatically, upon reaching that point the agreement expires.

H.M.Jr: What I said to White, carrying the thing - as far as I'm concerned, all I want to do is put a floor under sterling, and that's all I was interested in; and all that - well, just to make it easy for the President and myself, so that we wouldn't have this terrific job of going through a great discussion of trying to

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interpret what a wide variation is.

Now, if, let's say - first, we haven't agreed that we want to do it, but if we wanted to do it - I mean as far as I'm concerned, all I am after is to put a floor under it now, and I wouldn't suggest any more than that. At least that's the way I feel as of today. But I'm taking it that White feels that if we wanted to put a bottom the English would insist on a top.

Viner: My point is that this puts a ceiling too for each country.

H.M.Jr: Well, I didn't ask for that.

White: That can be modified, I think, to meet both objections. I think you've (Viner) got a legitimate point.

H.M.Jr: That's White's contribution.

White: All of us.

H.M.Jr: But anyway ....

Gold'r: I should think, Mr. Secretary, it would serve your purposes if you have your clause read that in case a variation of six percent occurs either high contracting party will have authority - will have the right to denounce the treaty, rather than to make it abrogated automatically. I don't believe you'd want to bind yourself to having it abrogated automatically when a certain point is reached, because you can't tell now what circumstances there might be at the time and you might not want to have it automatically lapse. You ought to have the authority to denounce it if you want to, but certainly not have it occur just of itself.

Williams: Couldn't you soften that by suggesting that at that point a discussion should begin?

Viner: That was one of the other clauses.

White: Well, you could make it that at one point discussion begins, at the next lower point the discussions are terminated. Now you can vary those points to meet -

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I think, to meet both your objections, because there would be a time in between in which negotiations could take place and in which case this portion of it could be modified. So the question would be whether - (a) what rates those shall be, and (b) whether you want anything of this sort in at all.

Williams: The modifications that would come out of discussion might render unnecessary and undesirable the abrogation. The thing that bothers me about it is that provision that it contains for dropping the whole business. It seems to me that's going pretty far, unless we're prepared to say now that so much - such a figure as what you gave, 4.57, is undesirable. I don't see now you can know that.

White: Well, apparently from the British point of view they regard it - not necessarily that it's proof - but they regard it as pretty important, because they all seem to feel that - such arguments as have been made in the press and by quasi-public officials are that a decline in sterling is necessary in order to prevent a continued disequilibrium or drain on their gold reserve.

Williams: What I'm saying - let's assume they might be right on that - would it be desirable for us to say that "at this point this agreement shall be terminated"? Couldn't we cover it with the provision for discussion, leaving the other question quite out of the agreement, covered in some more general way?

White: That avoids the very issue which the Secretary wishes to take care of.

Viner: I think the first point in this memorandum is important; that we might, on the best study we could make, feel that a slump in the English sterling rate was warranted by English conditions, but we might feel, for instance, that for Sweden, whose position is strong and so on, to go along with that is not warranted. And I don't see why we should hit at England in that case, but the question might arise on a whole range of other countries.

White: Except that England must bear the responsibility of, or must take into her considerations, as we must take

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into consideration, that if she goes down a lot of other countries must follow her.

H.M.Jr: Excuse me. I don't think Herbert Feis heard me say this. I'd like to say it again: that up to this point - never mind what the British newspapers have said, or all their comments, and everything else - I want to go on record here with you gentlemen that up to this point I am personally entirely satisfied that the British Treasury has done everything possible to hold sterling in line. Now, I don't think I said that when you were here.

Feis: No, sir.

H.M.Jr: But up to this point - never mind what they have said - I am personally convinced that the British Treasury has done everything humanly possible to maintain sterling where it is. I just want to say that, see? So - I think it's important - up to this point, I mean, I have no doubts in my mind as to their sincerity.

Go ahead.

I mean that's - you agree with me, don't you, Archie?

Lochhead: Yes. We can argue, but in the main they have gone out and supported it.

White: I don't agree with that.

Viner: I wouldn't be able to accept that proposition quite as stated. I'd say it is quite possible - I'm prepared to agree that they've done everything we could reasonably expect them to.

White: That's right, because after all they could have .....

Viner: They could have kept it at the original rate.

White: They'd have lost more gold.

Gold'r: Isn't that all you mean, Mr. Secretary: that they have done everything that could be reasonably expected?

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Viner: That we're not dissatisfied with the efforts they have made to maintain the rate?

H.M.Jr: I mean I have no - I've read the paper - for instance, a number of times the British Treasury has said, "Well, the United States Treasury doesn't say anything that they're dissatisfied." Well, I have no reason - if Sir John Simon should walk in here tomorrow and say, "Are you dissatisfied?" I couldn't put my finger on anything to say where they had not done everything within reason to maintain the present rates, and when they spend 60 million dollars in one day I think that they've gone as far as they could within reason. Now, somebody might say they ought to have spent 120 million dollars that day; but at least they've done everything that they could.

And for your information - it's all very confidential - they're drawing on their earmarked gold in France now, and they're even drawing on some of their gold in the Argentine.

So somebody could say, "Well, they should have spent twice as much." Well, maybe they should and maybe they shouldn't.

But the thing that bothers me is this little birdie that dropped this thought in my ear: that they'll do what they are doing up to the minute the trade treaty is signed, and then the bottom drops out.

Taylor: There is - I think there is one point that is historically interesting, before we get too far with this discussion of this particular clause. When this other clause with the ten percent limitation on it was proposed, we took the position that we'd prefer to stick to the standard clause and not mix up the dollar-sterling rate with the trade treaty negotiations; and that as far as we were concerned, why, the principles of the tripartite agreement - in other words, no competitive devaluation - were the ones that should be in our minds; that we had much greater freedom of action if we stuck to the tripartite principles and emphasized that.

We also had two conversations with the British here, very serious conversations, and told them to tell their trade delegation to lay off this trying to

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bring in this sterling-pound relation - I mean sterling-dollar relationship, at that time.

Viner: Has the original suggestion come from them on this question?

Taylor: Came from them, and they were trying to feel us out on this ten percent.

H.M.Jr: But date this. It was June and July.

Taylor: It was in June and July.

H.M.Jr: But the thing started with them.

Viner: What did they want?

White: Wanted to smoke us out, find out how low they could go.

Taylor: In other words, we thought about it quite carefully and we took the position that we did not wish to introduce what you might call the relationship of the pound and the dollar into the trade treaty. There were various reasons for doing that.

White: Yes, our chief motive was - we felt that all they wanted was information as to how far they could go down and we stand it. You see, their opinion has been, as evidenced by numerous statements and by the general attitude of the British press, that we would not stand for a break through 4.86. They said that numerous times out there - I mean the British press commented on that. And we felt that this in part was an attempt to find out whether we really felt that way, and the fact that they used a ten percent variation either way, and the fact that they weren't satisfied with the general tenor of the provision, which in itself is sufficiently liberal, led us to believe that they had an ulterior motive, particularly because the request came apparently from the British Treasury and not from those negotiating the agreement. And as a consequence of that, the answer then was as Wayne indicated.

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- Taylor: Specifically asked the British Treasury to tell its trade negotiators to lay off this one. We didn't want to talk about it in this connection.
- Sold'r: That ten percent, Harry, is based on the rate at the time of the signing of the treaty rather than ....
- White: That's - the first time it wasn't specified. First was an oral request; they were turned down, as Wayne Taylor indicated. About a month later on, when their drafting expert came from London, he had already written out - on July fifth, that was, almost - more than three weeks later he had a provision written out which embodied in words their oral request, and in this written request it was as of the date of signing. In other words, they felt they would like to try it again on July fifth. So though it is true that we took the position that the wide variations were adequate, I think the situation has changed and might warrant, if we felt that it was desirable from the point of view of the exchange rates, legitimately taking the position that the concessions were evaluated on the basis of the then prevailing rate; and those of you who are familiar with the agreement have in mind that a good many of the concessions granted were not large in terms of percentage of the total value - though there were a number of concessions which were 50 percent of the existing duty, the existing duty is not large in many cases - so that a variation of ten percent would wipe out most of the concessions that were granted, providing prices didn't move in a contrary direction, and it so happens that prices are moving in a direction which is again more unfavorable to us. So they can't say, "Well, our prices have risen, therefore these concessions are not wiped out by a ten percent depreciation." The opposite has been true.
- Viner: You mean their prices are moving down relative to ours.
- White: I mean their index. I wouldn't say the specific commodities; I don't know.
- Warren: I'd like to raise one other question. Does the treaty run for a stated number of years or indefinitely? That is, is there any other terminal

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than this clause provided for the treaty?

White: I don't know; I think it's indefinite.

H.M.Jr: Herbert Feis ought to know.

Feis: I don't remember the general phrasing of it.

Viner: None of them have an indefinite length, have they?

Feis: Oh no, there are provisions for termination. I don't just remember whether this is three months or six months.

Taylor: Have dates of termination, don't they?

Viner: And have dates, don't they, when they terminate unless renewed?

Feis: After a limited period of time, they can all be terminated. It's either three months' notice ...

Taylor: When I made my comments, I wasn't suggesting that we shouldn't review the situation. I was merely giving the historical background of what had already been done.

Viner: Of course, if there is a three months' notice clause in the agreement already for termination, that does raise the question as to whether you need any more provision than that.

White: Well, that depends on the motives for which the provision is written. There is adequate protection against trade difficulties.

Oliphant: If you acted under the three months' clause, Jake, you'd have to assign a reason for that.

Viner: What?

Oliphant: If you acted under the three months' clause, you'd have to assign a reason for so acting, which would bring you back to the embarrassment which the Secretary mentioned.

Viner: As compared to one form of this, but not as compared

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to the other form. It would still require a reason. There's only one of these which is automatic, you see.

White: I think perhaps sight is being lost of the fact that that was included - place for this discussion - as one of the ways for checking a decline. I mean, in other words, it isn't an attempt to protect the trade agreement; that's the trade agreement's business.

Williams: It seems to me that the really fundamental question is, now desirable is it to attempt now to put a definite bottom under sterling? It seems to me that we're coming into new conditions that we have had no experience of up to now. We have always faced the question whether England in a new depression wouldn't depreciate the pound, and indeed have to in spite of the best efforts possible to prevent it, and the question has always been, what will be our interest in that sort of situation? Now, we could fight back and so protect our trade position for the short interval. Another way to look at it would be to ask ourselves whether we wouldn't gain more on balance if the English policy were such as to alleviate the depression over there. I can imagine our losing out a little bit on the terms of trade and yet getting actually much more trade if England were in a healthy condition. Now, I don't know the answer to that; I don't believe anybody does.

I can see that the English in some ways would dislike a depreciation of the pound in so far as their thinking about the cost of armament, for example, the necessity of imports. They may be very desirous of preventing a drop in the pound. It is somewhat the same problem that arises for them in war. When they have purchases abroad to make, they're interested in supporting the pound. So it's a very mixed question.

But it would seem to me unwise to attempt to state a definite bottom such as would abrogate these whole arrangements. I would prefer to see some other provision which would make possible the modification of the terms of the treaty, or something of that sort, insure full discussion of the problem, but not close it out at some bottom which it seems to me nobody can really determine at this time.

White: At what point, either in point of history or in point

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of exchange rates, would you regard it as a reasonable point at which to say, "This has gone so far that we want to know what your proposals are in the future," that they are adversely affecting us? And though they're benefiting themselves, we may take the position that we would prefer to have them gain from our health rather than we gain from their health.

Williams: Yes, that, of course, is the difficult question. I don't know, but it seems to me that you can afford to be somewhat less certain about that - we could take your figures, for example - because all it means is, we all recognize that the time has come for serious discussion of the problem.

H.M.Jr: Pardon me - you say the time has come?

Williams: I mean at some such figure ...

H.M.Jr: I thought you meant the time has come now.

Williams: No. Upon a further drop of X amount.

Viner: I think if you thought that 4.50, let's say arbitrarily, was a time when serious discussion should take place - I'd say it would be all-important to have the discussion beforehand and not have it in the midst of an emergency or crisis; not have it on such a basis that we'd be in a position that we'd feel they have to retreat from a position they've always recommended.

Williams: That would suggest you'd want to put the figure a little higher.

Viner: No, it would suggest, from the point of view of discussion, that discussion ought to be outside of the agreement and ought to be early, if possible. So there ought to be a clarification of views as to what variables each country would take into account in deciding whether the other country's actions were justifiable.

Stewart: It occurs to me, Mr. Secretary - the original reaction you had - that it would be desirable to keep these things separate if possible.

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H.M.Jr: Excuse me - you're asking or telling me?

Stewart: No, I'm making an observation that one gets forced into a different point of view because one is concerned at the chance that the agreement is made and then the rate goes lower, and then you have to take some action outside the agreement; apparently even with the British Treasury doing all that can be expected of them, you have already had a decline of rate which may be embarrassing with reference to the rates established at the time the trade treaty was entered into as a basis of calculation. I assume that there is nothing in the tripartite agreement which provides any range of variation, nothing which automatically brings in discussion. Would it be feasible to have a trade agreement premised upon a continuance of the tripartite agreement and then have modifications in the tripartite agreement of the kind that you (White) have suggested in B and C (4 (b) & (c), pp. 8-9) upon the other; then use the mechanism of the tripartite agreement for bringing in the whole matter of discussion and laying down there the range of variation, separating the monetary from the trade.

White: It's an interesting suggestion, particularly .....

Viner: Particularly as the question of consultation has arisen in connection with the tripartite agreement. But our precedent ....

Taylor: You have a mechanism for consultation at any time on any subject, and you have 24-hour protection under the tripartite agreement.

White: Let's see if I understand that clearly.

H.M.Jr: May I interrupt just for a moment. I want to let you people know, so you have all the background - sometimes human frailty brings you to a position which subsequently seems important, but at the time very unimportant - this suggestion of the British was brought to my attention, oh, just a few days before I was sailing for Europe, and I was completely all in. And I said, "I just cannot take this up; this is too important to take up a couple days before." And I simply said, "Let's stall on this thing." So the thing

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was not that we didn't want to have this thing one way or the other, but the fact was that I was - my brain was just all in and I couldn't take the matter up three or four days before. And I also felt at the time - and I think that I was correct - that the British were bringing it up not so much because they were serious about it, but because at that time, for some reason we didn't know, they wanted to stall the trade treaty, postpone discussions. At least that was the impression that I had, and that impression gained strength after I saw Kennedy abroad.

So I just wanted to tell you this wasn't a policy that we sat around and delayed, said, "Well now, this is something..." - it was arrived at because it came up a few days before I was sailing and I wasn't physically or mentally in any condition to take up as serious a thing as that. I said, "Well, the only answer is we've got a whole lot of other trade treaties; we'll follow the same thing." And I told Taylor, "Well, let's just stall them on that thing."

But I wanted you to know how it was arrived at.

Stewart: I can see that, and furthermore, certainly circumstances now are very different from the ones existing in July. And I think quite reasonably a trade treaty calculated upon one rate of exchange, and with a three percent provision - you would be now on that basis of entering into discussion, at 4.57 - or rather, 4.72.

As to whether or not there ought to be a discussion, assuming narrow limits, assuming the unforeseen, also assuming the State Department can't enter into side agreements, it did seem to me that the tripartite agreement might give one an opportunity for discussion between those parts of government which now have that problem before them, more easily than the elaborate trade agreement, which has to go through different channels.

H.M.Jr: In other words, we already have a side agreement.

Stewart: You modify the side agreement.

White: There is a definite responsibility which the Secretary

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of the Treasury has which I think might be mentioned, although it is doubtless clear to all of us. I think it is worth while repeating. The trade negotiations are entered upon, are consummated; trade agreements are made. They are based on the assumption that certain exchange rates prevail; that is implicit in them. Otherwise, the trade negotiations have no significance whatsoever, and all the discussion, months and months and months of discussion, on concessions become absurd. And the responsibility for maintaining stable equitable exchange rates is the Secretary of the Treasury's responsibility. So that he cannot be subject to the criticism of saying, "Here we worked for two years to make a trade agreement, and you ruin the whole business..." - to say nothing of ruining other things, or spoiling other things, by not adequately protecting our interests so far as exchange is concerned.

Now, your (Stewart) thought is that that protection already exists in the tripartite. However, in order possibly to tie it up, your thought might be very good; in other words, you might interpret "wide" in this agreement as relating to competitive advantage in this other agreement, and then under the terms of the tripartite accord we can say, "Look here, these variations are such as to give rise in our opinion to the belief that they may be for competitive reasons; we therefore want some consultations to indicate what other criteria you are employing to lead you to that conclusion, to see whether or not we agree, whether we shall not consider the tripartite violated." However, it would make it a little easier if it were again tied back to the agreement so as to interpret "wide" from the discussions which are entered upon by the two Treasuries; that is, they should be the agencies to consider whether or not that depreciation is competitive or not, because all other agencies depend upon the Treasury - Secretary of the Treasury to maintain equitable, reasonable rates.

Stewart: I think it would be easier, if you could foresee the circumstances and be confident you could foresee the circumstances under which discussions would arise, if you could specify a rate. But if you have a rate specified and you can't foresee, I'd rather trust to consultation.

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H.M.Jr: You'd rather what?

Stewart: I'd rather trust consultation under the tripartite, I think.

White: Except that they haven't been very - they haven't been sufficiently helpful to give us an indication of the facts upon which they are going, up to now.

Stewart: I think your B and C here ....

H.M.Jr: Well now, just to give you - excuse me - give you some more facts - Herbert Feis will have to refresh my memory. Some time, Herbert, since I've been back, September or October, I did give Mr. Hull a memorandum which I understand he did give to the British Ambassador. Did he?

Feis: Not the memorandum, but the substance of it.

H.M.Jr: Would you mind telling these gentlemen while they're here - what did we say, do you remember?

White: I ....

H.M.Jr: Have you got it?

White: I have it here.

H.M.Jr: Will you read it?

White: Shall I read it? I mean just that ...

H.M.Jr: These things come back to me, see?

White: I assume it was given as you gave it to them. This is what you gave.

H.M.Jr: Herbert Feis says the substance was given to the British Ambassador here.

White: This was September 8.

H.M.Jr: September 8.

White: September 8.

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H.M.Jr: All right now, what does it say?

White: "There is one aspect of the fall of sterling which is disturbing me and which doubtless is giving you cause for concern; namely, the effect of the fall of sterling on the trade agreement now being negotiated between the United States and the United Kingdom. On April 26, 1938, when I understand the United States made a major part of its offers to the British Government, the sterling-dollar rate was \$4.937. Today the rate is around \$4.333, a drop of over three percent. This decline has, of course, already raised the value of the concessions offered to the United Kingdom and lowered the value of the concessions offered by the United Kingdom to us.

"What disturbs me particularly is not the fall which has already taken place so much as the possibility of a further decline. The British financial press contains frequent comment to the effect that sterling even now is overvalued with respect to the dollar. Officially we have received no indication that a lower sterling rate is contemplated, nor have we yet decided what action the Treasury Department would take in the event of a further drop in sterling. However, it is clear that in view of the relatively small reductions in the duties offered us on numerous American exports to Great Britain, any further decline might completely neutralize many of the benefits we had hoped to obtain from our export concessions, as well as increase the value of the concessions granted to the British."

I think the next sentence was left off.

H.M.Jr: Yes, I think so.

Fels: That's far enough.

White: The next paragraph was left out.

H.M.Jr: From whom to whom was that?

White: This was from the Secretary of Treasury to the Secretary of State. Whether it was formal or informal, I don't know.

H.M.Jr: Informal. And the date of that?

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- White: Well, the date of that is September 8, 1938.
- Oliphant: About what was sterling at that time?
- White: That date it was 4.833.
- H.M.Jr: And that was repeated informally to the British Ambassador. So I mean - do you see? - I mean gradually we'll give you the whole story.
- Viner: Was there any reaction to that memorandum of any sort?
- Fels: No marked reaction, but recognition of the fact that it was a matter of substance. We hadn't asked for any specific pledge or response.
- H.M.Jr: Now, Riefler's having trouble with blood-pressure, and I want it relieved, so will you please go ahead, Riefler?
- Riefler: Well, it seemed to me that we were - at least coming in rather cold to it, I was being confused between what seemed to me two issues. One is the immediate issue of the sterling exchange, in which you have a great many considerations that would indicate that they might want a lower value and that there might be reasons for advocating it; and there are other reasons - the sterling bloc and that sort of thing - which indicate the opposite. And that's the type of issue we've been dealing with in the tripartite.

The second issue is the issue of a trade agreement, which is a treaty to establish a basis of doing certain kinds of dealings for a long time. Now, at the present time there are a great many reasons why a drop in sterling bothers us. It is easily conceivable to me that during the life of this trade agreement sterling may go quite low; I mean the sterling bloc may break up. They've had a bad blow to their prestige. We may have a situation like we have had with France, in which all the effort in the world couldn't hold sterling to any agreed level. And we might not want at all to disturb a trade agreement during that period, although we would want different rates.

And I think that you ought to look forward to

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protecting yourself against the kind of contingencies that would arise under varying circumstances in the future. You don't want to be embarrassed. If sterling should drop drastically because of serious disorganization in British finance, and that is possible under the circumstances they face, you would have great pressure from exporters to change your rates; you'd have pressure from domestic interests to stop British imports coming in. And you would want to have a chance to look at those in a rather detached spirit and not under the pressure of heavy political pressure from the Hill.

So that - I go back to Walter Stewart's suggestion of distinguishing these two things, the tripartite and the trade agreement. And on the trade agreement I wondered whether it wouldn't be possible to have some sort of an escalator clause that automatically - with the change of a certain amount in the sterling rate the percentage of concessions varies a certain amount. I mean that would give you a protection against pressure outside. They would know beforehand that this did bring certain penalties. And then a further provision like the one you now have, that under those circumstances negotiations could begin - would be under way to rearrange the rates. I mean have an automatic penalty with a change in the rate, and then have negotiations to either modify or accentuate that automatic penalty. It would give you time and take pressure off of you. Because this may be very embarrassing as it comes, and I think some sort of automatic change in the rates ....

J.A.Jr: You mean ....

Wiafler: ...would give you a much better mechanism with which to deal with it.

J.A.Jr: You mean automatic as far as the trade treaty goes.

Wiafler: Yes, the trade treaty would have in it that with the change of a certain amount in the rate, automatically the concessions are then changed, but that those changes are then subject to negotiation. I mean you wouldn't then be in the problem of a completely new negotiation that you would have to initiate.

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H.A.Jr: Well, may I - just one second, Jake. Can you hold your thought a second, Jake?

Viner: Sure.

H.A.Jr: I mean my thinking is clear to this extent so far - I mean I just want to take a pause a minute - and that is that, after all, our first responsibility on the external dollar is in connection with the tripartite treaty, and that affects sterling and the whole sterling area. And I think the thing that we ought to - that I want help on - is to examine that picture and see whether this fall in sterling is one which is a natural fall from trade balances or whether it is one which is being stimulated for trade advantage. And is the fall already serious enough that we should do something about it?

And then I think after we take that look at it, then this other thing, which everybody can recognize - that the way the trade treaty is now, for me to buck that after it is signed and invoke the monetary clause - it will be a very, very difficult thing, because we'll see it first before business feels it, and we'll have to be out in the forefront, in the front trenches, before they realize there is a war that's on.

And thirdly, I don't want to have us find ourselves in the position we were in in '31 and '32 - to take two years to get out of it. Now, I mean on - I mean I'd like to be smart enough to foresee this thing and not have this collar around my neck and then maybe take 12 months or two years to wiggle out of that damn thing.

And just to go back to one little thing that somebody raised, if there was anything in it - I know the President wouldn't sign any agreement or let me sign any agreement which would tie his hands as to what he would do with the dollar. But - I mean you brought that out in the beginning. So I just wanted to - I'm just thinking out loud.

But go ahead, Jake.

Viner: Well, in connection with dissociating the trade agreement from the exchange rate problem, I'd say that

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our trade agreements thinking has generally been in the past in terms of stable exchanges. When you have fluctuating exchanges, you can't separate trade negotiations from exchange rates; you've got to think of them together for expedient purposes. But - you may separate them in agreements, but you've got to do your thinking together.

And I want to point out three alternatives from the trade agreement side with respect to exchange rates when they're fluctuating.

If your tariff has specific rates and the other countries depreciate, the ad valorem equivalent of your rates rises automatically. If you <sup>have</sup> ad valorem rates, as we have, the specific equivalent falls automatically.

Now, your (Riefler) suggestion is really an exchange depreciation duty - you're tying it to a regular duty - but an exchange depreciation duty which keeps the ad valorem constant.

Now, which one of those things three do we want to attain?

Stewart: Two of those I get; what's the third one?

Viner: The third one is the equivalent to his (Riefler) suggestion of having a flexible rate; that is the equivalent of an exchange depreciation rate, which is a supplement to the other duties, and when the other exchange falls and presumably cuts the duties, we ....

White: What would that do to the most-favored-nation clause?

Viner: Well, the British had an exchange depreciation duty which was discretionary after 1919, and they never applied or were attacked in Parliament for not applying it; and they explained then that they didn't apply it because their law officers told them it would violate the most-favored-nation agreement. I think that was one of the reasons given here in '20, '21, and '22 for not applying it. Now, you have that problem there.

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You see, if you stick in a supplement of that sort - well, no, you wouldn't, because you wouldn't be applying it against a particular country; it would spread at once to all the other countries entitled to most-favored-nation treatment.

White: And moreover, if you took that position, you would raise the question as to whether or not a change in the prices of the specific commodities in the various countries might not have to be reckoned against. Consistency would demand that kind of an approach and would raise all sorts of problems for the negotiators - specific ad valorem combinations ....

Viner: I think part of the background we ought to have here is a calculation of the percentage of our exports which is to sterling area countries which follow sterling, not England; and the percentage of England's exports which is to sterling area countries; because that indicates the additional elements of movement in our trade position when sterling moves.

Riefler: Assuming it's maintained.

Viner: Assuming it's maintained, yes.

Here is one little element at the present time from the Canadian position. The Canadians back in 1929, '30, '31, and '32 followed the dollar more than they followed sterling, and the Canadian Government is now being attacked by the western provinces for having done that and being charged with it as having been a mistake, and their Royal Commission is answering that it was a mistake but you can't blame them, because they didn't have a central bank or machinery to adjust it. Now they're in the same position again of having to decide which they're going to follow, and the pressure is strong there, I know, on them to follow sterling now.

White: Well ....

Viner: Now, that's another point.

White: They went down 1.1 during the period in which U.K. went down 3.3.

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Viner: Yes, I know, they're down 2 now.

White: Well, this is October 19.

Viner: They're cutting in between, but there is great pressure on them to follow the lowest one of those two currencies and not do what they did before and slide in nearer to us than them. Now, I just say the Canadian exchange is of some importance for us.

White: Which merely accentuates the importance of doing what we can to check the sterling decline.

Viner: Or bringing to their attention, at least bringing into the picture, the fact that we are interested in the sterling rate not only for its own direct sake, but for all the rates that it drags with it.

Riefler: May I add one thing more to my suggestion? I was suggesting that something that would be very roughly equivalent to a constant *ad valorem* rate be used, but I don't think it would be possible mechanically to work one out that would adjust automatically, because you have too many problems involved. What I was suggesting was that you have in the treaty automatically a rough compensating penalty for changes in the rates, and that those go into effect automatically as of a given period: at the end of 30 days; then the negotiations take place, it seems to me, in a much more favorable atmosphere. We were saying before that really those things could only be handled by negotiations at the time. I think that's true. But the negotiations should go forward in terms of an atmosphere of trying through the negotiation to restore what was a status quo, rather than disturbing a status quo which has become favorable to one party against the other.

I mean if sterling should depreciate and we simply have a clause in there which says that on 30 days' notice we may negotiate, we're going to be negotiating in an unfavorable atmosphere, because the depreciation of sterling automatically improves their position and makes ours worse, and it means an atmosphere of pressure and difficulty, tenseness - few days, 30 days, 60 days - atmosphere of pressure and high feeling that they're gaining the competitive advantage and therefore we won't let them do it, and so forth. Now if instead

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the depreciation of sterling automatically penalizes them, throws the weight the other way, it means that automatically the concessions are roughly equivalent or even tip the scale in our favor. Then when you enter into the negotiation, I think you have a better chance of adjusting the new concessions to the actual situation.

White: I think that proposal overlooks the most important aspect we are concerned with. It may help to restore any losses or any alterations in the concessions as between the United States and England. But we must constantly bear in mind that an alteration in the sterling rate affects our trade almost the whole world over, and any neutralizing effect that you may be able to introduce by altering the duties on British trade alone, aside from the objections of the most-favored-nation treatment, would leave untouched the losses sustained by this country in their trade with all other countries.

Viner: It would touch only those commodities which have concessions on them in the trade agreement.

White: You could raise a rate already incorporated in another trade agreement.

Viner: How about that, Herbert? Aren't there rates in the British trade agreement which are already provided for at minima in other agreements?

Fels: I don't understand that, Jake.

Viner: Supposing there was some escalator provision of some sort which provides that when the English exchange goes down 5 percent, one third of our concession is taken away. Would that involve us in difficulties with other countries with which we have made concessions on the same items?

Fels: (Nods yes) We'd be involved in numberless difficulties of many varieties, practical and commercial.

Viner: So that's that.

Lochhead: If the rate went down 5 percent on steel, the Swedish rate would go down 5 percent automatically. Well, that wouldn't ...

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- Viner: Yes, supposing we have a duty on steel from which we have made a 5 - 15 percent concession to Sweden, and now we make a 15 percent - or, 20 percent concession to England; Sweden gets the 20 percent rate. Now, we cut that concession to England because of sterling depreciation to 10 percent. Can we do that? You see, we have no right to cut it to Sweden.
- Lochhead: I was going to say that.
- White: It depends. If the lower rate was a result of the British agreement, she was being merely extended most-favored-nation treatment, in which case you could take it back.
- Viner: The case I was taking was where you went beyond the Swedish agreement in the British agreement.
- Warren: All this discussion seems to me to have been resting on a premise that a declining currency is an advantage to the country whose currency is declining, a competitive advantage; and some of it has rested so heavily on that premise that it has been assumed that the country might seek a depreciated currency in order to gain that competitive - hypothetical competitive advantage. I think that we ought to at least consider the possibility that the decline in sterling should be merely a reflection of economic forces beyond control, in no way either sought as a competitive advantage or even conferring a competitive advantage, and one in which the decline might be presumed to be no more than a sort of blind effort to reach a new equilibrium. And where a talk of a penalty presumes that the party who is suffering is doing something wicked for which he should be punished, in case it is something beyond control and mere groping for a new equilibrium, then the idea of penalty, it seems to me, should be exchanged for one of recognition that that might - that may be a way of compensation.
- Oliphant: And in that event your tripartite mechanism wouldn't do you any good.
- Riefler: What?
- Oliphant: Your tripartite mechanism wouldn't do any good.

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Viner: It would be an exchange depreciation but no competitive advantage; that's his point.

Olliphant: No, no. He says, suppose there is an exchange depreciation with a competitive advantage, but the competitive advantage was not sought.

Viner: No, he says if it reflects a basic change - if the fall in sterling reflects a change in the economic situation of England, you might ...

Warren: ... say that the United Kingdom with which these negotiations were initiated was a different United Kingdom from the one with which they were being concluded, and the latter is much weaker.

White: There are some phrases there that are the key phrases and must be examined, because they give a connotation which I think alters your conclusions very, very much. When you say "groping for an equilibrium" and use the assumption that there is an equilibrium which is good for England which she is groping for, and that she may - it isn't the competitive advantage which concerns her, it's the fact that she is in a disequilibrium and is searching for equilibrium - those are phrases which I think we all agree, because I think we've all examined them at some length, look good only when you don't get below the surface.

What we mean by disequilibrium as far as England is concerned, in this situation - those who claimed that England is in disequilibrium have always said that the proof lies in her international trade and her international balance of payments, or the evidence is there - proof - and that her attempts to alter that international balance of payments situation must rest on chiefly an attempt to alter her trade balance in an effort to restore that equilibrium in the balance of payments, not this general equilibrium that you (Warren) are speaking of. And I think we're apt to find, if we examine that carefully, that that is largely - not wholly and not always, but very largely a competitive, a bargaining matter; it's a question of one country's gain as against another country's loss, speaking in the short-run, not in the long-run episode.

And England's attempt to alter her rate, in so far as

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she is attempting to alter that rate, lies in the hope that - in the expectation that that alteration of rate will alter her balance of trade; in other words, that she will export much more relative to her imports. And they will export more relative to her imports because she has a more favorable price with which to capture markets. If you want to call that groping for an equilibrium, that's all right, but I might want to call that attempting to seek an advantage in third markets - which we might want to grant for various reasons.

Williams: That needs a lot of elaboration.

White: I grant that.

Williams: It may not amount to disagreement, but may - but put a different light on it. It seems to me that back in the great depression a lot of things we thought we knew were proved to be untrue or to need modification. The depreciations of currency didn't work out in changes of trade in the way that you would think.

White: It did in many countries, John.

Williams: And not in many others. It's a very curious thing that countries that depreciated their currency and had no advantages against each other nevertheless found their trade growing - that the effect was really internal rather than external.

Viner: Yes, but, John, there was also this difference. They started out on the gold standard and reserve requirements, and part of our troubles - the English trouble was impairment of their reserves for their banking structure.

Williams: Gave them monetary release, that's true.

Viner: I think that was the recovery element rather than the exchange depreciation. But I'm not sure that that same element is in the situation now.

Williams: That's right. I mention that as an illustration only. Now perhaps today we may be faced with some internal conditions which, of course, have external reflections; they always do have. But if you think of the capital

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items rather than the trade items and of the reasons why there may be flight from the pound and the effect of that on the exchange, it might very well be that, as Warren is saying - that there is some adjustment of rates that would have a good internal effect and a good effect on capital movements, and not be aimed primarily at the trade balance.

White: That's quite true, but if the examination is made on that basis, they've got the weakest case, because capital movements per se occur either when you expect a recession in the country you are in as compared with some other, or when you expect an alteration in exchange rates, and I would say that the chief motive of much of the capital which has left England in the last couple of weeks has been the anticipation of further alteration in the exchange rates.

and therefore to say that capital is moving out because it is afraid of exchange rates changing, and therefore we ought to change exchange rates in order to stop that capital from moving - that has some point. But one might also say that maybe you'll stop that capital movement by giving some evidence to the public that they're not going to lower the rate.

Williams: I can't argue against that.

White: That's the whole difficulty which is created by the breaking through of 4.86.

Williams: I've argued for it for years. But still it does seem to me that the British might come to rest somewhat lower than here, possibly 4.50, and in the interval when there was an increasing presumption in favor of that you might even hasten the capital movement, but after you've reached a level which they felt was sustainable, then the capital movement would be lessened and would possibly even be reversed.

White: That's quite true, and might justify our acceptance of a lower rate.

Viner: That depends, too, on how their budget policy reacts to the falling exchange, or how it is tied up with budget policy. I can cite the French case, where they let the exchange drop in order to improve their

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position. That creates a stimulus to increased budgetary deficit; they create the deficit, the exchange falls again, and you have a vicious circle.

Williams: Question is, though, whether you could transfer that to England.

White: Doubtful.

Williams: I doubt that you'd have that sort of fear with regard to the budget arising in England.

Viner: I don't think we have any cause for it under conditions at all normal. If a serious armament rivalry gets on, I don't think we can forecast what may happen.

Williams: The real point I'm trying to make is that we may be making a mistake in thinking about this thing as much as we have been accustomed to do in the past in terms of competitive trade advantage, because it is very difficult to say where our advantage lies there. Suppose there is an alteration of rates in our favor and we temporarily gain certain trade advantages. But suppose that has a harmful effect on the country to which we sell; then at the end we may be selling less than before and have lost our advantage. That's the nature of our difficulty. And it might well be that we should allow England a certain amount of advantage in our own interests.

White: That's quite possible. In other words, the larger situation has to be examined, and that's what I take it we were going to do here.

But to revert to Mr. Warren's point, which I think is important because the implication is that an alteration in exchange rate may not be a serious factor or a significant factor in trade. And yet look at the lengths we go to in attempting to secure trade agreements, which after all merely alter the prices of certain commodities a little bit to the advantage of one country to another.

I say that if one could say with validity that an alteration in exchange rates within reasonable, moderate amounts of 5 or 10 or 15 percent is of no significance in the long run - then I say an alteration in tariffs and duties is, in the main, with the

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exception of certain cases, equally unimportant, and our trade agreement program looks rather unimportant.

Viner: Except this: supposing you assume there is a tariff reduction here which is simultaneous with an increase in costs there and a fall here. Then I'd say that tariff reduction leaves the situation as it was before.

White: Yes. You can get all sorts of hypothetical cases.

Viner: The same way with exchange rate depreciation. If it takes place while the price level here - sterling depreciates while the price level here is rising and there is falling, or while both are staying constant, then I'd say that's competitive advantage, but if their costs are rising or ours are falling ..... The point I'd make as to all of this is the old point that tariffs are a matter of international concern and so are exchange rates, there are many factors entering into it, and that what we ought to try to work for, at least, is that substantial shifts in exchange rates shall not occur unilaterally without consultation and without taking into account a general picture. And I'd say sterling is the pivotal rate for us and by any means we can we ought to bring consultation into the picture, so we can express ourselves at least.

White: Let's examine the basis for their hopes, because I think you might find that when they put all their cards on the table, if they do put all their cards on the table, they believe, rightly or wrongly - they believe they'll get a competitive advantage or some advantage which will alter their balance of trade, which will turn their balance of payments to a less unfavorable degree.

Now if they believe it and are acting in that way - and I think consultation might be in order - then we might point out to them that "you're mistaken." If on the other hand they're saying, "We feel we must go down to 4.50 because capital believes we're going to 4.50 and it's flowing out of the country, then we might well ask them, "Why did you ever start that business?" or we might agree with them in its being a good thing. But certainly we ought to know the basis

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for their conclusion and be able to give the other side of it, which we haven't.

Williams: Doesn't it mean that what we're trying - really trying to do is find a basis for consultation that will come into play more or less promptly and effectively, rather than to set arbitrary lines that we really can't ...

Viner: Or rather than insert any rigid formula which cannot possibly meet the variety of situations that may arise.

Warren: That's what I wanted to express; didn't make it so clear. I think nobody could defend the position that fluctuations of exchange rates are inconsequential; I think they're extremely important. But I think that the imposing of certain automatic penalties, like prescribed compensatory provisions of duties and so on, might undo the very thing that we were aiming at doing; that was securing a continuing satisfactory trade relation between the two countries over an extended period of time.

Riefler: But that was just what I thought that I was advocating with automatic adjustments. It seems to me - I mean I was advocating - I mean a shift in exchange, whatever the cause, raises the question of competitive advantage or disadvantage, because it goes against existing trade concessions, existing tariffs.

Viner: Unless prices are moving the opposite way to the exchanges, you see.

Riefler: But it's a relative one at the time - as of the time of discussion, because the prices have moved, I mean, as of the time of discussion.

Viner: But in order to maintain the status quo if the prices have moved, you may have to keep the same rates, you see?

Riefler: Exactly. That's why I say have provision for discussion - have provision for discussion, but have provision that if the discussion does not eventuate, that then there has been an automatic ....

Viner: In other words, the purpose of the automatic device is to force discussion.

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Riefler: To force it on a more realistic basis.

White: Well, that can be achieved by some part of the provision as suggested here.

Viner: Well, I'd say you can agree on discussion without having a penalty clause in it with which to enforce it. They'd keep the agreement in any case.

Riefler: But it changes something, puts a certain emphasis on it.

Oliphant: Jake, how does the tripartite mechanism protect the Secretary? I mean isn't that clause - wasn't it this sort of a background: that "you shan't use your exchange rates for the purpose of obtaining a competitive advantage"? Now, take the Secretary's embarrassment if England finds herself in this position, which is quite likely: that the two considerations dominating her policies are, first, the desire to purchase materials abroad at a cheap price - war is imminent; and second, the desire to preserve her war chest, her gold chest, for war. Now, if under those circumstances flight of capital or what not sends these rates way down, there is no protection for the Secretary in the tripartite agreement.

White: Those are contrary ....

Viner: Those are contrary; those would work in opposite directions. Supposing she wants to preserve her gold stocks for war emergency purposes and will not give it up; then if there is pressure at all on the exchanges, they will go down, you see.

Oliphant: I understand.

Viner: Now, how does that protect the Secretary? I'd say the Secretary could then say, "You're getting a competitive advantage because of a war or military objective."

Oliphant: Well, as I understand it, the tripartite agreement - it was addressed to the seeking of competitive advantage.

Viner: Yes, but ...

Oliphant: The what?

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Oliphant: The seeking.

H.M.Jr: Yes, seeking.

Viner: Yes, but Herman, if you fall back on that and interpret that strictly and try to search for it, you're going to leave out most of the phenomena that occur. What do they permit? - not merely: what do they incite or induce? Because if they let any pressure on the exchange push sterling down, then that encourages the speculative elements to operate for a decline, push it down further. In other words, I'd interpret that to mean: induce - or, permit an exchange depreciation which creates a competitive advantage; otherwise, it's meaningless. You could never prove that they've induced it, you know.

H.M.Jr: Let's stop here a minute again, and somebody - let's just summarize how far we've gone. Where are we right now? I mean what's being recommended?

White: Well, the discussion ....  
catch

H.M.Jr: Well, let's just/catch our breath a minute, see where we're at now.

White: The discussion the last half hour or so has been around two points, I take it. One is whether there is any possibility of determining at this time whether the larger interests are in favor or opposed to putting a floor so close to the present one. And the second one is, might we not receive adequate protection and might we not achieve the principal objective, which is consultation to determine just what criteria are being applied by England, through the operation of the tripartite accord?

H.M.Jr: Through the tripartite rather than through the trade?

White: Yes, because the tripartite accord indicates that each country has agreed not to seek a competitive advantage in the movements of exchange rates, and therefore I take the implication is, if you feel they are seeking a competitive advantage it would be appropriate at that time for you to ask consultation, or if you were convinced that they were so doing, you might wish to

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say they are violating the tripartite accord, and therefore nothing of that sort is necessary in the trade agreement.

H.M.Jr: Now, I'd like to ask Feis a question, if he doesn't mind. He may not be ready to answer. Purely from the State Department standpoint, see, which channel do you think that they would rather see me pursue? Using the clause - I mean let's say that sterling goes down, and - let's say sterling goes down considerably more, to a figure at which I would become disturbed and the people in this room advise me to become disturbed, see? I mean that situation. We have a meeting, let's say, in two weeks or two months from now, with the treaty already signed - call a meeting because we're all bothered. And you're sitting over there with Mr. Hull and his advisers. Which channel do you think that they would rather see me pursue: the channel through the trade treaty clause, or to use the vehicle of the tripartite? If you don't mind my asking.

Feis: No, no, I - may I talk a little bit?

H.M.Jr: You can talk. I mean you people are sitting over, you have a meeting. Which would ....

Feis: The most important question, as far as I can appraise it - first, that this whole negotiation is taking place against a background in which our chief difficulty in making of our commercial relations an effective weight in our general international relations, is our very marked excess of exports, relatively perhaps the greatest in American history, and that as a practical matter the anxieties and troubles that are upon us now are connected with that excess of exports and not with the question of insupportable loss of general position.

Second, that this negotiation with Great Britain is connected with the one with Canada - if they are effected, both are large-scale negotiations. They bring the economies of the three countries into much - would bring the economies of the three countries into much closer relationship with each other, and you simply have to anticipate from the economic standpoint that there are going to be necessary points of difficulty

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and adjustment; the thing is not going to be without dislocating influence from time to time here and there. And you must really make your decision on very general ground of mutual slowly-developing benefit for all parties concerned, through making some such trade relationships.

If that's your background, why, then your prospective problem arises in a somewhat different fashion than I think has been indicated in the discussion. It arises when as a consequence of trade, of an exchange variation, or some other cause, it turns out that the import movement of a commodity dealt with in the trade agreement becomes unexpectedly large and disturbing.

H.M.Jr: What, Herbert?

Feis: Unexpectedly large and disturbing.

H.M.Jr: What becomes ...

Feis: The import of some competitive commodity that's been dealt with in a trade agreement. That's the way the actual problem presents itself. For years we've had to try to keep the public straight on the fact that most of the branches of increased exportation were not due at all to any action we took under the Trade Agreements Act - namely, to drought, etc. - but cases arise ....

Viner: You mean increased importation.

Feis: That's right - imports.

If, having signed this British agreement, an exchange variation takes place and you begin to get - and where we fear it, frankly, most is in the textile schedules - you begin to get an unanticipated movement of competition, much more thoroughly disturbing than had been anticipated, then we're up against something that we can't avoid, no matter what clauses in the treaty or clauses not in the treaty. The industry begins to come at us, the representatives down at Congress begin to come at us, prospective legislation is formulated to do something about it, and we've got to take our hat in our hand and go around to the other country and

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say, "See here, we're in a hole, we've got to try to work out some way of dealing with this situation."

The number of such instances have been remarkably few. They will be more likely to arise under the British agreement than any other, if there were this substantial exchange variation. But I do think that the general clause that we've got in there is quite sufficient to enable us to act in the face of such actual situations as will present themselves from the import side. And therefore my own predisposition is to say, let it be at that, that will give you the instrument you need to protect yourselves against too serious unanticipated competition. And I'd leave that problem to be handled through the trade agreement and by such a general formula.

Now, turning from what is therefore the State Department problem to what is more completely the Treasury problem, the decline in sterling would have effects of another type, affecting perhaps our competitive relationships in third markets and in the rest. I don't see that you can deal with that effectively under any trade agreement formula anyway; that you'd have to deal with under your tripartite formula on broader ground.

So, to summarize, I am led to the conclusion that you're going to find it difficult to do anything practical that is much of an improvement over that general formula; that, on the other hand, you must foresee the possibility that a type of situation might arise that you can't deal with satisfactorily either under that formula or any alternative trade agreement formula, and you would be thrown back on to the tripartite agreement. And that's about the way it looks to me.

White: I'd like to make some possible factual corrections, if I may, that I think are significant. First place, we have had larger excesses of exports. In 1920 alone it was a billion - always ran eight, nine hundred billion, so on - but it's high.

Feis: Wait a minute. If you're going to correct the facts, correct the facts I give and not the facts you think I give. I said higher proportionate excess of ....

White: Proportionate to what?

Feis: To imports.

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- White: Oh. But the more significant fact I think you'd have to take in consideration is the fact that in the first quarter of 1938 our excess of exports was 320 million; second quarter was 310; the third quarter, 214. In other words, our excess export is showing a decidedly downward trend.
- Viner: Not only that, ....
- Feis: How long do you think you can keep that up?
- Viner: It will keep up, because the favorable balance last year was largely due to the fact that we were leaders in a depression and therefore cut down drastically on imports of raw materials, and as and if business recovers, we'll increase our imports of raw materials.
- Feis: Precisely the point I was trying to make was that that was the existing background, which, unless saved by an increase in imports, would inevitably bring around a decline in our exports.
- Viner: That's right.
- Williams: It seems to me we ought not to try to prevent that kind of change in trade. It's partly cyclical, and it's got to happen. We'd be in a most unreasonable position in this country if we were insisting on always having a very large surplus of exports.
- White: John, that coming from you - I'm a little bit surprised. After all, why look at the excess exports? Don't we have a continual excess of imports on our tourist expenditures that amount to eight or nine hundred million? Isn't it, after all, the movement rather than particular levels?
- Williams: Exactly. But what I am referring to is cyclical variations within movements. They've got to be permitted to happen.
- White: The significant thing is, why is it down? It's down in part because our exports are declining. Therefore, it is a little more important to us than it would be if it were due to an increase in imports, which would reflect recovery here. It may well be that recovery would continue here, but I think we always have to recognize

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that it may become more difficult if the sterling rate drops to a point which gives them a competitive advantage, which needs to be examined.

Williams: Let me put my thought this way. Suppose we got now an increase in imports because we are in the recovery phase of the cycle; supposing we get some of those imports from England. Doesn't that serve to sustain our trade later, and is there any other way to do it, essentially?

White: That's right.

Viner: I think Feis's point was that for the time being, at least, England has the problem of a big import surplus which is pulling them down. My point is that within another year the picture may be substantially different.

Williams: It seems to me the point essentially is whether we want to do anything to attempt to protect that export surplus. Eventually oughtn't we to recognize that it is unusual and perhaps unreasonable in our favor, that it has got to be modified? Isn't that an element of our problem?

White: Depends entirely on how the surplus is arrived at, John. Your preliminary assumption that your imports were increasing by virtue of continuing recovery here - why, yes, I think that's an excellent thing, particularly since the repercussions are desirable all around. If, on the other hand, the export surplus is declining by virtue of a sustained downward trend in our exports, then the conclusions we might come to might be a little different. We might be willing to see that continue, but I don't know whether we would be willing to see that accentuated by changes in the exchange rate. That is, we might be willing to let sterling remain around 4.76 and say, "let's see what happens in the next few months; we're going down in our exports, but we're willing to take that rap, we can afford it." But should we introduce a new element in the situation at this particular juncture by letting sterling go down to 4.50 in the expectation that that will measurably stimulate the flow of trade? Accentuation in that trend might have domestic repercussions which a sensitive plan such as our present recovery might not stand easily. Those are the problems.

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H.M.Jr: Herbert, how do you suppose the State Department would feel if I - I'm just throwing this out, the suggestion - that I should invite a representative of the British Treasury to come over at once to discuss with them the trend of the sterling-dollar rate?

Feis: Without making any reference to the trade agreement negotiations?

H.M.Jr: I'll put it this way: discuss the tripartite agreement with them, not discuss the treaty at all. "This trend has been going on; I'm bothered about it. I want somebody to talk to about it."

Feis: I think we'd have no views about it whatsoever. Just a continuation ...

H.M.Jr: I mean I am bothered, this thing is going on this way, and I'd like somebody to come over and talk to me about it.

Waite: Before the treaty is signed or after?

H.M.Jr: What I'm talking about is now.

Waite: In other words, before the treaty is signed.

H.M.Jr: I'm not thinking of the treaty. I'm thinking of my responsibility under the tripartite.

Feis: We'd regard it as a most natural action.

H.M.Jr: Most natural action. And if I don't do it, they'll wonder why I don't do it, huh?

Feis: That I can't answer. If you do do it, it will seem a most natural action.

H.M.Jr: Most natural action.

Well, here - I mean to again give you just a little side remark which I think is rather interesting. We fought tooth and nail when we were creating the tripartite to have a clause that sterling - we should keep sterling within ten points up or down of 4.90. The British refused - just throwing out a little history -

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and they said they wouldn't tie themselves to anything. So when they came along with this thing, it interested me very much. But we fought tooth and nail to have - to try to have a ten point - have 4.90 the mean.

Stewart: Does it follow from that, Mr. Secretary, that it would be difficult to get modifications in the tripartite agreement at the time which would automatically bring discussion in in the event that the range of variation, quite apart from any seeking, should become wide? Would it be difficult to get that kind of modification?

Viner: Consultations are supposed to take place whenever any party wishes them, you know.

H. M. Jr: Now, when the European war - it was a matter of hours whether they would or wouldn't - I didn't want to bring it up, because during that period they did everything they could in the way of - I mean they had even - Bank of England even work on Saturdays to pack gold. You know what that means.

Did they work on Sundays?

Lochhead: No, no.

H. M. Jr: But they worked on Saturdays. I mean they did everything that anybody could do during that whole thing to keep the thing open and keep them moving. I mean they slipped gold on their boats without insurance and the Treasury attitude was, "Well, we'll answer who will stand the loss afterwards." But I mean they did everything possible while that crisis was on to keep channels open so that people could buy dollars. So for me to bring it up at that point would both have been ungenerous and would have been unreasonable, because they did everything. Now that's over. And certainly I didn't foresee as a reaction to this thing, and particularly to what I call Hitler's "governess" speech, the tremendous sinking feeling which would take place as a result of that. Now that thing has happened. Now I don't think it would be unprecipitous for me to invite them over to discuss the situation as it is. And I'm just throwing that into the ring, see?

Stewart: What has been the experience with consultation?

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H.M.Jr: Pardon me?

Stewart: Has there been consultation apart from the sort of thing that happens over the telephone?

H.M.Jr: In the tripartite agreement?

Stewart: I mean under the tripartite agreement, over a period of time, has there been consultation of the kind that you are anticipating the possibility of having now?

Viner: In connection with France it's been large.

H.M.Jr: Well, in connection with France, yes. The occasion hasn't arisen in connection with sterling, see? But in connection with France, yes. And then when we had the French - the quarterly French crisis, why, we would consult with England, yes.

But here's a movement which, if you look at it on the monthly basis and not on a daily basis, is down, down, down; and I would have every reason to say I'm worried. The British press keeps wondering why I'm not worried. We've had an analysis made of the press since June - all references of the British press to this thing, and I don't think that they could say - well, that this is a bolt from the heavens, unexpected, you see? I mean I think Herbert Feis's reaction - it would be the way he says, would be a very natural thing.

I mean I'm just - what you people do for me is to give me a chance to think with you, and I'm just throwing that out, and - but I think - I mean entirely aside from the trade treaty - I mean our responsibilities under - not only with England. But certainly they must feel embittered that during their troubles people like Sweden couldn't get out of London fast enough. I mean there's no sense of loyalty or anything else; Sweden couldn't get the gold out fast enough.

And then for a while it looked as - there was talk of Holland tying to the dollar; but as far as we are concerned the only thing that happened during that whole period was France asked us one day whether we'd cooperate with them in asking our banks not to deal in francs except on strictly commercial transactions. Then we sent back word in an hour that we would; they were delighted. That was the only thing ever asked

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us during that whole period - plus, I mean, the cooperation that we got to get the gold out of England after we bought it; and they broke all kinds of laws to cooperate with us. I mean they - I don't know how many laws they broke in order to cooperate with us to get the gold out.

So I mean I'm just thinking kind of - I don't know whether possibly that mightn't be a move. Of course, there's the question, when they come over here, what you going to say to them? "I'm worried."

White: I think we might well ask them what they propose to do and what's the criterion upon which they base their actions, and let's examine them mutually; might be a little more extended analysis of the various proposals. But I think that's exactly what the tripartite accord plans for.

Viner: What would you do if they denied in the light of previous statements - denied they were doing anything except just straightening out sharp fluctuations?

White: They couldn't sustain it. The discussions between technical men would show that's baloney.

Viner: I think that their capacity for sticking to that position is greater than you judge.

White: They could keep repeating it.

Viner: What would you do?

White: That would be a question to be decided. If the discussions were unsatisfactory, if in other words they stuck to a point which we felt - which the Secretary felt was not sustained by any competent analysis, then he would be confronted with the choice as to whether or not he wanted to regard their action as being - as seeking competitive advantage; what he would do then depends on the circumstances.

H.M.Jr: Well now, let me say this. You people have been so refined; I think you've been a little bit hampered in these conversations by my presence. Some of you always are, but others need to get a little more vociferous. I think they've been cramped this morning.

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I don't know what your plans are, but if you could go - take off your coats and go at each other the way I know you like to, then come back at three o'clock and see me again.

White: Is there disagreement, Mr. Secretary? I thought most of the people here expressed the opinion that consultation was in order.

H.M.Jr: Well, I don't know the way - I felt this way: I have certain little things I have to do as far as I'm concerned on the external picture, strictly Treasury, not thinking of the trade treaty at all; and that it's a problem and I don't know whether - I don't think these people have cleared their own thinking yet. I mean I don't think it's jelled, has it? I think if they had from now to three o'clock to exchange views - Mr. Burgess has been very quiet; I suppose he's embarrassed sitting down with so many economists.

Burgess: Not the slightest.

H.M.Jr: His silence, his dignity ....

Burgess: I'm trying to think, Henry. It's always a strain.

H.M.Jr: Well, anyway, you've been very silent. So I mean if you could - I have nothing from three o'clock on for the rest of the afternoon; I would like to talk a little bit about South America.

Burgess: I think we have a lot of very difficult questions and we can very well think about them before we give you a judgment on them.

Feis: We've got a South American meeting on over there at three.

Taylor: I've got that Peruvian coming in at three.

H.M.Jr: All you've got to do is say "Hello." Couldn't you get him in a little earlier?

Taylor: I could try. I've already said, "How do you do" to him; he wants to talk business.

H.M.Jr: Well, see what you can do.

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- Feis: The trouble is that not only - I mean I'll be at the three o'clock meeting, but everyone else that you'd like to have over at the Department will be at the same meeting, because it's on South American affairs.
- H.M.Jr: Financial?
- Feis: The whole Lima Conference.
- Burgess: Make it two.
- H.M.Jr: I can't do it at two. Well, we'll go along - I'd like to see what these people have to think about South America, and we're not going to sell out South America this afternoon.
- Feis: It may be that that will be shifted over there.
- H.M.Jr: And anything - if I'm correct, there is no finance on the agenda, is there? Usually isn't.
- Feis: Well, there will be proposals; there always are. But nothing ....
- H.M.Jr: Well, see what you can do.
- Feis: Nothing serious.
- H.M.Jr: See what you can do. And have you people got a little more time this afternoon?
- Feis: Mr. Secretary, may I raise this? If - I see nothing on the possible agenda even worth troubling anybody with, they're such impracticable suggestions, except one which we were going to bring over to the Treasury, and it's a possible proposal for periodical meetings of representatives of Treasuries or central banks among the American republics.
- H.M.Jr: Well, you gentlemen ....
- Feis: Don't know whether you want to give any thought to it or not. Of course, it's clear that if we go in for such periodic meetings that whoever you send there is going to have to deal with a new group of loan proposals at every meeting.
- H.M.Jr: I think before we decide that we should decide whether the United States Government is going to make loans. Then, if it is, the meetings will be pleasant. I'll see you all at three.

October 21, 1938

Secretary Morgenthau

Mr. White

Subject: The Dollar-Sterling Situation

(Summary)

1. What currencies followed sterling down?

Appended is a table indicating the percentage change in rates of exchange from August 1, 1938 to October 17, 1938.

It will be noted that most of the currencies have depreciated during that period at least as much as or more than has sterling. The important exceptions are Belgium, the Netherlands, Canada and Switzerland. Of these only Belgium did not decline at all. The special German marks show particularly sharp declines.

In evaluating the effects of the depreciation of sterling it is therefore essential to bear in mind that most currencies drop with sterling and a decline in sterling really involves the appreciation of the dollar in terms of most currencies. This makes a decline in sterling more important for the United States and less important to England.

2. Does the total economic situation justify a lower sterling rate with reference to the dollar than \$4.86?

The following reasons might be advanced as justification for a lower sterling rate:

(a) England has been experiencing an adverse balance of payments exclusive of capital movements of substantial proportions while we on the other hand have been gaining a large amount of gold exclusive of capital movements.

(b) British exports are dropping while her rearmament program calls for sustained imports.

## Secretary Morgenthau - 2

(c) England no longer has a balanced budget and her re-  
armament program combined with the possibility of a deep-  
ening recession will still further unbalance her budget.

(d) England cannot afford to lose much gold through an  
adverse balance of payments on non-capital account because  
she is the resting place for a large amount of short-term  
capital. She therefore needs to conserve her gold supply  
to make her less vulnerable in the event of a flight from  
sterling.

(e) England must reserve its gold stock as part of her  
national defense program.

(f) In her efforts to prevent sterling from weakening  
England has already given up, she claims, large sums of  
gold.

(g) Since the recession in England is concentrated largely  
in her export industries any improvement in her interna-  
tional competitive position is an important means of check-  
ing the recession.

(h) England is now faced with more powerful competition  
from one of her chief competitors -- Germany. Britain  
thus must take strong and, if necessary, unusual measures  
to protect and even increase her share of the world's ex-  
port trade.

3. Some information pertinent to the above claims.

(a) Great Britain's unfavorable balance of payments on non-  
capital items is large and has been increasing during the  
past three years. Our estimate for the first six months  
runs around \$50 million and probably somewhat less than  
that for the second half. For the year as a whole her "un-  
favorable" balance may be as much as one-half billion dollars.

In contrast, our "favorable" balance on non-capital  
items is about \$1 billion a year. This balance is due  
chiefly to a low level of imports accompanying our recession,  
and a relatively high level of exports sustained in part by  
the foreign armaments consumption and by the return to an  
export surplus in agricultural products.

(b) United Kingdom exports in the third quarter are 17 per-  
cent less than the comparable period of the previous year.  
Last quarter the decline was only 14 percent from the pre-  
vious year, and the first quarter of the year 2 percent.

Secretary Morgenthau - 3

Our exports, however, show an even greater decline. The first quarter showed a 16 percent increase compared with 1937, whereas the second quarter showed a 7 percent drop, and in the third quarter there has been an 18 percent drop (compared with previous year).

(c) The United States deficit for this fiscal year will be in the neighborhood of \$4 billion. The estimated deficit for Great Britain is the amount of the National Defense Loan raised during this fiscal year -- less than one-half billion dollars.

No matter what basis of comparison is employed, it seems likely at the moment that our expenditures on armaments during the next couple of years will be greater than those of Great Britain.

(d) We do not know how much gold the British Equalization Fund has lost in the last few months. We estimate that the Fund probably lost no more than \$300 million and possibly much less. It must be remembered that a substantial portion of the outflow of gold from London consisted of gold belonging to other countries and newly-mined gold. England has about \$2,600,000,000 in the Bank of England and at least another billion in the Equalization Account.

We have no figures indicating the amount of foreign short-term capital left in England but certainly the "hottest" portion of that capital must have left London during the past few months.

(e) There can be no doubt England must conserve part of her gold stock for a national defense program. The question is - how much is a reasonable amount? As a practical question the limiting factor will not be the amount of gold she needs for war purposes but something in excess of that.

4. What can we do about it?

Possible moves which we may take, listed in order of severity:

(a) We can request the British to consult with us on any further proposed variation in the sterling rate, in accordance with the terms and spirit of the Tripartite Accord.

(b) If the British fail to agree to the consultations, or if the outcome is unsatisfactory we can announce the termination of the Tripartite Accord.

Secretary Morgenthau - 4

(c) Use the proposed United States-United Kingdom trade agreement as a lever to prevent further substantial depreciation of sterling by insisting that a general provision be included which would terminate the agreement if the sterling rate declined by more than a stated percentage (possibly 5 percent) from the rate pertaining on April 22, 1938, the date on which active negotiations began.

(d) We can raise the dollar buying and selling price of gold.

(e) Use of the Stabilization Fund to prevent sterling depreciation and, if necessary to carry out this program, ask Congress for an increase in the size of the Stabilization Fund.

5. Should we do anything about it?

(a) To what extent will our export trade be affected? Estimates prepared by the Commercial Attache in London indicate that a decline in sterling of \$4.40 would result in a loss in our exports to the United Kingdom and other sterling countries (which is only a part of the loss to our exports) as being \$150 million per year based on 1936 trade figures, and \$100 million if sterling drops to \$4.60. This estimate to be complete should be increased by the loss in trade resulting from depreciation of non-sterling currencies, and the loss in trade in non-sterling markets. Only 40 percent of our exports go to sterling countries.

(b) Our domestic markets will be subject to intensified competition from imports.

(c) Consequences upon domestic business conditions of adjustments in the export and import trade volume and character.

## Foreign Exchange Rates

Country	Unit	Rate - United States cents per unit		Percent change
		August 1, 1938	October 19, 1938	
Bolivia	Boliviano	5.00	3.90	- 20.0
Brazil	Reis	5.7500	5.2000	- 11.3
Canada	Dollar	22.87	21.38	- 6.5
Chile	Escudo	42.90	40.90	- 4.7
Uruguay (Free)	Peso	64.7016	62.4975	- 3.4
Uruguay (Official)	Peso			
Hong Kong	Dollar	30.7187	29.4687	- 4.1
Argentina (Free)	Peso	26.10	25.10	- 3.8
Argentina (Official)	Peso	32.7670	31.6005	- 3.5
France	Franc	2.7508	2.6991	- 3.6
French Settlements	Dollar	57.3625	55.3290	- 3.6
British India	Rupie	36.7362	35.4936	- 3.4
China (Shanghai)	Tuan	16.3281	15.7687	- 3.4
Cuba	Escro	7.25	7.00	- 3.4
Denmark	Krona	2.1681	2.0935	- 3.4
Ecuador	Dracon	.9010	.8707	- 3.4
Finland	Mark	394.7687	381.9850	- 3.2
Sweden	Krona	25.9403	24.4762	- 3.4
Australia	Pound	391.6000	378.9466	- 3.3
Denmark	Krona	21.9389	21.2071	- 3.3
Japan	Yen	28.6485	27.6993	- 3.3
Norway	Krona	24.6962	23.8725	- 3.3
Union of South Africa	Pound	486.6666	470.4875	- 3.3
United Kingdom	Pound	491.9000	475.2013	- 3.3
Yugoslavia	Dinar	2.3175	2.2800	- 1.6
Canada	Dollar	99.6895	98.5985	- 1.1
Switzerland	Franc	22.9069	22.6894	- .9
Netherlands	Guilder	54.8533	54.4194	- .8
Czechoslovakia	Koruna	3.4908	3.4372	- .8
Germany 1/	Free mark	40.1718	40.0494	- .3
Germany	Imigrant mark	4.13	4.93	+ 19.4
Germany	Securities mark	4.13	4.93	+ 19.4
Germany	Registered mark	18.45	17.63	- 4.4
Germany	Support mark	19.18	18.48	- 3.6
Germany	Reserve mark	19.18	18.48	- 3.6
Germany	Travel mark	21.49	20.89	- 2.8

**Foreign Exchange Rates**  
(Continued - 2)

Country	Unit	Rate - United States cents per unit		Percent change
		August 1, 1938	October 19, 1938	
Germany	Credit mark	5.00	4.97	- .6
India	Milreis	5.8940	5.840	- .2
Bulgaria	Lev	1.2390	1.2325	- .2
France	Franc	19.8333	19.7900	- .2
Holland	Guilder	18.8300	18.775	- .2
Hungary	Forint	19.6690	19.6300	- .1
Italy	Lira	5.2606	5.2603	- .005
Romania (Free)	Franc	49.00	49.00	-
Romania (Official)	Franc	56.18	57.15	+ 1.7
Switzerland	Quintal	100.00	100.00	-
Venezuela	Bolivar	31.90	31.90	-
Yugoslavia (Export)	Franc	4.0000	4.0000	-
Yugoslavia (Official)	Franc	5.1716	5.1766	+ .1
Belgium	Belga	16.9085	16.9052	+ .02
Spain	Leu	.7292	.7300	+ .1

German rates - free mark from Federal Reserve Board. Blocked mark rates from The Financial Times, London, for August 3 and October 7, 1938, converted from marks per pound.

REH:ab  
10/21/38

October 21, 1938

Coming down with Hanes to the Treasury this morning, I told him to change the memorandum that they were preparing in connection with the five-year contract to buy tung oil from China, which involves some \$42,000,000. I said, 'Make it for three years because if the amount in dollars is smaller, or roughly about \$20,000,000, it would be more palatable to the President and what I wanted to do was to establish the principle.' Hanes said, 'That is fine, because if we get this thing through, the Chinese suggested that we give them a similar contract on bristles, an item which is most important to American business.'

# TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

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DATE OCT 21 1938

TO Secretary Morgenthau  
FROM Mr. Taylor

A conference was held in my office at 2:30 this afternoon to discuss the set-up for refinancing the Series K notes of the Reconstruction Finance Corporation. The conference was attended by Messrs. Bell, Broughton, Kilby, Foley, Tietjens and myself.

It was pointed out that the usual exchange transaction which we have been accustomed to use in our own financing under the Second Liberty Loan Act could not be employed in this case because the Reconstruction Finance Corporation Act confers no authority on the Corporation to exchange its notes. To meet the problem raised by this lack of authority, the suggestion was made that the transaction be handled by inviting subscriptions at par for the new notes and at the same time offering to purchase on November 1, 1938, at par and accrued interest, the outstanding Series K notes of the Corporation which mature on December 15, 1938, to the extent to which the holders thereof subscribed to the issue of Series P notes. The amount of the offering of Series P notes under this plan would be limited to the amount of Series K notes tendered for purchase. This transaction would in legal effect be a purchase and sale transaction but the net result would be to effect an exchange of the new notes for the old in a manner which would be in compliance with the Reconstruction Finance Corporation Act.

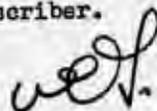
-2-

The fear was expressed that the changes which this transaction would necessitate in the set-up would be harmful to the market. To meet this fear the suggestion was made that a short wire be sent to the Federal Reserve Banks informing them in advance of the changed set-up and the reasons for it.

The proposed changes in the set-up and the explanatory wire were checked with Mr. Allen Sproul of the New York Federal Reserve Bank and he gave it his approval.

It was then decided by the conference that the transaction would be handled in the following manner:

- (1) The secretary of the Treasury would invite subscriptions for the Series P notes of the Reconstruction Finance Corporation.
- (2) The Secretary of the Treasury would offer to purchase on November 1, 1938 the Series K notes of the Corporation to the extent to which the holders thereof subscribed to the Series P notes, the amount of the offering of the Series P notes to be limited to the amount of Series K notes tendered for purchase.
- (3) Payment would be made for the Series K notes tendered for purchase at par, the principal proceeds being applied in payment of Series P notes and the balance, which is accrued interest from June 15, 1938 to November 1, 1938, to be paid to the subscriber.



MA 39

**TREASURY DEPARTMENT**

INTER OFFICE COMMUNICATION

DATE October 21, 1938

TO Secretary Morgenthau  
FROM Mr. Taylor

Colonel Fuchs, the special envoy sent to this country by the President of Peru, called this afternoon and discussed the subject of his mission with Mr. Lochhead and myself. He reviewed his understanding of major developments in the silver market and the silver policy of the United States from 1932 to date. He then stated that his government wished to make an arrangement similar to the one made with China and Mexico for the sale of what amounted to the total annual silver production of Peru. It was apparent that about this point the President of Peru had been misinformed, as to both the nature and the extent of the Mexican and Chinese arrangements, and also did not know of the Canadian agreement. We clarified this point for him and obtained considerable general information about the ownership of silver mines in Peru, which are approximately as follows: sixty-two per cent of the production is owned by Cerro de Pasco; eighteen per cent, of which seven per cent is contracted for by Cerro de Pasco, is owned by Peru nationals, and the remaining twenty per cent is owned by other foreign interests, including the American Mining and Metals Company, a French group and an English group.

We informed Colonel Fuchs that this country was not particularly interested in purchasing silver as such, but that it desired to develop closer monetary cooperation with countries of this hemisphere, and in the case of Peru, which happened to be also a leading silver-producing country, there were additional reasons why conversations leading to cooperation

- 2 -

building up Peru's reserves of silver and other exchange resources could be productive; that we would welcome the opportunity of discussions along broad lines, and that it was the desire of all branches of this Government to further friendly trade relations. We emphasized our feeling that it was preferable to treat monetary matters as being separate from trade agreements proper, and in general delivered the type of speech that we have given to the Cubans, Brazilians, etcetera.

I suggested that he transmit to his President his impressions of the preliminary conversation and also any further information which the President might need about our silver purchase agreements, etcetera, which might give the President the necessary background.

In general, it was a pretty satisfactory preliminary discussion and Colonel Fuchs, who is former Minister of Finance, as well as the leading mining engineer of his country, understood pretty thoroughly what we were talking about. He also appeared enthusiastic about the possibility of doing something for silver, as he confessed that he is a bi-metalist.

We backed away from any questions directed to what we would expect his country to do, the amounts of silver which we might purchase under proper conditions, etcetera. This situation is a particularly touchy one, as most of the silver production is controlled by foreigners and especially by Cerro de Pasco, but I believe that there are possibilities of cooperation which should be fully explored.

W.S.

## TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE October 21, 1938

TO Secretary Morgenthau  
FROM Mr. Taylor

Hamilton of the State Department called me before lunch and stated that he had taken up the two Chinese questions with the Secretary of State, and that on the question of the State Department's recommendation regarding the silver located at Tientsin, the Secretary preferred to handle the matter orally as hitherto. Hamilton stated that the State Department's position was that any move by this Government to acquire property rights in the silver in question under the circumstances surrounding this particular lot of silver would be inadvisable; that subject to our agreement they wish to send a message to our Consul-General instructing him to communicate orally and informally with the British Consul-General to the effect that they were informed that the silver in question was not specifically included in any arrangement between the United States Treasury and the Chinese Treasury.

The State Department is attempting to get information on the question of any possible understanding which the Japanese and British may have on the subject of the railroads and other British property. They are making inquiries in London as well as in the Far East on this and will report as soon as possible.



FEDERAL RESERVE BANK  
OF NEW YORK

October 21, 1938.

Dear Mr. Secretary:

If any further demonstration were necessary, the performance of the new issues market, during the past week, would seem to prove that there is a strong demand for high grade bonds. Two utility company first mortgage bond issues totaling \$135,000,000, both rated Aa and both for refunding, were oversubscribed on the day of offering and bid up to premiums of a point or slightly more. \$80,000,000 of 3 1/2s of 1968 of the Public Service Company of Northern Illinois were priced to yield about 3.34 per cent, and \$55,000,000 of Ohio Power Company 3 1/4s of 1968 were priced to yield about 3.17 per cent.

Next week, the scheduled offerings of \$50,000,000 Firestone debentures and \$55,000,000 Wisconsin Electric Power Company bonds, will add another \$105,000,000 to the month's total of new issues. Following that there are at least two weeks in which no large public issues are to be expected (with the possible exception of the \$25,000,000 issue of Argentine 4 1/2s of 1948, originally intended for the market in August, and which has been "kept alive" in registration since that time), as none has been placed in registration since the two issues just mentioned were registered on October 5.

On the basis of present figures, therefore, corporate financing in October will come to about \$270,000,000 unless additional private sales are announced between now and the end of the month. Of this total, the only sizable amounts of new capital are \$24,000,000 for general corporate purposes of the Union Carbide and Carbon Corporation, announced last week but actually sold some time ago, and \$37,000,000 to repay bank loans of the Firestone Tire and Rubber Company, the proceeds of which have already been used for expansion of plant and working capital. The total of refunding issues, however, will be the largest since December 1936. It is true, of course, that offerings have been concentrated in this month, the totals for last month (when war fears helped to restrict the market) and in prospect for November being much lower than the October total.

Both the corporate and municipal bond markets remain eager for additional high grade offerings.

Yours faithfully,

  
Allen Sproul,  
First Vice President.

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

REB

PLAIN

London

Dated October 21, 1938

Rec'd 4:48 p. m.

Secretary of State,  
Washington.

1231, October 21, 6 p. m.

FOR TREASURY FROM BUTTERWORTH.

One. The market opened with the dollar bid at 4.74-7/8. The British authorities offered dollars at 4.75 and subsequently sales of dollars by those wanting to buy gold took the rate to 4.75-1/2 just before fixing. 225 bars were sold at 146S 2-1/2D mostly supplied by the British fund. The rate was steady this afternoon at around 4.75, with some profit-taking sales of dollars by Swedish institutions. When New York came in a seller of dollars and the rate went to 4.76-3/8 where it now stands. The market was narrow throughout the day.

The franc remained steady at 178-3/4 and relatively idle.

Two. It is reported in the British Financial press that the foreign transactions advisory committee has been asked to sanction a deal whereby a further £6,000,000 of stock in the English Woolworth Company will be acquired by

British

HEB

2-#1231, From London, Oct. 21, 6p.m.

British from American interests and consequently the sum passed across the exchanges.

Three. Only about £19 million of the crisis £27 million note efflux has returned to the Bank of England, this week's return showing the second decrease in the note circulation of about £10 million. Government securities in the banking department were reduced by about £9.5 million and now stand at £104.9 million. Public deposits which increased from £12 million on October 5th to £28 million on October 12th were up again this week to £33.8 million, reflecting in part the exchange equalization account's operations. The effects of the heavy reduction in short term balances in London resulting from the exodus of capital to New York continue and are reflected in reduced bankers' deposits which now stand at the low figure of £91 million as compared with £113 million in July and £100 million before the onset of the acute stage of the European crisis. The capital efflux has also curtailed the volume of outside money available for loans to the discount market, and credit has been tight for the past two weeks. The Bank of England has been, especially since Monday, making heavy purchases

REB

3-#1231, From London, Oct. 21, 6p.m.

purchases of Treasury bills in the market and rates have slightly eased. Today's Treasury bill rate of 13S 9D per cent compared with 15S 5D last week, though well below the 25S 8D rate of the crisis week, is still above the pre-crisis rate of just over 10S per cent around which level it has stood for the most part since early 1935.

KENNEDY

EMB

RE STERLING EXCHANGE RATE AND  
GOVERNMENTAL LOANS TO SOUTH AMERICA

October 21, 1938.  
3:00 p.m.

- Present:
- Mr. White
  - Mr. Burgess
  - Mr. Stewart
  - Mr. Warren
  - Mr. Goldenweiser
  - Mr. Gardner
  - Mr. Aiefler
  - Mr. Viner
  - Mr. Williams
  - Mr. Oliphant

H.M.Jr: Well, gentlemen, I suppose you've got everything solved, sterling is up ten cents, the world looks rosy? Who's going to report?

Stewart: I think Mr. White.

H.M.Jr: White, you sum it up.

White: I'm not sure that I have the report, but I'll give what my impression is of the story; others will check up.

It was generally agreed that no such floor or ceiling as was suggested or might be contemplated should be included in the British trade agreement as such. That's in answer to one of the questions.

Two ....

H.M.Jr: Am I going to be given the reasons? Give me the reasons why.

White: I'll let those who felt strongly about it give them, if you don't mind.

H.M.Jr: I'd like to take one thing at a time. Let's put Burgess on the spot.

Burgess: Well, I think we all felt that it was extremely difficult to set any limits within that agreement that wouldn't lead to difficulty. One point is that any limit put in tends to operate as a maximum rather than a minimum. You put in 4.50 and you give a free ride down to 4.50. Another thing is that it confuses administration to put in monetary limitations within this arrangement, because it mixes up the State Department and other elements of the administration, and tends

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to make less effective the direct operation between the Treasury and the other Treasuries.

Our feeling was that the same result might be better achieved by trying to implement the tripartite a little further by seeking to get better consultative arrangements.

H.M.Jr: Say that again.

Burgess: Well, I think probably I would clarify that best by making the second part of that proposal, which really ties into this.

H.M.Jr: Well, go ahead.

Burgess: Our thought was that in answer to your second or third question, as to whether there should now be consultation, that there was a desirable need for consultation at the present time, and that one might utilize this opportunity by sending a message by Butterworth, say, to the British Treasury that our considerations of this clause in the trade agreement have led us to raise the question whether there shouldn't be in the tripartite agreement a better mechanism for consultation, and say that we'll prepare a memorandum ....

H.M.Jr: Pardon?

Burgess: Say that we're working on that plan and hope to prepare a memorandum and wish they'd be thinking about it. It seemed to us that raising that question right now, before this is signed, might give it more weight and might perhaps lead at least to some better consultation under the tripartite.

H.M.Jr: Now let me just get this thing. Who differs - I mean leaving out the Treasury people for the moment, who takes an opposite view from this expressed by Dr. Burgess?

Stewart: Mr. Riefler has about the most specific suggestion as an alternative.

H.M.Jr: I mean who thinks that this/<sup>is</sup>not the move? Riefler?

Riefler: Well, I became convinced in the end that it was much too late in this trade negotiation business with England to

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raise the sort of question I was raising; that it would mix up more things than it solved.

I do feel very strongly that just saying "We'll consult when situations arise," isn't enough; that when we come to these times we'd like to consult, the onus is against a little against the passive party, or the party likely to be injured by a change in exchanges. And it seems to me we ought to seriously attack the problem of insuring that consultation does take place and does take place on an equal basis between the two parties. And I'd like to see this group work on that problem and meet on it again and see what we can do about it. I mean I - I was convinced in the end by the discussion that I was raising the thing a little too late.

H.M.Jr: Late in the discussion, or late in the agreement or trade negotiations?

Riefler: Yes, it isn't thought through and it would take time to work it out.

H.M.Jr: Well, I don't quite see where you differ from what Burgess says.

White: I think, Mr. Secretary, it might be a little better, before you attempt to get the reaction on that point, if you heard what the positive recommendation was, which I think would take care of some of the things which you have in mind and some of the things that Riefler has in mind.

The thought was that if consultations could be initiated with a view to establishing a range of variations within the exchange rates that would call for automatic consultation in the tripartite accord - that was John Williams' suggestion: that we might tie that kind of automatic consultation not with the trade agreement but with the tripartite accord, where it more appropriately belongs. And as a move toward attaining that objective, the first step would be an exchange of messages based on the statement that we, as the Treasury, had been asked to interpret the phrase "wide variations" which appears in the trade agreement.

H.M.Jr: Asked by whom?

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- White: Well, we could say asked by individuals or State Department. That wasn't indicated.
- Riefler: President.
- White: And that in our attempt to come to some definitive conclusion as it applied to the trade agreement, we saw that there were several things which hadn't been synthesized or agreed upon, and that you wished to initiate some consultations with a view toward filling in that link in the chain. And that preliminary might take the form of an exchange of memoranda setting forth the criterion of wide variations.
- H.M.Jr: Well now - are you through?
- White: One more step beyond that.
- H.M.Jr: Go ahead.
- White: And then upon that exchange of memoranda you might wish to proceed with further consultations, or you might come to some agreement which would serve the very purpose you had in mind in wishing or thinking of including a floor to this agreement.
- H.M.Jr: Well now, let me get this thing straight, if I understand what you gentlemen are saying: that you don't think, for one reason or another, that we should use the trade agreement as a mechanism to try to talk about the price of sterling. Huh?
- Burgess: That's right.
- White: That's not wholly ....
- Viner: No, no - we shan't use it at this moment, but, you see, we may use that provision in there as it is now proposed later on.
- White: But an interpretation of the word "wide" variation.
- H.M.Jr: But at this time ...
- Gardner: ...we put no figure in the trade agreement.
- Viner: We put no figure in the trade agreement.

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H.M.Jr: Yes, you don't put any figure in, but ....

Gardner: We use it as a point of departure for discussion.

Viner: For discussion now.

White: Under the tripartite accord. But it would really apply to the phrase in here.

H.M.Jr: Let's see if I understand it. I mean supposing just for argument's sake I sent for Mr. Bewley, who happens to be here - the British Financial Attache - and said, "Well, Bewley, I'm bothered about the.." - from what I understand you to say - "...about the clause in the trade agreement which covers exchange, and therefore, under the tripartite agreement, which calls for consultation, I would like to sit down with your people and talk this thing over."

And then he says, "Well, what bothers you?"

"Well, what bothers me is what kind of conditions may exist which would necessitate us to invoke that clause."

Is that the idea?

White: That's putting it very boldly.

H.M.Jr: What's that?

White: That would be putting it very baldly and very boldly.

H.M.Jr: Well, I'm not going to beat around the bush. I never have with the British. I tell them what I have on my mind.

White: I think you want to dress that up a bit.

Viner: But not to use that provision in the clause which calls for a conference.

H.M.Jr: I'm trying to get - I don't quite get what you people have - it seems to me... Let's say we have no trade agreement and just under the tripartite - let's just forget the trade agreement - I think it calls for a conference.

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Walter: We all agree.

Viner: We all agree.

Williams: That's the point.

H.M.Jr: I think it calls for a conference.

Viner: And we say, approve of this clause in the trade agreement, but use this clause as the occasion for calling the conference, say that that clause and the discussion arising in the course of its drafting has led us to believe that we're not as clear with the English on certain points that are certainly involved in the tripartite agreement as we should be, and we'd like to get our relations further clarified by conference or exchange of memoranda.

H.M.Jr: Well now, where I don't quite go with you people is this. You say - everybody nods his head when you say the way sterling has been acting calls for a conference with England on the trend of sterling. And let's say that they send somebody over here. Then out of that conference do I understand that you people are suggesting that I'll say, "Now we'd like to understand each other better as to under what conditions we would have to invoke that clause, rather than to wait until the conditions are so bad we'd have to do it on the spur of the moment"? Is that the idea?

White: I'm afraid ....

H.M.Jr: Is that the idea?

White: I'm afraid that they haven't faced that problem, and if they were to face that problem there might be some doubts in this group. But as I gather - let them speak for themselves - there has been no attempt to say that if in the opinion of the Treasury after these conferences 4.00 was the type of wide variation which was regarded as prejudicial to our industries, that we should say that we should invoke this; that that decision whether or not to invoke this clause is something I think implicit in the discussion - is something to be left wholly with the State Department and not with the Treasury Department.

H.M.Jr: You mean as to when to invoke the clause?

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- White: That's right. Maybe I'm wrong there, but that's what I would gather from the discussion.
- Viner: But the situation which would justify the State Department in appealing to that clause would, in terms of the tripartite agreement, justify the Treasury in opening up discussion.
- Oliphant: Well, wasn't the suggestion to have this Englishman come over here and say to him, "I want to discuss with you an amendment to the tripartite agreement setting up machinery for discussing the effect of exchange variations on trade agreements"?
- White: On everything else.
- H.M.Jr: I wouldn't want to use that.
- Oliphant: I was going to say, this pretty near brings trade agreements over into the Treasury.
- H.M.Jr: I don't want to do that. That's what I don't want to do.
- Oliphant: That's what I wanted to bring out.
- Burgess: I don't think you ...
- H.M.Jr: I don't want to do that.
- Burgess: That isn't what he had in mind at all.
- Viner: I think what we were aiming at was that the discussion of this provision in the trade agreement has made it clear to us that there are things unsettled and uncertain in the tripartite agreement that should be clarified.
- H.M.Jr: Well, there we are in accord.
- Now on this monetary - not monetary - foreign exchange clause in the trade agreement, the British have tried their best to get me to interpret that for them and I have refused to. I mean they have tried to get me to interpret that and I have refused to, for a very good reason: I didn't know what the answer was.

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But I have no hesitancy in sending for Bewley on Monday and simply saying, "I'm bothered about the trend and I'd like the best Treasury man to come over here and talk things over." And then if out of that discussion - and then say, "I don't want to wait until the thing is so serious..." - that I'd like to discuss this thing before it gets serious. and then if he says, "Well, what about the - what about that clause in the State Department," I'd like you people to advise me; I think it's very - that's very important: whether the Treasury should set the red - the danger signal; or whether the State Department should.

Now I think that you people could overcome my difficulties if you decided after consultation: let the State Department interpret this; it's their treaty. Why should I interpret a State Department treaty for them? We can give them the facts.

The thing that I don't want to do, gentlemen - I always try to be as frank with you as I know how - I don't want to be in the position, after we get this trade treaty through, which is the apple of the eye of Mr. Hull - that I should be placed in the position that I have to say, "Call that treaty off," see?

Now they have taken years to build up a publicity machine to get this country ready for this thing, I mean, and to put this thing across; then it goes through. Then I've got to be in the position - that's why I was looking for something automatic. To say - now, I - I don't have to ask anybody in the State Department to call over the English or the French or anybody else to consult with them about the tripartite, and Mr. Hull always leaves - keeps out of it and doesn't want anything to do with it. Now, that demarcation between the two departments is clean-cut and it's worked beautifully for four years.

Williams: Mr. Secretary, it seems ...

H.M.Jr: Just a minute - excuse me, just a second - and if I can find some way of keeping out of their bailiwick, so that I don't have to take a clause in there and tell them that "your trade treaty is through" - now, that's what I don't want to do.

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- Williams: It seems to me that that was what was running in our minds and that's why we thought that it would be a good idea to try to make the tripartite agreement more workable, try to introduce into it some more definite provisions for consultation without tying that into the trade treaty really in any way. I mean it doesn't involve a judgment on your part, for example, that the trade treaty should be abrogated. It only tries to take care of a situation like the present, for example.
- H.M.Jr: Well, I don't need anything more than I've got. All I've got to do is send for Bewley and say, "Mr. Bewley, I want to consult." That's all that's necessary.
- Williams: But wouldn't it be an advantage to you to have the British come to you occasionally, when it's their currency that's fluctuating, if you could put upon them the responsibility for explaining their position to you without having to ask them? Wouldn't that relieve you in some situation of a certain amount of embarrassment?
- H.M.Jr: I don't embarrass that easily. It doesn't - it wouldn't embarrass me a bit to call him in this afternoon and simply say, "Gentlemen, I want a consultation." Wouldn't bother me the slightest.
- White: The additional thought that I had ....
- H.M.Jr: I mean I don't think - I mean I doubt whether we could be smart enough to work out a set of signals so that as we begin to pass those block signals, on such and such a point we'd consult; because if we had had signals like that I would have had to kick France out.
- Oliphant: That's the point.
- H.M.Jr: If you had worked out a set of signals for me, France would be out.
- Williams: Yes, that's right.
- H.M.Jr: Now, whatever the signals were, I just had to take them, go like this and this (stretching hands apart) and then get a new rubber band. So you give me a

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new set of signals and the thing breaks.

But I have no hesitancy at all, if you people think that the situation calls for it, to call for a consultation tomorrow. But the thing that does bother me - I mean besides the big question of the whole trend - the whole movement and what it means to recovery in this country. After all, that's the fundamental thing - what it means; and that we don't wait too long, until we have lost our position of advantage.

But the other thing which bothers me, trying to be practical, is being in a position to interpret a clause of the trade treaty which might lead to calling the trade treaty off.

Stewart: Mr. Secretary, I think that in these conversations we had we had exactly that same objective in mind. We didn't intend ever that you should be in a position of having to pass on whether or not that clause was affected. We intended to try to keep the relation between the State Department and the Treasury just as nearly separate as possible. But we thought the reference to this clause would put the British in a better frame of mind to come to the conference than just an invitation to consult about the tripartite agreement, and that they would come with a more serious intent if they had reference to that phrase than they would if you said, "We want to talk."

We also had considerable doubt in our minds as to how much value a consultation would now be, with no preparations on either side; that if tomorrow you were to ask a representative of the British Treasury to come in, it would be very doubtful how much would be gained. It would depend largely on the personnel on the two sides. But probably it would be wiser to have some exchange of views and definition of problem before an invitation was extended.

H.M.Jr: Now, Professor Stewart.

Stewart: Yes, Mr. Secretary.

H.M.Jr: Is that right? Again let me be very frank. If my advice is correct, and if Mr. Kennedy is correct, the

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tripartite agreement means a great deal more to the British Government than the trade treaty does. Now, I'm just reporting what he says. He says - he told me when I was over there - he says, "Nobody in the British Government wants a trade treaty." I don't know whether that's correct, but that's what Mr. Kennedy told me; I'm only quoting Mr. Kennedy, who is our Ambassador to the Court of St. James. Maybe he's all wrong, but that's word for word what he told me.

So if he's correct, then using the trade treaty as an excuse wouldn't bring them here any quicker. Frankly, it might keep them away.

As to your second suggestion, I wouldn't dream of making this move until I had at least one, two, or three weeks' time to sit down with you people and work out a very careful agenda across the table, back and forth, each taking the side of the British, and the others going back - "Where do we want to land after this consultation?" See? I mean I'd want, oh, two - from one week to a month of careful work on just where we're going to land, before I even suggested it. So I mean I'm entirely in sympathy with you on that.

And I think the thing that - if you people say to me, "Morgenthau, we think the situation is serious enough that you should consult," then what I'd like to do is to immediately put the Treasury to work, with the help of you gentlemen, and begin to work on an agenda, and to see where we'd end, where we'd arrive at, what are our objectives. I don't know enough about it - I mean that's why ...

Stewart: Even that doesn't meet what I had in mind, because it wasn't an agenda here or the assurance of preparation here; it was that there be some preparation there, that they would have some advance notice as to the kind of question you would raise with them. And it may be that this reference to the treaty is not the proper occasion for it, but I think the experience that apparently you have had before - if these Britishers retire behind a vague phrase, furnish very little information, and more or less considering motives on two sides.....

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Williams: That's my feeling too.

Stewart: What you need, I think, is that whoever comes here goes through a process of preparation and he knows in advance some of the questions he's going to have to face.

H.A.Jr: Let me put this to you this way. Do you think - would you advise me, as of today, that I should suggest a meeting without further preparation?

Stewart: No.

H.A.Jr: What? Huh?

Stewart: Advise a meeting without preparation?

H.A.Jr: That I should ask for consultation without doing any home work.

Stewart: I would not.

H.A.Jr: What? I need more home work even before I ...

Stewart: You need home work and you need assurance that there is some home work going on on the other side.

H.A.Jr: Would you hint that I'm calling such a meeting?

Stewart: I'd go beyond that. I would hint it and I'd have enough preparation so that you gave them something which you said on your side - that you're getting prepared to discuss this kind of question.

Gold'r: It seems to me, Mr. Secretary, what you need is a letter to them, or a conversation based on a memorandum, in which you would say that "We would like to have a consultation, but at this consultation we'd like to take up these questions, and we'd like to have you come prepared with thoughts on these questions, and we're preparing for them also. Then we can meet and discuss it."

So they would have to have some concrete stuff - you could say, "Well now, what level of sterling would be satisfactory to you from your point of view in relation to your foreign trade and your

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need for raw materials on the one hand, and your need for exports on the other? On the other hand, we'll have material to show what levels of sterling are likely to be damaging to our economic development and our recovery." And say that those are the terms in which we want to discuss it and that there is no use discussing it unless we've got some concrete terms before us.

Isn't that what - wouldn't that be what you (Stewart) have in mind?

Stewart: I think some outline of questions, yes.

Williams: What bothers me now - it may be just repetition, but there is nothing in the tripartite agreement that requires the country whose currency is being depreciated to make any explanation of any kind. Sure, you can ask for it whenever you want it, and they may hide behind a form of words and really not tell you very much; and that's very different from an undertaking to go into conference on the matter, and it seems to me that's what the tripartite really needs. This may be the opportunity to get it.

White: I think your interpretation of the rubber bands was due to a slight misunderstanding, Mr. Secretary. There wasn't the thought that there would be a range at which action would take place other than the consultation - a range at which consultation would have taken place, just as occurred with the French: you could have consultation if certain things happened.

And there was a thought suggested - I don't know whether anybody opposed it; some agreed with it - that while this was going forward, in the beginning at any rate, the signing of the trade agreement might be postponed, to give it more force. But I don't think everybody commented on that or passed on that. Merely a thought that was raised. I felt that you'd get more effect, if this were withheld in the interim, when you asked for consultation, without indicating definitely that you were withholding it because of that.

Oliphant: Discuss the likelihood of the British postponing the signing of the trade agreement if this question were raised at this time.

-14-

- White: I had assumed - and apparently my version of the case is diametrically opposed to the Secretary's source of information - my impression is that the British Government, Chamberlain particularly, is extremely eager to get this signed.
- H.M.Jr: Well ....
- White: That's at variance with our Ambassador. He's probably better .....
- H.M.Jr: He's most emphatic about it. And I only heard again the other day, indirectly, that he still says the same thing. Now, I'm - I have no other information other than what Mr. Kennedy says.
- Gold'r: Does Butterworth say it?
- H.M.Jr: Well, he sticks to his knitting, which is just to represent the Treasury. But I've never asked, I wouldn't ask him, I couldn't. It would embarrass him; I mean he never sends any cables or any letters on that.
- Gold'r: Well, he told me he thought they were pretty anxious to have that.
- Gardner: They're not anxious for the economic consequences, but are extremely desirous of the political good will that it would create.
- H.M.Jr: I don't - I'm not trying to interpret Mr. Kennedy, but I know he told that to me, and I've heard it within the last week. A man saw him and quoted him; he repeated exactly the same thing.
- Well now, what I'd like to do is to let this thing sink in, and then what we might do, you people - to prepare some questions here in the Treasury that we might put to the British, and take the liberty of asking you people to come down again and take a look at the things that we might want to ask them. How would that be? What? I mean I think I've got what you people have in mind: in other words, that we do this thing through the tripartite and not try to do it through the trade treaty. Isn't that right?
- Stewart: That's right.

-15-

Viner: First, we're agreed it should be done, and secondly, it should be done through the tripartite.

H.M.Jr: All right. There's no - I can go along on that.

Now, let's talk for a few minutes about South America. All I have to offer you people is this. I know the situation of many of the countries is bad financially. I know that in some of these countries United States business men are losing ground. I know they have difficulty in getting cash.

Now, are we just going to sit here and take it, or are we going to do something about it? I'd be glad to hear anybody that would like to talk about it. You've (Burgess) got a couple offices down there?

Burgess: We have some offices down there. And I may say that the organization, before I joined it, made considerable loans in those parts. It was easy to make the loans; the great problem is to get them paid back. I haven't had a chance to give it the study with our organization that I'd like to. I might be able to get some more light on it. I think it's a very tough problem to make loans down there that haven't any reasonable chance of being paid, but I think that it's possible that something could be done.

Our people are keen about continuing the Export-Import Bank, not that it's done very much, but it is an organization that does ferret out a few situations. But I'd like to study it further before making any definite recommendations.

H.M.Jr: You're not ready. Well, we'll go around the room. Mr. Warren?

Warren: Well, never having been in Latin America, I don't have any acquaintance with the opportunities there. I think that the general history of inter-governmental loans is not very satisfactory, including those that we now have outstanding. On the other hand, all other nations seem to be doing it, and it is possible that the only way that we can maintain our position in the contemporary world is to do the same sort of thing.

-16-

H.M.Jr: But you don't want to go beyond that.

Warren: I couldn't go beyond that.

H.M.Jr: Dr. Goldenweiser?

Gold'r: I'm afraid I haven't anything at this moment. I'll think about it. If I have any thoughts, I'll let you have them.

H.M.Jr: Gardner?

Gardner: Very doubtful about it. I don't see that it could be done on a business basis, and I doubt whether it would create political good will; that is, among debtors in default. Those nations that have been able to work out credit arrangements with Latin America have occupied a trading position which gave them a strategic advantage to enforce collection. We haven't that trading position.

H.M.Jr: You want to say anything, Harry?

White: No, I haven't anything.

H.M.Jr: Riefler?

Riefler: Well, my feeling is also one of hesitancy at embarking on this new line. Inter-governmental loans have a bad reputation. On the other hand, I am quite clear that the United States, as a creditor nation, as a repository of 14 billions of gold, and as a potential leader of the Pan-American bloc - all require that there should be credit facilities between New York or Washington - between the United States and Latin America, and there should be loan facilities of some kind. And we're going to have trouble until normal relationships are there; I would much prefer it if there were private credit arrangements, because you would avoid the difficulties of inter-governmental connections when it comes to the collection phase. But I see no chance of that. So I'd at least consider it quite seriously.

Williams: I have nothing to add to that.

Burgess: He lived there several years.

Stewart: Oh, did he?

-17-

- H.M.Jr: We loaned Williams once.
- Williams: I don't know; I think it's a pretty dubious business. I agree that we ought to offer them all facilities possible. We ought to for our own position. But I think you can get into an awful mess. The South Americans get to disliking their creditors about ever so often, and I should think that it would be pretty dubious. I thought that Herbert Feis's suggestion that we arrange some machinery for meeting with them - central banks and governments - a rather good one. I should think that that might be done.
- White: That ought to go a long way to help them out (sarcastically).
- Williams: And I see what might come out of it. You might say, "That's nothing, that's just another round of talk." And it might well be that.
- Riefler: The idea of it would be loans.
- Williams: It might be it would eventuate in some sort of loans. I would rather approach them that way.
- H.M.Jr: What are you going to approach?
- Williams: There are lots of things you can talk about with them.
- Burgess: About meeting some of their obligations up here.
- Riefler: And we're up against the proposition where other countries will be offering them ....
- Oliphant: Sure. Standard technique. Happened in the last two weeks in eastern Europe. Going on all the time.
- Gardner: Collecting on a barter basis or a clearing arrangement.
- H.M.Jr: I mean here we are on the one hand, tied up with a favored-nation clause and against barter; and on the other hand every day, let's call them these nations that do business through barter are getting a wider and wider field.
- Oliphant: Through barter and outright government loans.

-13-

H.M.Jr: through what?

Oliphant: Outright government loans: Turkey, Poland - what's the list in the last two weeks?

H.M.Jr: Turkey and Poland.

Oliphant: That all? Other credits.

Viner: Czechoslovakia.

Oliphant: Czechoslovakia.

Williams: There goes along with that a development of a sphere of interest which I think would be pretty unwelcome; in Latin America they talk about "the great Colossus of the North" and if we were to start out to make loans through all South America, they'd say, "We see through that." They might ....

Oliphant: There might be some such thing as a New Deal in "the great Colossus of the North." I think a real description of what that Colossus of the North has done under the "Old Deal" is enough to turn anybody's hair white, but there's such a thing as a New Deal in the great Colossus.

H.M.Jr: You don't think - you think they'd turn us down on our money?

Williams: Oh no, they'd take the money, but they'd blame you for giving it to them later on.

Riefler: It would be an excuse for a revolution to get rid of the government that contracted the loans.

H.M.Jr: Well, I - I'm just going around. I don't - right now the State Department's asking me to appoint a commission of three to go to Cuba - to do what? What will they do when they get down there? Talk about sugar growing?

Jake?

Viner: I don't know. I think we've had an experiment with the Export-Import Bank; I'd like to know what their experience is, what they think about it, why they haven't been able to make the loans, and why that isn't the best

-19-

agency for doing it. What's wrong with that set-up? I don't know anything about it.

And I wouldn't express any opinion; I would say that the fact that other countries are making such loans is something that ought to lead us to give serious consideration to whether we have to do it for both political and economic reasons. They won't like us if we make them loans, but they'll like us still less if we refuse to make them loans.

White: We might like them still less.

Viner: That doesn't matter.

White: Oh yes, it does. Depends on the reason we dislike them.

H.M.Jr: Mr. Stewart?

Stewart: I'm perfectly clear about it myself.

H.M.Jr: You are?

Stewart: Yes. I wouldn't think of it myself. I think the long record ....

H.M.Jr: You wouldn't what?

Stewart: I wouldn't think of making a loan on governmental account. You've got a long record of rescue parties organized by central banks and by governments which is just a record of disappointment and misadventure behind it. It buys you short-time good will and long-time ill will. The people that do it, I think, are wrong. I think they're suffering for it now. I think the government will suffer exactly as a private banker suffers when it comes to buying it off. I think it's a first-rate mistake. I wouldn't contemplate it myself.

The only possible basis that I think could be considered would be in the contrast between the two types of loans that have been made to Turkey. The British make them a loan and they expect that money to be spent in England, but they don't really ever expect to

-20-

buy anything from Turkey to help the repayment of the loan." If the government of this country is prepared to make advances to certain South American countries and specify the goods which they will receive in payment of that loan over a period of time, it's a feasible thing to consider.

But unless you've got something which is like the German thing - the German thing is really built that way. There's a real difference between the British loan to Turkey and the German loan to Turkey.

H.M.Jr: There is a difference?

Stewart: Yes, a basic difference, I think. One is that the Germans are prepared to give an advance credit in which Turkey buys goods from Germany, but at the same time they expect over a period of years presumably to have the loan paid off in the goods that they want from Turkey. Now, if you've got a list of goods, then you've got a trade relationship; the loan is only incidental to that.

But the foreign lending that's been done out of the London market, out of the New York market, which has been done with the accumulation of debt, with no prospect of ever repaying it, is ill-will. If along with it you can carry a trade basis upon which you really stimulate the trade between two countries, that's a conceivable thing to do. But you'd have to specify your list, say, "This is the sort of thing.." - whether it's tariff or whatever it is - "...these are the goods we want that you have." You might do something if you have ....

H.M.Jr: Would you when you get back mind sitting down and writing me - developing me a little - writing me a memo on that, just along the lines you've been talking?

Stewart: I think everybody here will testify that I never write a memorandum, Mr. President - Mr. Secretary.

H.M.Jr: Don't you?

Stewart: I never do.

H.M.Jr: Well then, let's get you to say a little more right now.

-21-

Stewart: That's about all I've got, really.

H.M.Jr: I don't quite follow you.

Stewart: The only idea I had in mind was the difference between the German loan to Turkey and the British loan to Turkey. But I assume that the German loan to Turkey is intended to give them a credit which they can spend pretty promptly in Germany.

H.M.Jr: To Germany. And you'd follow that.

Stewart: Yes. And they expect them to receive goods over a period of time from Turkey, which is the old-fashioned notion that the banker had about why loans were made, and how they were paid off, in contrast to most of these international inter-governmental loans, where it's a rescue party and it's intended to support the exchange, improve the government finances, and never has any method of getting it repaid.

H.M.Jr: What you're suggesting is, if we do anything, we take a look at the German method.

Stewart: Yes, I think that's a genuine reciprocal trade agreement on the grand scale and it will build an economy in the long run; may have other difficulties ....

Viner: You need import controls to do that. You can't do it on a free import basis. The Germans know they can decide just what shipments of tobacco to Germany shall be made against that credit.

Stewart: I don't see how an inter-governmental loan can have meaning aside from the practice of an authoritarian government.

H.M.Jr: You and Keynes are not far apart.

Stewart: We always have been.

H.M.Jr: If I'm correct - and you (White) check me - he suggested just this to England last week.

Stewart: Uh-huh.

H.M.Jr: As you - did you (White) see it?

-22-

- White: Yes.
- H.M.Jr: Am I right?
- White: That's right, as an approach to bilateral ....
- H.M.Jr: But as I understand, Maynard Keynes' suggestion to England that in their dealings with Germany - his suggestion is practically what you're saying now. Is that right, Harry?
- White: Well ...
- H.M.Jr: Well, I mean the same pattern.
- White: Same direction, same objective.
- H.M.Jr: If you haven't seen that, you ought to take a look at that.
- Viner: Was it a loan proposal or a barter proposal?
- White: No mention of a loan, but there may have been a loan implicit - may well have been a loan implicit in it, because he suggested following in the direction of the German pattern but chiefly in the way of bilateral balancing; but they wouldn't hesitate, as they haven't hesitated, to make loans along with that sort of arrangement.
- H.M.Jr: If I may just - well, I can hold my thought; go ahead.
- Siefler: One thought I wanted to put in, and that is that there is a great misconception prevalent almost all through the United States: that under certain proper conditions Latin America would be able to absorb productively fairly large amounts of capital. I don't think that's true, and I think you ought to realize, in going into this, that they can't possibly use and pay for very much money; the loans should never be very large.
- White: Depends on the interest rate which they pay.
- H.M.Jr: Well, I'm - all I'm going to say is, you fellows have not discouraged me. I think there's enough brains in this room that we can - the fact that it hasn't been done successfully doesn't mean that we can't do it. And I at least haven't been able to think it through,

-23-

and I'd like to take another - have you all take another look at it, because I can see the thing slipping through our fingers, because other countries are doing it and we're just going to - we're just going to lose ground, because we have nothing to offer them.

Stewart: Is it - in South America is it chiefly Germany?

H.M.Jr: Pardon me?

Stewart: Is it chiefly Germany in South America? In South America.

H.M.Jr: Yes, yes. Yes.

Stewart: I think it's awful hard to beat that system on their scheme.

Viner: Is it possible to get the record of the Export-Import Bank as to their experience and why they haven't been successful in making more loans?

White: Well, one partial answer to that is that the President has just taken a trip - the President of the Export-Import Bank has just taken a trip all around and apparently has stimulated a lot of questions on small amounts, not large amounts. But I mean the mere fact that Pierson went around might indicate that their previous experience was not adequate for them to come to a conclusion, that they wanted more information.

Viner: I should think Pierson would have something to contribute on this.

H.M.Jr: I should think so.

Viner: Why isn't that set-up - I haven't heard why that set-up isn't satisfactory.

White: I think the approach has got to be very different: much broader gauge, much reorientation of your whole proposal. And I think that any attempt to come to a conclusion on the basis of the type of past loans which have been given, in which the interest rates have been preposterous - I mean the real rate, not the nominal rate, and in which the uses to which they were put were doubtful ....

-24-

- Viner: The nominal rates were preposterous, real rates very low.
- White: Only because of defaults.
- Riesler: Tremendous amounts loaned at perfectly normal rates. These cases that are preposterous are awful cases, but they're not the general one.
- Waite: 6, 10, 12 percent - real rates of interest. If loans were made and tied to exports, possibly even of certain commodities or for certain purposes, and if some mutual negotiations went on as to the purpose for which those loans would be made then and possibly some reasonable reduction in rates for the particular commodity which - the tariff rates for the particular commodity which they engage in, and if the interest rates were made extremely low, because we may be lending them in a large part a dead asset and commercial considerations aren't the only ones, there may be possibilities. I don't think we can go on past record as decisive.
- H.M.Jr: Well, what I'm going to do is this. I'll get for you gentlemen just what the Export-Import Bank has or has not done. I'll try and find out what their problems are in South America, how they feel about it.
- We'll also prepare a memorandum on the things that we think we ought to put up to the British, and when we have that I'd like to invite you to come down again, if you'll be willing to see - take a look at it.

## PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Paris  
DATE: October 31, 5 p.m.  
NO.: 1794

FROM COCHRAN

Today the Paris exchange market was very slow, with French stabilization fund giving a little sterling this morning around 178.75. Until after Sunday's elections and any resultant political developments are known, everyone is delaying new commitments. In spite of continuing gossip of a possible capital levy, subscriptions to Government paper still satisfactory.

I received a call today from Beyen of B.I.S., Jay of Morgan's and Grant of Guaranty, all of whom are attending the meeting here this week of the monetary and credit policy committee of the International Chamber of Commerce. These gentlemen said that efforts were being made to reach a compromise this afternoon on some rather innocuous resolutions about return to the gold standard, utility of stabilization funds, international credits and so forth. A report will be given of the final texts.

END SECTION ONE

SECTION TWO. With regard to the French situation Beyen insisted that a real French financial recovery will necessitate a conversion of the present state debt forced or

otherwise.

-2-

otherwise.

The delay in issuance of financial decrees is a subject for complaint among French business circles. Because of the increased cost of living, French civil servants are renewing their demands for higher pay. A criticism of "dumping" of French wheat is beginning to be made by the British press. Purchase of dollars and sales of sterling by Scandanavian banks and particularly Stockholm are also drawing adverse comment in the financial circles of London.

END SECTION TWO.

WILSON

EA:DJW

REB

GRAY

Paris

Dated October 21, 1938

Rec'd 3:40 p. m.

Secretary of State,  
Washington.

1794, October 21, 5 p. m. (SECTION THREE)

Swiss press reproduces a memorandum addressed to the Committee for National Defense and Combating of Unemployment by the Swiss Federal Council dealing with the question of utilizing part of the book profits from revaluation of the Swiss National Bank's gold stock to cover unemployment relief expenditure to the extent of 150,000,000 Swiss francs. The Swiss National Bank had again and again been invited to consider this plan and in a report to the Federal Council the bank maintained its opinion that those profits should remain untouched in the interests of the Swiss currency and in view of the increased uncertainty with regard to a postponement international currency situation. The bank repeated its readiness to grant to the cantons and the Federal Government extensive discount credits on most favorable terms.

WILSON

WWC

EMB

REB

GRAY

Paris

Dated October 21, 1938

Rec'd 4:10 p. m.

Secretary of State,  
Washington.

1794, October 21, 5 p. m. (SECTION FOUR)

Dutch press publishes excerpts from a statement by President Bachmann of the Swiss National Bank on Swiss currency policy. The continued depreciation of sterling in relation to the dollar and gold he declared had raised the question for Switzerland whether the Swiss franc should be allowed to follow the downward movement of sterling or whether the gold price expressed in Swiss francs must be kept stable. In this connection commercial considerations were of primary importance. During the first seven months of this year the sterling bloc absorbed 27% of total Swiss exports while the share of the dollar bloc was only 7%. This would suggest that Switzerland should keep step with any further depreciation of sterling; but that would mean a rise in the exchange rates of not only the so-called free currencies but -- and this was of particular importance -- of the blocked currencies also for instance the Reichsmark and currencies of other countries with which

REB

2-#1794, From Paris, Oct. 21, 5p.m.  
(Sec. Four)

which Switzerland had clearing agreements. A higher Reichsmark rate in relation to the Swiss franc would lead to a reduction in imports from Germany the proceeds of which were not only financing German tourist traffic to Switzerland but also payments to Swiss creditors holding German bonds. Professor Pachmann stressed the fact that the Swiss franc was linked neither to sterling nor to the dollar.

WILSON

EMB

KLP

REB

GRAY

Paris

Dated October 21, 1938

Rec'd 4:02 p. m.

Secretary of State,  
Washington.

1794, October 21, 5 p. m. (SECTION FIVE)

Switzerland maintained her complete freedom of action in respect of all possible future decisions in the currency sphere. The interests of Swiss economy were always the deciding factor. Non-economic motives could never prompt Switzerland to follow other countries in their currency policy. In conclusion Bachmann expressed himself in favor of maintaining the gold standard as the best currency system. The increasing collaboration between central banks and foreign exchange funds for the maintenance of certain elastic currency relations afforded proof of the world-wide tendency towards the re-introduction of the gold standard. In view, however, of the present world political situation and its economic repercussions a return to the gold standard in the near future could hardly be expected.

(END OF MESSAGE)

WILSON

KLP

MY

GRAY

Paris

Dated October 22, 1938

Rec'd 8:50 a.m.

Secretary of State

Washington

1799, October 22, 11 a.m.

FROM COCHRAN.

Council of International Chamber of Commerce yesterday unanimously adopted, on the proposal of Aldrich of Chase Bank, Chairman of the Chamber's Committee on Monetary Policy and Credit, the following resolution:

"The removal or modification of barriers to international trade, the balancing of governmental budgets, the stabilization of currencies, the removal of exchange controls and the growth of peaceful relations among the nations are all interdependent. Progress in the accomplishment of any one of these objectives facilitates progress in all the rest. There is no fixed order of priority among them. In different countries, special circumstances may suggest that efforts may be concentrated at a given time upon one rather than the others.

With respect to the currency problem the Chamber maintained:  
(End section one).

WILSON

CW  
CSB

MJD

GRAY

Paris

Dated October 22, 1938.

Rec'd. 9:13 a. m.

Secretary of State,  
Washington.

1799, October 22, 11 a. m. (SECTION TWO)

One. Gold standard: notwithstanding the increase in gold production and the accumulation of large gold reserves in certain countries, the International Chamber of Commerce reaffirms its faith in the ultimate restoration of gold as the international measure of value, and in the fundamental economic function of a gold standard.

Two. The tripartite agreement: The International Chamber of Commerce recognizes the importance of the tripartite agreement and suggests that consideration should be given by the powers adhering to this agreement to the establishment of appropriate means of reinforcing their present collaboration, and more especially to determine the proper relative values of the three principal currencies, with a view to maintaining a stable relation between them and ultimately restoring gold parities.

Three. Cheap money policy: The International Chamber of Commerce rejects the fallacy that artificially cheap

money

MJD -2- No. 1799, October 22, 11 a. m. (SECTION TWO)  
from Paris

money is necessary for business activity and that money  
markets must NEVER again be called upon to stand the  
discipline of firm or tight money rates.

WILSON

GW  
WWC

01718353

01718353

TELETYPE UNIT

UNITED STATES DEPARTMENT OF COMMERCE

McC

GRAY

Paris

Dated October 22, 1938

Rec'd. 9:15 a.m.

Secretary of State

Washington.

1799, October 22, 11 a.m. (SECTION THREE)

Money rates should tell the truth regarding the actual situation as to the supply and demand of capital. By an adequate supply of capital is meant an abundant volume of true investor's savings and corporate savings".

Paris editor of the NEW YORK HERALD TRIBUNE today carries three column head line "Morgenthau Calls in Experts for Mystery Monetary Talks, Gold Welcome, Says Secretary".

AGENCE ECONOMIQUE gives one column to the meeting, suggesting Washington uneasiness over depreciation of sterling.

Wilson

GW:WVC

rr

GRAY

London

Dated October 22, 1938

Rec'd. 9:30 a.m.

Secretary of State,  
Washington.

1235, October 22, 1 p.m.

FOR TREASURY FROM BUTTERWORTH.

Wolsey confirms the report in today's financial press that the Foreign Exchange Advisory Committee has given its sanction to the pounds 6 million Woolworth deal reported in paragraph two of my 1231, October 21, 6 p.m. Incidentally the basic policy upon which this decision was founded is outlined in my 81, February 1, 8 p.m., but it is noteworthy that the condition of the dollar sterling exchange at the time it was enunciated was quite dissimilar from that it is today.

The dollar opened at 4.76 $\frac{1}{2}$  bid and moved rapidly to 4.76 at which point the British authorities intervened. But as soon as they went out of the market the rate went up 4.75  $\frac{3}{4}$ . 197 bars were dealt in at gold fixing at 146 shillings 1 $\frac{1}{2}$  pence of which the British fund supplied all but 15. After the resultant dollars had been absorbed the British

2 - 1235, October 22, 1 p.m. from London

the British authorities again came into the market and held the rate at 4.75 3/4. After they went out at noon the rate moved to 5/8. The volume has not been large.

KENNEDY

JCLP  
WNC

MY

GRAY

Berlin

Dated October 22, 1938

Rec'd 11 a.m.

Secretary of State

Washington

568, October 22, 2 p.m.

No. 26 FOR TREASURY FROM HEATH.

The composite statement for all German banks excepting savings banks shows that in September their total liabilities were 18,205 million marks a decrease of 707 million marks from August 31. The decrease was mainly in deposits of other credit institutions which fell from 6,700 to 6,090 million marks. On the assets side there was a heavy decrease in bill holdings; from 6,012 million marks on August 31, to 4,997 million marks on September 30. The percentage of liquid assets of all German banks decreased from 54.8 on August 31 to 52.5 September 30, or to about the same percentage as a year ago. Cash reserves, however, increased from 2.1% to 3.1% during September. It is asserted in the press that there are no more Government "special bills" left in German bank portfolios. Bank holdings of Treasury bills increased only 242 million marks during September to a figure of 3,499 million marks as compared with an increase of 425 million marks in August.

WILSON

KLP  
GV

## PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Rio de Janeiro, Brazil

DATE: October 23, 1938, 1 p.m.

NO.: 249

I am told by the Director of Exchange that during the week of October 24 the Bank of Brazil will close exchange for maturities and daily quotas for the whole period September 8-15.

You are requested to inform Commerce of the foregoing.

CAFFERY.

RECEIVED  
EA:LWW

OCT 24 1938

TREASURY DEPARTMENT

WASHINGTON, D.C. 20540

Federal Surplus Commodities Corporation  
Summary of Commodities Procured -  
Fiscal Year 1938 and Fiscal Year 1939 to date

(Figures in thousands)

Commodity	Unit	Total fiscal year ending 6/30/38	7/1/38	7/7/38	7/14/38	7/21/38	7/28/38	8/4/38	8/11/38	8/18/38	8/25/38	9/1/38	9/8/38	9/15/38	9/22/38	9/30/38	10/6/38	10/13/38	Total 7/1/38 to 10/19/38	
			to 7/6/38	to 7/13/38	to 7/20/38	to 7/27/38	to 8/3/38	to 8/10/38	to 8/17/38	to 8/24/38	to 8/31/38	to 9/7/38	to 9/14/38	to 9/21/38	to 9/28/38	to 10/5/38	to 10/12/38	to 10/19/38		
1) Apples (Dried)	Pounds	14,557	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	
2) Apples (Fresh)	Bushels	5,625	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(1)	
3) Apricots (Dried)	Pounds	2,990	-	-	-	-	-	-	-	-	-	-	-	-	-	-	3	110	198	
4) Beans (Dried)	Pounds	56,800	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(2)	
5) Beans (Snap)	Bushels	33	5	4	8	9	3	4	1	1	1	-	-	-	-	-	-	-	(3)	
6) Beans (Fresh)	Bushels	11	6	7	18	13	9	5	6	5	5	2	-	-	-	-	-	-	(4)	
7) Blackberries (Canned)	Cases	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(5)	
8) Butter	Pounds	15,035	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(6)	
9) Cabbage	Bushels	990	26	40	31	45	62	36	30	66	81	130	338	2,741	3,377	5,109	3,783	3,804	(7)	
10) Cane Syrup	Gallons	237	107	-	-	-	-	-	-	-	-	-	56	134	165	357	370	234	216	(8)
11) Carrots	Bushels	-	1	2	11	7	7	6	7	10	12	8	15	8	7	6	1	16	124	(9)
12) Cauliflower	Crates	-	-	-	-	-	-	-	-	-	-	-	2	-	-	-	-	-	21	(10)
13) Celery	Bunches	1,174	-	-	-	-	17	65	39	15	13	19	4	8	9	5	-	-	165	(11)
14) Cereal (Whole wheat)	Sacks	408	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	14	(12)
15) Cheeses	Pounds	3,446	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(13)
16) Corn	Sacks	-	-	-	-	-	-	1	4	3	-	-	-	-	-	-	-	-	8	(14)
17) Cotton	Bales	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	10	(15)
18) Cotton Fabric	Yards	1,133	-	-	-	-	-	-	-	10	49	1	29	44	14	5	3	22	173	(16)
19) Cottonseed oil	Pounds	9,780	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(17)
20) Eggs (Shell)	Cases	270	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(18)
21) Fish	Pounds	3,677	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(19)
22) Flour	Barrels	2,699	-	-	-	-	-	279	-	-	-	-	-	-	-	-	-	-	279	(20)
23) Grapefruit	Boxes	401	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(21)
24) Grapefruit Juice	Cases	552	-	-	-	-	-	-	-	-	-	464	-	-	-	-	-	-	64	(22)
25) Grapes	Tons	8	-	-	-	-	-	-	-	-	-	-	-	7	-	-	-	-	-	(23)
26) Labels	Labels	-	-	-	-	-	-	-	-	-	-	-	15,560	-	-	-	-	-	15,560	(24)
27) Mattress Ticking	Yards	-	-	-	-	-	-	-	-	-	-	-	-	-	2,550	-	-	-	2,550	(25)
28) Milk (Dry skim)	Pounds	21,520	-	-	-	-	-	-	-	-	2,681	5,960	-	-	-	-	-	-	8,641	(26)
29) Milk (Fluid)	Quarts	12,497	497	515	523	528	525	538	530	531	528	509	515	524	415	534	551	580	8,577	(27)
30) Onions	Pounds	3,000	-	-	300	25	8	11	22	16	12	7	39	53	181	78	153	74	979	(28)
31) Oranges	Boxes	1,932	2	48	59	57	38	46	49	55	50	50	66	55	64	54	47	44	784	(29)
32) Paper bags	Bags	21,825	-	-	-	-	-	-	-	-	9,075	-	-	-	-	-	-	-	9,075	(30)
33) Peaches (Dried)	Pounds	2,534	-	-	-	-	-	-	-	-	-	-	1,223	-	2,300	-	-	-	6	(31)
34) Peaches (Fresh)	Bushels	8	2	4	-	-	-	-	-	-	-	-	-	-	-	-	-	-	6	(32)
35) Pears (Fresh)	Boxes	318	-	-	-	-	-	-	-	-	31	96	73	17	12	-	-	-	229	(33)
36) Peas (Canned)	Cases	862	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(34)
37) Peas (Dried)	Pounds	6,000	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(35)
38) Peas (Fresh)	Bushels	-	-	-	-	-	-	-	-	3	-	-	-	-	-	-	8	204	122	(36)
39) Potatoes (Sweet)	Bushels	440	-	-	-	-	-	-	-	-	-	-	-	-	-	42	45	19	2,365	(37)
40) Potatoes (White)	Bushels	4,315	-	466	483	120	44	167	266	142	219	108	12	-	-	-	-	-	-	(38)
41) Potato starch & flour	Pounds	2,562	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(39)
42) Prunes (Dried)	Tons	95	-	-	-	-	-	-	-	-	-	-	5	5	3	-	-	-	13	(40)
43) Prunes (Fresh)	Bushels	-	-	-	-	-	-	-	-	11	-	-	-	-	-	-	-	-	11	(41)
44) Raisins	Tons	15	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(42)
45) Rice (Milled)	Pounds	73,190	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(43)
46) Tobacco	Pounds	3,500	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	145	(44)
47) Tomatoes (Canned)	Cases	50	-	-	-	-	-	-	130	15	-	-	-	-	-	-	-	-	114	(45)
48) Tomatoes (Fresh)	Bushels	282	3	-	-	1	-	7	18	22	22	16	20	4	1	-	-	-	-	(46)

October 22, 1938

Treasury Department, Division of Research and Statistics.

\* Weekly figures reported by Federal Surplus Commodities Corporation are based on telegraphic reports and are unverified.  
Fiscal year totals have been revised to include all contract cancellations and other adjustments.

Regraded Unclassified

Monday  
Dictated October 24, 1938

Ambassador <sup>Oct 22</sup> Bullitt and Mr. Monnet had supper with me Saturday night and stayed after supper until twenty minutes past twelve. They had just come from Hyde Park.

Monnet was sent over here by Daladier and the Minister for Air of France with the idea that he could organize a corporation to build aeroplanes in Canada for France.

While in Hyde Park, last Tuesday, I had talked to the President about this and left with him a memorandum prepared by White and told him that I was opposed to this for many reasons.

Friday the President called me, about five minutes of one, and told me that he had this talk with Monnet and Bullitt and that my particular worry that the French could not supply the foreign exchange was nothing and that that had been taken care of and that he would like me to see these people.

After supper Bullitt told me that the President had been most frank with Monnet; that he had drawn a map and shown him just where outside of Montreal this plant should be located; had even told Monnet how many planes the English had built and how many the French had built in their respective countries, and that they should build a plant in Canada which would produce 1700 planes on an 8-hour shift and 5,000 planes on a 3-hour shift.

I tried a number of times to stop the conversation and get on to how they were going to finance this, but Bullitt did not want me to do it. Finally, after they had let me know that everything was lovely and that the President had given the plan his blessing, I said to Mr. Monnet, 'Let's take it for granted that you could overcome all technical difficulties.' I said, 'How much do you think the plant will cost?' '\$25,000,000 to build?' He said, 'No; \$50,000,000 to \$100,000,000.' I said, 'How are you going to pay for that?' He said, 'Frenchmen who have their money over here will subscribe to the stock.' I said, 'I don't believe it, but lets, for

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argument's sake, say they will, because any Frenchman who has his money in America, before he subscribes to stock of a new company will want to know to whom the product is going to be sold, and the answer is the French Government, and the first question he is going to ask is how is the French Government going to pay for these.' Mr. Monnet said, 'The Frenchman has confidence in his country, but not in its money and if he could buy a bond or stock which was payable in United States or Canadian dollars, he would do so.'

I said, 'Well, don't let argue. I won't argue. Let's take it all for granted that your plant is built.' I said, 'How much do you people figure it will cost to pay for 1700 planes?' He said, 'About \$85,000,000 a year.' 'Well,' I said, 'to my knowledge, I say it's impossible for the French Treasury to find \$85,000,000 a year of foreign exchange.' I said, 'I have grave doubts as to how they are going to pay for their own budgetary expenses during the next three months, let alone find \$85,000,000 to send over to Canada.'

I felt my way gradually in order not to offend his feelings, but he encouraged me to go on. I made up my mind I wasn't going to argue as to the theory which they had sold the President, but would stick to the subject which I knew, viz: Government finance.

Bullitt again tried to side-track the meeting by saying that before you can get stability in France, the international political situation has to be straightened out. Monnet, to my surprise, pushed this aside. He said, 'That is not so.' He said, 'We have been hearing that for a long time and we have been hearing for four years that if we continue to give the Frenchman his freedom, eventually his confidence in the Government will return and he will bring his money back.' He said, 'That has proven not to be so.'

(I am not giving this quite in its sequence, but I am giving the salient point of the argument.)

About this time, I decided I might just as well be frank and get everything off my chest and I said, 'Mr. Monnet, we figure that during the last four years there must be at least \$4,000,000,000 gold that has

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left France. Just as long as that is abroad, and what little money is left continues to leave France, there isn't any use talking about building aeroplanes or anything else.' And I said, 'You people have to devise means and methods whereby you get this money back.'

I said, 'If the French Government had the courage to put through decrees whereby they would make their citizens bring back their money or put them in jail, I say that overnight you have such a change in your domestic situation it would be hard to even realize it.'

So he said, 'How do we do it?' I said, 'I am sure that the American Government would assist you to locate this money. I am sure the British would do the same. Then you have to discharge about two-thirds of your Cabinet, because most of them would be involved. You might have to put a thousand people in jail.' He said, 'That's too many. Two or three would be enough.'

I said, 'For example, after the return of capital, instead of the Government paying 7% for its money on its debt, it might get it at 3%.' He again said, 'But how could you do it?'

And then I got what Bullitt said was an absolute stroke of genius. I said, 'If Leon Blum could get elected on a platform of no devaluation and then devalue under the cloak of the Tripartite Agreement,' I said, 'Mr. Daladier, if he has the courage, can do the same and under the cloak of the Tripartite Agreement he can announce supervision of foreign exchanges and issue decrees which would make it a jail offense not to bring your money back.'

Both Mr. Monnet and Mr. Bullitt were simply beside themselves with joy. I further pointed out, I said, 'I am correct, am I not, that your very Left party members are for exchange control?' He said, 'They are.' I said, 'Your whole situation overnight would change,' and Monnet said, 'If we made this move to bring foreign capital back, we would please the Left very much and, in return, Daladier could demand of the Left that they ease up and let the people go to work in the munitions factories, etc.'

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The last thing I said, Saturday night, I said, 'Mr. Monnet, if you don't do something like this, your country is through.' And I repeated it twice. I said, 'You might just as well make up your mind, it's through!' I said, 'It's impossible for you to continue with the bulk of your capital abroad. The French Treasury is busted and,' I said, 'you just can't continue.'

Bullitt and Monnet returned on Sunday, after having slept over the matter, and Monnet could not say enough to thank me. I said, 'Do you think Mr. Daladier will have the courage to do this?' 'Well,' Bullitt said, 'the way you painted this picture, it will give Daladier the opportunity to be the saviour of France, and that would give anybody courage.'

I said, 'Does he realize that he will have to start with Mr. Bonnet and from then on down either fire them or put them in jail?' He said, Monnet realizes all of that.

So I said, 'Well, the quicker Monnet can get on a boat and go back, the better.' Monnet had already looked up the boats and saw that he could get back by November 4th and that the decrees are still possible until the 15th of November. Up to date, Daladier has issued no decrees. He said the reason for that is that he just does not know in what direction to turn.

I have never seen Bullitt so enthusiastic about anything. He said he had thought it over whether he should go back to France and help or go down to Bermuda and he decided that inasmuch as so many of his friends were involved, that it would be better for him to be in Bermuda.

Monnet wants to go through the motions of seeing Peoples, because there are only two people that know he's over here -- Daladier and the Minister of Air. He is not reporting to the French Embassy and he is sending no cables. I then said I would arrange for him to see Mr. Oliphant who, before he left on Thursday, would give him a memorandum or would explain to him verbally what we could do in the United States to assist the French Government to locate French capital.

They again asked me whether they thought the British

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would cooperate and I said I was sure they would. He said, 'Well, they can work through Monnick.' I said not if they wanted my cooperation. So he said, well, how would they approach the British? We have always offered to approach the English for them. We could either do it through the British Embassy here or they could do it themselves, but they should decide.

I then said to Bullitt, 'How about if we do this for the French -- help them locate the capital -- might we also have to do it for the Germans and the Italians?' He said, 'Don't worry about that. I can give you 16 reasons why you would not have to do it for them.'

So Monnet asked me how would they draw up these decrees and I said we didn't have the French law, but I was sure that give Jacques Rueff 48 hours and he could draw it up, but that we would explore our own facilities for helping them locate the French capital.

From our own domestic standpoint, this whole question of having 14 billions of gold would also be greatly assisted if 2 or 3 billions should go back to France and would ease the pressure on me what to do with all this gold.

Another thing I said to Bullitt, with this money back it gives them a chance to loan cash to the Balkans as against the Germans offering them credit against barter and it gives France a chance to hold up its head with Turkey and with Poland and Roumania and again be in the position of being the banker for what they call the 'Little Entente' instead of this cock-eyed scheme of Bullitt's to build an aeroplane factory in Canada.

In the telephone conversation I had with Cochran from my house, I pointed out that we ought to do something to assist South America. So Bullitt said to me, 'I had a talk, last week, with Cochran and he is the craziest blankety-blank fool you ever saw! He's just crazy! What do you suppose he suggested? He suggested that we go down and conquer South America!' I said, 'What for?' And Bullitt said, 'Well, he said Europe is through and we have to look into South America as a future sphere, so let's go down and conquer it.' This is Cochran putting my ideas to work. And Bullitt said, 'I said to Cochran, you are nothing but a God-damn

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Fascist!' I was so afraid that Cochran would say, 'That's Morgenthau's idea.' And he said, 'After all, they are a half-educated people. Let's go down and conquer them.' And he said Cochran also said, 'The strong have to dominate nowadays.'

I said to Bullitt, 'But will he have the courage?' and he said, 'Put it on a platter that he can be the saviour of France.' And he said, 'Daladier six days a week he is magnificent and on the seventh day he goes completely to pieces; the seventh day he is all blah. The only hope is you don't get him on the seventh day.'

Bullitt has the audacity to say to me, 'This has been my idea for two years' when he fought me, tooth and nail, on exchange control.

I said, 'Can't you find some peasant, somebody who is so honest and has his feet right on the soil and nobody can shake the man?' I said, 'It means a French revolution.' He said that the Communist party in France, they want this and if you give them this they will go along on the other stuff because they say why should we work 48 to 60 hours when those crooks on the top are making all that money? And they are right. And I said, 'In America we have only one policy: pay your taxes or go to jail.' So he said, 'Don't let's bring up the tax question right now.'

oOo-oOo

Saturday  
October 22, 1938  
11:27 a.m.

HMJr: I mean I'm making a record?  
Wayne Taylor: Yeah.

HMJr: What's the market?  
T: What do you want first?  
HMJr: Bonds - Government bonds.  
T: Quiet and steady - ah - practically no change.  
HMJr: How are stocks?  
T: Industrials up a .28.  
HMJr: Yeah.  
T: Rails - half a point; - Utilities 22/100ths.  
And volume in the first hour 510,000 shares.  
HMJr: And commodities?  
T: Commodities - wheat - ah - practically unchanged.  
Corn up pretty nearly a - oh, not quite a cent -  
three quarters of a cent. Cotton unchanged.  
Averages up .02.  
HMJr: How - how is sterling and francs?  
T: Sterling - last sales 75 and 7/8ths.  
HMJr: Is that up or down from yesterday?  
T: Ah - that's ah -- off from close - closed at  
76 and 3/8ths. Francs - 66 and 1/4 - off a quarter.  
HMJr: Now, if we sell a 3 year and 7/8ths R.F.C. note  
how many thirty-seconds do they figure there is  
in it? Is Harris there?  
T: Twelve or thirteen.  
HMJr: Is that what he figures?  
T: Yeah.

HMJr: What was it last time?  
T: Well, we figured pretty nearly a half a point last time.  
HMJr: Not quite as good, is it?  
T: No. And this isn't exchange, you see, and no - no cash and so on.  
HMJr: Now, if you could arrange that you could listen on the loud speaker and let me talk to Matteson why we'll finish up.  
T: O. K.  
HMJr: See?  
(Short pause.)  
Operator: Operator.  
HMJr: Hello.  
O: Yes, sir.  
HMJr: I want them to listen and I want to talk to Mr. Matteson in New York, please.  
O: All right.

11:29 a.m.

Operator: Go ahead.  
HMJr: Hello, Matteson?  
Walter Matteson: Yes. Yes, Mr. Secretary.  
HMJr: Ah - Matteson, I'm talking to you from the house but the men are listening at my office so I'd like to know what it looks like to you on a three year R.F.C. note.  
M: Ah - 7/8ths - 3 years - interest only up to November first.  
HMJr: Yeah. Ah - how many thirty-seconds ah -

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M: I don't quite hear you.

HMJr: How many thirty-seconds premium do you think there'll be in it? What do you think it'll sell at?

M: Ah - it - it figures mathematically about 13, based on the price of the outstanding issue.

HMJr: Yeah. And practically what do you think it'll do?

M: And ah - as a practical matter the ah - the ah - the Street - I've talked to them this morning again and they think that they will command a premium of about a half.

HMJr: About a half?

M: Yes.

HMJr: Well that's comfortable isn't it?

M: That - that's comfortable. Three quarters would be a little tight.

HMJr: Uh huh.

M: Three quarters figures out mathematically ah - a premium of only about four thirty-seconds.

HMJr: That's too close.

M: That's too close. Ah - Mr. Secretary, Mr. Harrison is here and he wants to talk to you.

HMJr: All right.

M: If you'll hold the wire I'll have you transferred.

HMJr: Thank you.

M: Is there anything else you'd like to ask me in the meantime?

HMJr: That's all.

M: Will you hold the wire?

HMJr: Surely.

(Pause)

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M: (Speaking to his operator: Secretary Morgenthau is on my wire. Will you transfer him to Mr. Harrison, please.)

George Harrison: Hello.

HMJr: Hello, George.

H: Hello, Henry.

HMJr: My heavens! You didn't give up the football game on this beautiful day?

H: I know. But I just had so much to do here before going down to my meetings that I thought I'd stay at the bank.

HMJr: Well that's a shame.

H: But I'll get out this afternoon. Ah - Henry, as far as the market is concerned we still feel exactly as we did yesterday.

HMJr: Good.

H: And I see no reason why you shouldn't go ahead unless all these lawyers are messing it up - I don't know. I don't know what is going to be the conclusion of their deliberations right now.

HMJr: What lawyers?

H: Well, they've found out, as you probably know, that the R.F.C. can't make an exchange.

HMJr: Yes.

H: And that you've got to offer to buy - ah - to sell to somebody who is willing to buy some from you.

HMJr: Yes.

H: And Matty says he thinks it's all right and that it won't make any difference but he hopes that the Treasury fellows will be liberal in letting - in the way they word their heading, so as not to confuse people too much.

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HMJr: The heading where?

H: Heading on the offering slip.

HMJr: I see.

H: On the circular.

HMJr: Uh huh.

H: Because it - instead of being an exchange offering it - apparently it will have to be a statement that the Treasury is going to be willing to sell to somebody who will sell something to the Treasury.

HMJr: Yes.

H: But we can probably explain that all right. It's too bad it had to come up.

HMJr: Well, ah - do you think the lawyers are right?

H: I don't know a thing about it. I don't know what the R.F.C. can do and apparently - they say the R.F.C. can't make an exchange offering.

HMJr: Yeah.

H: But I think we've got to accept the lawyers' judgment about it.

HMJr: Oh yes, I don't think there's any question about that.

H: Ah - and I'm raising the question not at all - ah - to dissuade the lawyers, because I don't know enough about it.

HMJr: Well, does Matteson think there's any question?

H: Did he speak to who?

HMJr: Does Matteson have any doubts about it?

H: No. Ah - he was a little perturbed that they might confuse people by the form of the heading on the circular.

HMJr: Well I'll tell Bell to be extra careful.

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H: Yes. And I've got him now, and Logan - they're all downstairs studying it and waiting to hear from the Treasury.

HMJr: All right. Well as soon as I hang up you'll hear.

H: All right.

HMJr: And ah - do you think if they leave that open Monday and Tuesday that'll be enough?

H: Well, I don't know, Henry. They're are only about 45 holders.

HMJr: Yeah.

H: We estimate.

HMJr: Well, I mean two days ought to be enough, oughtn't it?

H: I should think it ought to be enough because they're the type of people who get information quickly.

HMJr: Well, we - if there's any - for instance - confusion on Monday you can let me know; I won't say anything until Monday afternoon - when I'll close it.

H: Yes. I think that's best. I'll be in Washington Monday for a President's conference. But, what I'll do is - if it doesn't look as though it's going right during the day Monday -

HMJr: Yeah.

H: - I'll have Matty let you know so that you won't make a statement about closing it Tuesday.

HMJr: All right.

H: First rate.

HMJr: Now, one other question - did you see those stories about sterling?

H: I did.

HMJr: How did you like that?

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H: Well, I don't know - I couldn't get very much out of the stories other than the fact that you're all studying it. Now the net effect of that would be merely that it would show the British that you're interested in it -

HMJr: Yeah.

H: - and ah - that you are studying it.

HMJr: Well, that's just - that's all I wanted to do was to let the - let the World know we were interested.

H: Yes.

HMJr: And studying it. Well, shouldn't we be?

H: What's that?

HMJr: Shouldn't we be studying it?

H: Well, I think you should be. (Laughingly)

HMJr: Yes. Exactly.

H: Very much. I'll be interested to know what develops - when I get down there I'd like to talk to you about it.

HMJr: I'll be glad to see you.

H: All right.

HMJr: Thank you, George.

H: First rate.

HMJr: Goodbye.

HMJr: Hello.

Wayne Taylor: Hello.

HMJr: Well, you heard.

T: Yeah.

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HMJr: Ah - so - I don't know how the circular is worded but ah - ah -

T: We're going to ah - as I - I sent you a memorandum about that last night -

HMJr: I read it.

T: And we're going to send a special wire to each of the Federal Reserve Banks calling attention to that wording and explaining why it is necessary.

HMJr: Yes.

T: Ah - Matteson, Sproul and the rest of us down here feel that on account of the small size of the offering and the fact that it will only be of interest to forty or fifty people -

HMJr: Yes.

T: - all of whom will understand the circumstances, that we haven't got anything to worry about.

HMJr: Good. Well then I won't worry.

T: Yeah.

HMJr: And - now, Wayne, we'll let it - we'll do it just the way we're talking - 7/8ths.

T: Right.

HMJr: Will you notify Jesse Jones?

T: Yeah.

HMJr: So that he can have a Board meeting and legitimatize it?

T: Yeah.

HMJr: Now, what else am I to do?

T: Well, ah - papers will come right up if you're ready for them.

HMJr: Now, is Gaston around?

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T: Yeah.

HMJr: Is he in the room?

T: Yeah.

HMJr: Well then, he heard the discussion.

T: He did?

HMJr: Yeah. Anybody want to talk to me?

T: (Short pause) No. Apparently they want to go out and play golf or something.

HMJr: Well, let me talk to Gaston. (Laughingly)

T: Yeah.

HMJr: Hello.

Herbert  
Gaston: Hello.

HMJr: Herbert.

G: Yes.

HMJr: Did Davenport say when he wanted that article back?

G: Ah - not in any correspondence does he say definitely.

HMJr: Have you called him up?

G: I haven't called him. I - I can do that.

HMJr: I wish you'd call him.

G: Yes.

HMJr: And I wish you'd tell him that I've read it -

G: Yes.

HMJr: And I like it.

G: Yes. All right.

HMJr: See?

G: Yes.

- 10 -

HMJr: And then I wish you'd ask him what the deadline is for us.

G: Yes, I'll do that.

HMJr: See?

G: Yeah.

HMJr: Ah - is Bell reading it?

G: Yes. Bell read it rather hastily and made some notes and then he passed it over to one of his people to check some figures and transactions that he gives there.

(No more of this conversation was recorded.)

RADIOGRAM

AA

201

U S S Canopus  
(Hongkong)  
October 22 1938

NICHOLSON  
Spagent

Washa DC

Eugene Chen telephoned United Press tonight Generalissimo and Madame Chiang Kai Shek and Wang Ching Wei arrived Hongkong to negotiate peace terms with British Ambassador to China. T V Soong denies this report. In view latter's lack of vital information past week we cannot furnish definite data in regard to this subject.

CAMPBELL

U S S Canopus  
(Hongkong)  
October 22 1938

NICHOLSON  
Spagent

Washa DC

Canton formally occupied by Japanese today. The suddenness of Japanese victory has dazed British and Chinese leaders at Hongkong who believed latter would make strong resistance. The British view is that there must have been wholesale selling-out by Canton group to Japanese. Canton industrial plants including electric power cement paper plants destroyed by Chinese before Japanese approach. The bridge over the Pearl River was also blown up. T V Soong and others are shocked at the lack of resistance and have been totally uninformed in regard to events of last two weeks. British military and other authorities are disgusted with Canton give-away and expect definite reaction Central Government set-up. Yesterday United Press at Hongkong had informative report from United Press at Shanghai stating that British and German ambassadors to Japan had approached Japanese Government with mediation proposals which included Japanese recognition of status quo foreign interests and investments in China based on resignation of Chiang Kai Shek. United Press showed copy of this message to Ambassador Clark Kerr who is now in Hongkong on his way to Hankow. Kerr said confidentially and not for publication that such rumors were picked and pernicious that British ambassador to Japan had not approached Japanese Government on such plan and that rumors were probably instigated by Japanese who wish to undermine Anglo-American relations. Kerr further stated that he did not want such denial stated in press but that repeated undercurrent rumors along this line were continually instigated to influence American opinion against the British.

8891 48 799

CAMPBELL

TREASURY DEPARTMENT  
Office of the Secretary

October 22, 1938

TROUTBECK  
AMENIA  
NEW YORK

Dear Henry,

I suppose you have seen my friend Knollenberg's article on tax-exempt income, but I am enclosing it in case you have not.

W. White and I are most grateful for your kindness in the Helvering matter. He has promised sympathetic consideration of the case.

Ever yours,

J. S. Spingarn,



## THE SUPREME COURT AND TAX-EXEMPT INCOME

BY BERNHARD KNOLLENBERG

(now head Librarian of Yale University)

IN 1925 I had a hearing in London before one of the British Commissioners of Inland Revenue. After the matter in hand was threshed out he asked me if I minded answering a few questions about the United States income tax law and administration. Most of his queries dealt with our tax on capital gains, a feature of our law which Englishmen find rather puzzling. But the point that really baffled him was how we could make our tax system work at all if it was true, as he had repeatedly heard, that our State and municipal governments could issue an unlimited supply of bonds, the interest from which was entirely exempted from tax by the central government.

He said that at one time during the World War, when the British Treasury was particularly hard pressed, Parliament had authorized an issue of bonds the interest from which was exempt from supertax in the hands of British as well as foreign holders. But everyone regarded this as so unfair to British citizens whose funds were invested in taxable securities that the tax-exempt bonds were retired as soon as possible and no similar bonds were ever thereafter issued.

I was of course compelled to admit to the Commissioner that his information as to tax-exempt bonds in the United States was correct. But I went on to say that the system was not as unfair in operation as it might appear to be on the statute books, and that we were very British in not bothering about the logic of a thing if it worked tolerably well. I explained

that many of our well-to-do business men avoided a large part of the individual surtaxes, which nominally they were supposed to pay, by investing their capital in operating companies like the Ford Company which accumulate most of their earnings to acquire new sources of raw material or expand their plants and inventories. Others organized individual holding companies the income of which was accumulated and invested by the corporation in various ways free, except in extreme cases, from individual surtax.

I conceded that a few thousand outstandingly successful corporate executives, stock brokers, lawyers, and accountants were badly pinched by the surtaxes from which they had no means of escape. But since the income of these men consisted mainly of salary or fees from corporations or wealthy stockholders, they were not in a position to raise a serious outcry against a system which was acceptable to their benefactors. The Commissioner saw the point and agreed with me that, despite its lack of logic, the American system of tax-exempt bonds would probably survive until Congress made the surtax on corporate stockholders fully effective by forcing corporations to distribute their profits.

Such action came, eleven years later, by the adoption of the corporation undistributed profits tax of 1936. Finding his ox gored, the American business man now became keenly alive to the inequity of the tax-exempt bond. Complaints poured in to Washington over the unfairness of tax-

## WINE PARTY

It was so spontaneous (it was frightening). They looked at each other frightened. It was as if they had wanted to spring into each other's arms and had been restrained by the thought of how much, actually, separated them.

"You're cold," she said at last. She put his hand under her arm and hugged it into her warmth. It made it seem as if she were smuggling up to him. "Maybe," she said, "if you throw this jacket of mine round you . . . You must be very cold."

He looked down at her with an uneasy smile and she dropped his hand. She was

staring urgently up at him. There was fear in her face. He looked deep into her, as if he were plunging through the flesh. He did not see anything with his eyes. His brain was fainting with emotion. They were going to be together . . . soon now.

Her eyes jerked past him to the sea. "Where is Tom?" she cried. The sea was empty.

"Who?" asked Dick dully. "Who is who?"

He heard her whimper. He saw her begin to run toward the bare sea.

## WINE PARTY

BY BABETTE DEUTSCH

AS COINS because they shine  
Remain unspent,  
The golden-bodied wine  
Will first content  
The pure lust of the eye.  
Enough, if such rich luster pay the sight  
With interest upon long-washed light.

This pleasure as it pales  
Seems not so fine  
As what the glass exhales—  
Breath of the vine.  
Rare gust, be slow to die!  
We'll take it on the tongue, mixed with our breath  
The ghostly grape laughs jollily at death.

The wine, though cool as snow,  
Being drunk, is fire.  
The taste transmutes the glow  
Until desire  
Puts its long grieving by,  
Or finds some savor of sweetness in what's left.  
Though wrong, the heart exults, the shuddering heart.

The failure of delight  
That makes us rage,  
The treachery, the spite  
Of this fouled age,  
Wine's power can defy.  
The blood bounds in the vein, flesh unsubdued  
Forgets its pain, the soul forgets its solitude.

## THE SUPREME COURT AND TAX-EXEMPT INCOME 539

ing, at devastating rates of surtax, the active business man who risked his capital in productive enterprise while the investor who salted away his hoard in tax-exempt bonds escaped tax entirely. The "recession" was attributed in part to the movement of capital from highly taxed productive business enterprises into non-productive tax-exempt government bonds. Industrial leaders and the Administration agreed that the tax-exempt bond must be eliminated.

The only question was whether the ponderous method of a constitutional amendment must be invoked or whether an ordinary act of Congress would suffice.

The President decided to try the latter, and, on April 25th, sent a special message to Congress recommending that the existing federal income tax law be amended to include in taxable income the interest from State and municipal bonds. Congress will probably act favorably on this recommendation, at its next session, and thus precipitate one of the most important and exciting legal battles that our generation has witnessed. For the tax-exempt bond has a longer and more acrimonious history than any other constitutional question that the Supreme Court has had to face in the past five turbulent years of constitutional development.

### II

During the regime of Chief Justice Marshall, the United States Supreme Court handed down decisions in two cases (*McCulloch v. Maryland* and *Weston v. Charleston*) holding that taxes imposed by the State of Maryland and the city of Charleston, South Carolina, were unconstitutional because they discriminated against agencies of the federal government. Since a discriminatory tax by one government, State or federal, against the other would strike at the very roots of the dual system of government provided for in the Constitution, these decisions were unimpeachably sound. Marshall, however, in writing his opinions in these

cases unhappily made some superfluous statements—lawyers call them *dicta*—tending to imply that the taxes in question would have been invalid even though non-discriminatory.

In 1842, after death had removed Marshall from the bench, the Supreme Court decided *Dobbins v. Commissioners of Erie County*, involving a non-discriminatory tax imposed by Pennsylvania on all property including the value of any office held by any resident of the State. Dobbins, captain of a United States revenue cutter stationed at Erie, Pa., contended that the tax was unconstitutional as applied to the value of his office even though the tax was not discriminatory. Relying on Marshall's *dicta* in the *Maryland* and *Charleston* cases, the United States Supreme Court sustained Dobbins' contention, and thus established the doctrine that no tax could be imposed by a State based on income received from the Federal Government.

This unfortunate decision could perhaps be theoretically justified on the ground that if the Court sustained the tax, Pennsylvania or some other State might go communistic, impose a 99 per cent tax on all salaries in excess of some insignificant amount, and, if federal officials were subject to the tax, deprive the Federal Government of the necessary personnel for carrying out its operations within the State. But, however theoretically impressive this supposed danger might be, it was and is too remote to justify the Court's giving it controlling weight.

In a subsequent case, *Collector v. Day*, the Supreme Court carried its unsound decision in the *Dobbins* case to its logical conclusion by holding that the federal income tax, adopted temporarily as an emergency measure during the Civil War, could not be imposed on the salary of Day, a Judge of Probate for the County of Barnstable, Mass.; thus establishing that State officers engaged in a governmental function are completely immune from federal tax on their compensation from the States. But the question whether

private investors are exempt from federal tax on the income from bonds issued by the States was not raised until 1894, when Congress enacted the first peace-time federal income tax, which included a tax on income from State and municipal bonds held by private investors.

The entire tax, as far as it applied to income from property, was bitterly assailed as unconstitutional on the ground that taxes on income from property were "direct" taxes, within the meaning of Article I of the Constitution, and that the Constitution provides that "direct" taxes can be imposed by the Federal Government only

if apportioned among the several States which may be included in this Union according to their respective numbers.

The tax was concededly not so apportioned (in fact the very purpose of the tax was admittedly to extract much heavier taxes from the wealthy States than from the poorer ones without reference to their populations) and, therefore, if held to be a "direct" tax, was clearly unconstitutional. The opponents of the tax also contended that, even if the tax was constitutional as applied to income from property generally it was clearly invalid in so far as it applied to income from State and municipal bonds because of the decision of the Supreme Court in *Collector v. Day*. These questions were brought before the Supreme Court in *Pollock v. Farmers' Loan & Trust Co.*, which eventually held the tax unconstitutional on both counts.

There the matter rested for some time—until in 1909 the pressure for an unapportioned federal income tax became so strong that an amendment to the Constitution, which would permit Congress to impose such a tax, was pushed through Congress with almost no debate, being adopted by a unanimous vote in the Senate and with only fourteen "Nays" in the House.

As initially drafted, the proposed Amendment clearly dealt only with that part of the decision in the *Pollock* case holding that taxes on income from prop-

erty were "direct" taxes which must be apportioned among the several States according to population. It provided simply that:

The Congress shall have power to levy and collect direct taxes on incomes without apportionment among the several States according to population.

But the Bill was amended in the Senate Judiciary Committee to read as follows:

The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.

And this is the form in which the proposed Amendment was adopted by Congress and eventually ratified by the necessary number of the States.

It will be seen that there was a striking change in language between the first and second drafts of the Bill, namely, the substitution of the words "from whatever source derived" for the word "direct." There was no statement in Congress as to the reason for this change, but the natural implication from the words themselves is that some member or members of the Senate Judiciary Committee insisted that the proposed Amendment be enlarged to give Congress power not only to levy an unapportioned income tax but also to levy taxes on income from sources which, but for this enlargement, would be held exempt from tax.

In February, 1913, the Sixteenth Amendment was ratified by the last of the required three-fourths of the States, and in August of that year Congress enacted a federal income tax law. Congress limited the possible grounds for holding the new act unconstitutional by specifically providing in the law:

That in computing net income under this section there shall be excluded the interest upon the obligations of a State or any political subdivision thereof, and upon the obligations of the United States or its possessions; also the compensation of the present President of the United States during the term for which he has been elected, and of the judges of the

supreme and inferior courts of the United States now in office, and the compensation of all officers and employees of a State or any political subdivision thereof except when such compensation is paid by the United States Government.

The constitutionality of the new law was sustained by the Supreme Court in the case of *Brushaber v. Union Pacific Ry. Co.* But in its opinions in that and two later cases, *Stanton v. Baltic Mining Co.* and *Peck v. Lowe*, the Court gratuitously asserted that the only function of the Sixteenth Amendment was to relieve Congress from the requirement of apportioning federal income taxes among the States according to population, and that the words "from whatever source derived" did not give Congress power to tax sources of income previously immune. Such gratuitous statements are, however, so frequently ignored by the Court itself that Congress was plainly justified in disregarding these dicta, as it did, in enacting the Revenue Act of 1918.

### III

In the 1918 Act Congress, in its dire need for increased revenue for the War, provided specifically for the inclusion in taxable income of the salaries of federal judges. Walter Evans, a United States District Judge in Kentucky, sued to recover the federal income tax imposed under the new Act on his salary, and the case reached the Supreme Court in 1920, in *Evans v. Gore*.

Judge Evans contended that a federal statute requiring the inclusion of the salary of a federal judge in his taxable income "diminished" his compensation contrary to the provision in Article III, Section 1, of the Constitution that the compensation of federal judges "shall not be diminished during their continuance in office"; and that the Sixteenth Amendment, in empowering Congress to impose taxes on incomes "from whatever source derived," did not modify this Section.

There were two possible answers to this contention. The first is that the inclu-

sion of a federal judge's salary in income on the same footing with all other income does not "diminish" it, within the meaning of Article III, Section 1. The second is that even if the inclusion of a federal judge's salary in taxable income does "diminish" it and hence would have been unconstitutional prior to the adoption of the Sixteenth Amendment, the provision in that Amendment explicitly empowering Congress to impose a tax on incomes "from whatever source derived" meant what it said, and was intended to give Congress power to impose taxes on income from all sources including those previously immune.

The first point was ably developed by Attorney General Palmer in his argument before the Supreme Court, but the Court (Justices Holmes and Brandeis dissenting) rejected the Attorney General's argument on grounds that are not pertinent to this discussion. The second point, however, was completely abandoned by the Attorney General, who expressly conceded in his brief that:

It is not, in view of recent decisions, contended that this Amendment rendered anything taxable as income that was not so taxable before.

There were in fact no such "decisions." In the *Brushaber*, *Baltic Mining Co.* and *Peck* cases, previously referred to in this article, the Supreme Court had gratuitously asserted that the words "from whatever source derived" in the Sixteenth Amendment did not enlarge the power of Congress to tax sources of income previously immune; that the Amendment only relieved Congress of the necessity of apportioning such income taxes as it had always had power to levy. But the veriest tyro of a lawyer knows that such dicta—not "decisions" as the Attorney General described them—carry little weight and are frequently disregarded by the Court when it is called upon to decide (not merely talk about) a moot point.

The Justices, realizing that in passing on the exemption of Judge Evans' salary they were in effect deciding whether their

own salaries would be exempt, felt impelled to deal with the abandoned point on their own account. But this self-initiated consideration did not change the Court's decision. The Court held (Holmes and Brandeis again dissenting) that the Sixteenth Amendment did not give Congress power to tax sources of income previously exempt from tax, but merely made it no longer necessary for Congress to apportion amongst the States such income taxes as it had always been entitled to impose by apportionment.

The majority opinion on this point begins by saying:

Let us turn to the circumstances in which this Amendment was proposed and ratified and to the controversy it was intended to settle. (Italics mine.)

and follows with the statement that the only controversy in the *Pollock* case was whether Congress had power to impose an unapportioned income tax.

This statement is not true. As we have seen, there was not one controversy—"the controversy"—in the *Pollock* case. There were two. The second was whether or not income derived from a particular source, namely, interest on State and municipal bonds, could be taxed by Congress at all—even by a properly apportioned tax. This second controversy was not a mere lawyers' fight. It reflected a deep-seated issue between the radicals in Congress, who were determined to eliminate any loophole through which the well-to-do might be able to escape federal income tax, and those who regarded this consideration as of less importance than the retention of the existing limitation on the power of Congress to burden the States.

This difference in point of view was clearly brought out in the debates in Congress over the income tax law of 1894. While the 1894 tax bill was pending in Congress, Senator Hill of New York moved that interest on "the bonds of any State, county, municipality or town" be expressly exempted from the tax. But Senator Vest of Missouri successfully opposed this exemption on the ground that:

If this income tax be constitutional it ought to be equal in its terms, and it ought to operate upon all securities alike. If we should do now what we are asked to do, what would be the inevitable result? All the State and municipal securities would immediately go to an immense premium and all the capitalists of the country would invest in them because we should make them by act of Congress more valuable than any other investment.

When Senator Hill offered a new amendment to exempt from tax the interest on the bonds of any "State" (omitting "county, municipality or town"), Senator Vest successfully opposed this, also, saying:

If I wanted to murder the bill with the people of the United States I should put his amendment upon it. . . . Who makes investments in these bonds? Is it the man dependent upon his every day labor for subsistence? Is it the man living upon a salary even of five or six thousand dollars? It is the Capitalist.

Consequently the 1894 Act, as finally passed, imposed an income tax on "interest" generally, without any exceptions in favor of that derived from State or municipal bonds.

The same conflict appeared in the relatively limited debates on the Bailey-Commins income tax bill of 1909 (which was dropped to make way for the Sixteenth Amendment). Possibly because the Supreme Court's decision on the State and municipal bond interest point in the *Pollock* case made it clear that there was no hope of securing a reversal of the Court's position on that point, the 1909 bill provided for the exemption from tax of interest from State and municipal bonds. But this strategic consideration did not deter radical Senator Burkett of Nebraska, who favored the bill as a whole, from questioning this particular feature of it on the ground that:

how are you ever going to get over the unfairness in the case of a man who has his million, say, invested in county, state, municipal, district, and United States bonds? The Senator specifically exempts them. How are you ever going to make the law fair in the case of that kind of man who, in my opinion, contributes

the least to society and the least to the government than any other man on earth?

But to get back to the text of the Court's opinion in the *Evans* case, the next statement in support of its opinion on the meaning of the words "from whatever source derived" was as follows:

The message of the President recommending the adoption by Congress of a joint resolution proposing the Amendment, the debates on the resolution by which it was proposed, and the public appeals—corresponding to those in the *Federalist*—made to secure its ratification leave no doubt on this point. Governor Hughes, of New York, in a message laying the Amendment before the legislature of that State for ratification or rejection, expressed some apprehension lest it might be construed as extending the taxing power to income not taxable before; but his message promptly brought forth from statesmen who participated in proposing the Amendment such convincing expositions of its purpose, as here stated, that the apprehension was effectively dispelled and ratification followed.

The facts referred to in the foregoing statement are as follows: In June, 1909, President Taft recommended the adoption of an Amendment giving Congress power to impose an income tax without apportionment among the States. His message said nothing one way or the other about giving Congress power to tax income from sources which might be entirely exempt from tax, and, as first introduced, the Amendment was directed solely to the point referred to in the President's message. But, as previously pointed out, the proposed Amendment was later redrafted to include the words "from whatever source derived," and was adopted by Congress in this revised form.

As to the Court's reference to "the debates" on the resolution for the Amendment, they were, in fact, so meager as to throw no light on the meaning of the Amendment and justified the complaint of Congressman McCall of Massachusetts that "for the House to perform its part in such a solemn transaction as amending the Constitution of the United States without having the form of the amend-

ment seriously considered by one of its committees strikes me as a proceeding of extraordinary levity."

As to the "public appeals" to which the Court referred, the situation was as follows: When, in January, 1910, the question of the ratification of the proposed Sixteenth Amendment came up for consideration by the New York legislature, Governor Hughes of New York sent a special message to the legislature pointing out that the words "from whatever source derived" in the proposed Amendment, "if taken in their natural sense," would empower Congress to tax incomes derived from State and municipalities. He questioned the advisability of giving Congress this power, and recommended that the proposed Amendment be rejected unless and until this provision was eliminated.

This was a bombshell to the members of Congress who were trying to rush through the speedy ratification of the Amendment, lest Congress be tempted to thumb its nose at the Supreme Court by enacting a federal income tax law without waiting for a constitutional amendment expressly authorizing it to do so. A number of them, including Senator Root of New York, issued statements pooh-poohing Governor Hughes' suggestion and stating that, in voting for the proposed Amendment, they had thought the words "from whatever source derived" were intended merely to emphasize that Congress should be permitted to impose income taxes on the sources previously subject to tax, free from the requirement of apportionment. The New York legislature, without giving its reason or reasons, refrained from ratifying the proposed Amendment at this session.

However, in the fall of 1910 John A. Dix, candidate for Governor of New York on the Democratic ticket, ran on a platform pledging his support of the proposed Sixteenth Amendment, without revision. He was elected, and carried out his pre-election pledge by writing a public letter to Mayor Gaynor of New York City in April, 1911, in which he said:

I cannot agree with those who maintain that the proposed constitutional amendment should be defeated, because of the possibility that it empowers the National government to tax the income of state and municipal bonds. This interpretation is doubted by many authorities; but even if it were valid, the amendment, in my opinion, should still be approved.

Assuming that the amendment will be ratified by the necessary three-fourths of the states and thereby become an integral part of the United States Constitution, the income tax it authorizes can be imposed only by the vote of Congress. The states are fully represented in both houses of Congress, and in the Senate equal representation and vote is given each state.

How, then, can a Federal income tax be imposed which could be oppressive in its effect on state and municipal bonds, without the consent of a majority of the states? Is it possible that the states through their representatives in Congress would vote an unjust and destructive tax upon their own credit and securities?

Governor Gilchrist of Florida had issued an even more emphatic challenge to Governor Hughes' view that it was unwise to give Congress power to tax State securities. In an open letter to the *New York Times*, he said:

The proposed Constitutional amendment provides "that Congress shall have power to lay and collect taxes on incomes from whatever source derived". Congress could, therefore, tax incomes derived from state and municipal bonds, and could exempt incomes so derived. Senators and Congressmen, being necessarily residents of states and generally of municipalities, would not pass a law which would destroy through taxation the credit of their own state and of their own municipalities. Senators and Congressmen understand the law of self-preservation as applied to themselves. They wish to be re-elected. I favor the income tax amendment, Gov. Hughes' objection to the contrary notwithstanding.

Shortly after Governor Dix's pronouncement the New York legislature ratified the Sixteenth Amendment, and in February, 1913, ratification was completed by a favorable vote of the necessary three-fourths of the States.

In the light of these facts, what justification had the Court for its assumptions

that (a) the State legislatures were disturbed by Governor Hughes' warning that the Amendment might be held by the Supreme Court to mean what it said and (b) were reassured by the declarations of certain "statesmen" that it did not? Considering the history of the Amendment herein set forth, is it not equally reasonable, or more so, to believe that the Hughes message was reassuring, not disturbing, to most of the State legislatures which were considering the proposed Amendment; reassuring because it convinced them that the Amendment, if adopted as it stood, would empower Congress to tax incomes from whatever source derived, and not leave a loophole of tax-exempt bonds through which "the Capitalists"—to recall Senator Vesp's speech—could escape the tax?

It is a firmly established and reasonable rule of construction that if the language even of an ordinary statute is grammatically unambiguous and provides for something that Congress might conceivably have been seeking to accomplish, the statements of individual legislators that it means something else are to be disregarded. In the case of a federal constitutional amendment, this rule must apply with special force, because Congress, in submitting the amendment, acts as a proposing rather than a legislating body, so that even if it could be assumed that Congress as a whole had used the language of the proposed Amendment in some Pickwickian sense, it would not be fair to assume that the State legislatures had adopted this eccentric meaning.

It seems evident that the majority opinion and decision in the *Evans* case was erroneous in holding that the words "from whatever source derived" did not mean what they say.

#### IV

It was eight years more before the question of whether Congress had power to impose a tax on income from State and municipal bonds arose. But unless the Supreme Court was prepared to overrule

its decision in the *Evans* case, it was a foregone conclusion that the Court would decide against the power of Congress, and this it did in the case of *National Life Insurance Company v. United States*, decided in 1928. Still later the principle of the *Evans* case was stretched to its ultimate conclusion in *Brush v. Commissioner*, in which the Supreme Court held that Congress could not impose a tax on the pay of an employee of the New York City Water Department, because this income was derived from a source immune from federal taxation.

Thus, federal judges, the owners of State and municipal bonds, and most State and municipal employees are now held to be a privileged class, immune, wholly or in part, from one of the major burdens to which their fellow-citizens are, or can be, subjected. This situation, especially the tax-exempt bond aspect of it, is intolerable. It prevents the formulation of a sound and equitable federal tax program in ordinary times. It constitutes a serious menace to our national well-being in time of war or other fiscal emergency. And finally it is a breeder of financial difficulties for many of the States and municipalities that it is supposed to protect, by tempting them to borrow extravagantly because of the relatively "cheap" money to which the tax-exempt feature of their bonds gives them access.

As to the cure, the President was on solid ground in declaring in his message of April 25th that the most practical solution of the problem is for Congress to tax income from supposedly immune sources and give the Supreme Court another opportunity to pass on the question whether or not the words "from whatever source derived," in the Sixteenth Amendment, mean what they say. The Supreme Court as now constituted would probably welcome, not disapprove, a statute presenting the question to it anew. In view of the fact that even the ordinary layman can perceive the unsoundness of the majority opinion in the *Evans* case, it may easily be imagined how glaringly apparent this must be to most of the present

justices of the Supreme Court,—and how galling, considering that they are in a sense its sponsors!

The willingness of the majority of the Supreme Court as now constituted to overrule indefensible decisions on constitutional questions, no matter how long established, is strikingly illustrated by the recent decision and majority opinion of the Court in *Erie Railroad Co. v. Tompkins*. For over ninety-five years, the Supreme Court had adhered to the rule, which it had established in 1842, that the federal courts are not required to follow the decisions of the State courts in matters of non-statutory local law. But in April of this year the majority of the Court discarded this long-established rule, saying:

If only a question of statutory construction were involved we should not be prepared to abandon a doctrine so widely applied throughout nearly a century. But the unconstitutionality of the course pursued [i.e. pursued by the Court itself] has now been made clear and compels us to do so.

As shown by the quotation, the Court, in considering whether to overrule an earlier decision which it now thinks was erroneous, will distinguish between decisions construing the meaning of an ordinary act of Congress and those construing the meaning of the federal Constitution. This distinction, which has long been advocated by Justice Brandeis, is eminently reasonable. If the Supreme Court makes a mistake in construing an ordinary statute, Congress and the President can, at the next session of Congress, amend the statute, stating in more explicit terms what was intended in the first place. Such being the case, it may well be preferable to let Congress rectify the Court's error rather than for the Court itself to overrule its earlier decision. But the same is not true of an error in construing the meaning of the Constitution. In such a case Congress has no power to correct the Court's mistake, and, unless rectified by the Court itself, the error must persist until corrected by the cumbersome process of constitutional amendment.

But in providing for a tax on income now exempted, Congress must, in fairness, take into account the fact that billions of dollars' worth of outstanding bonds have been sold by States and municipalities at an abnormally low rate of interest on the assurance that the interest would be exempt from federal income tax. I estimate that the interest on tax exempt bonds is about fifteen per cent less than would have been demanded if the interest had been taxable. If this estimate is correct, the owners of State and municipal bonds should be allowed to deduct from their income taxes otherwise payable an amount not exceeding fifteen per cent of the interest received by them from such bonds. If, after investigation, the Treasury Department should find that the differential has been more than fifteen per cent, the maximum tax credit should be correspondingly increased.

Secondly, to guard against the unfairness of retroactive taxes, Congress should provide that if the Supreme Court sustains the new tax on income previously held to be exempt, the Treasury Department shall not attempt to impose taxes on similar income received in prior years.

In the third place, the salaries of our federal judges should be increased by an amount roughly offsetting the federal income tax that will be payable on their salaries under the proposed new tax law. Fairness requires this in the case of federal judges now on the bench, most of whom must have taken into account the prevailing exemption of their salaries from federal income tax in considering whether to

give up their law practice to accept their appointments. In the case of future appointments, the increase will be necessary to induce men of high ability to leave private practice for the bench. For reasons which will be apparent to those familiar with the operation of the surtax, the proposed increase will not fully offset the existing tax exemption in the case of federal judges with substantial incomes from other taxable sources, but it would be inexpedient to make any special provision for such special cases.

As a corollary to its taxation of the income of State officials and from State bonds, Congress should give the States the right to impose income taxes on the salaries of federal officers and on the interest from future issues of federal bonds. No constitutional amendment is required for this purpose. The rule of immunity of federal instrumentalities from State taxes was developed by the Supreme Court to protect the federal government, and if the federal government sees fit to waive this immunity the Court will presumably give effect to the waiver.

Finally, Congress should put a stop to future issues of federal securities containing a clause for exemption from federal income tax. The interest on outstanding federal securities containing such a clause, must, of course, continue to be exempted from federal tax. A federal tax on this interest would be a breach of the public faith. But if Congress will stop issuing such bonds, this one remaining loophole of tax-exemption will gradually close itself by the redemption of the existing bonds, most of which fortunately have an early maturity.

RE FEDERAL BUDGET AND NATIONAL INCOME  
(2211 30TH STREET)

October 23, 1938.  
8:30 p.m.

Present: Mrs. Morgenthau  
Mr. White  
Mr. Leon Henderson  
Mr. Leuchlin B. Currie  
Mr. Isador Lubin  
Mr. Gardiner C. Means  
Mr. Charles W. Eliot, 2nd  
Mr. Mordecai Ezekiel

H.M.Jr: Well, gentlemen, I took the liberty of asking you to come here tonight for this reason. We've got a lot of problems in the Treasury, as you know, and particularly at this time of year when we're working on the budget - question of revenue, question of taxes. And the more I look at this thing, the clearer it seems to me that maybe - you people may have seen it all the time, but it hasn't been ... - that certainly, talking for ourselves - we give a little piece, some other department does a little piece, then somebody suggests, say, to the President, "Won't you make a talk of peace to business," and he gets very grouchy and he says, "Why put on that old record again?" and that puts it off.

And what it looks like, I mean, is that from my standpoint - and that's what I want to - if you'll talk about - when we begin to talk about taxes and Government expenditures, the thing that we - I think we've got to have is a much, much bigger national income than we have ever had before. And if we could get a sufficiently big national income, why, then a lot of these things like taxes and prices for agricultural commodities, lot of these other things, fall into their ....

Henderson: "Peace for the business man."

H.M.Jr: "Peace for the business man."

.... lots of things will become easier.

Ezekiel: Even C.I.O.

H.M.Jr: Well, from the figures we developed, the thing that stuck in my mind was this: a hundred billion dollars national income meant 149 percent Federal Reserve

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index for production. And the most interesting figure of all, I thought, was that 100 for the Bureau of Labor Statistics prices. And people talking about price inflation - well, you've got to get up to 149 percent, from the calculations we made for a hundred billion dollar income, in order to get your figure, which is around 78 now, up to 100.

Henderson: That must have been a straight assumption.

White: Yes, it was, Leon.

Currie: You have to make an assumption.

Lubin: You could turn it the other way around.

H.M.Jr: We turned these figures over to the Committee the other day. Guess Haas has given them to you to check.

Means: They conform to our figures also.

H.M.Jr: They do?

Means: Yes.

H.M.Jr: Well, I'm not - I just want to throw out what I have.

Henderson: I mean right at that point I don't agree for one minute that on a hundred billion dollar income the price level will only be 100, unless there is a tremendous amount of intervention on the part of government in factors of supply and control of credit, and things like that.

Lubin: Maybe I didn't understand the Secretary the way you did. I understood him to mean that with an index of production of 149 and a price index of 100 you get 100 billion dollars worth of income.

White: That's right. It's not the other way around.

Henderson: That's all right.

H.M.Jr: And as I say, we have turned these over to be checked and we'll be more than pleased to have anybody else check them. I mean I can't defend them, I didn't work

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them up. I mean they're there, and I ....

Henderson: Put it this way, Mr. Secretary. One of your big problems is what you do to prevent a blowing up of prices with any kind of an increase in production that falls short of the full use of capacity. The difficulty we had in '36 and '37 was that in a number of the segments of industry where the utilization of capacity was only 60 to 70 percent, there was an increase in prices that ran beyond the 1929 level, and that was the cause of the dislocation and disturbance, in many cases.

H.M.Jr: Well, may I .....

Henderson: And one of the prime problems is how you exert the governmental participations in economic activity to the extent that you do not get those runaways.

H.M.Jr: Well, I just want to give you ...

Means: ...what we're shooting for.

Henderson: It's all right to assume it.

H.M.Jr: I just want to give you one other figure, if I may. If - as I say, I'm not - I'm not saying that we want a hundred billion, but I just use that as a figure and I want to - what I want you fellows to do is, how can we get there and do we want to get there? I mean is that a mark we want to shoot at?

The other theoretical figure is this: that if we should reach a hundred billion on the present tax basis, if taxes weren't changed one iota, our revenue would be over nine billion dollars, see? And that's - I mean those are the figures I carried.

Now, the thought I had was this: can the country produce a hundred billion? What will become dislocated, and all the rest of that? Is that a thing we want to work at?

And instead of always going to the President and having people say, "Well now, let's all get together with brotherly love" and all that sort of thing - is it something we want to do, to have all the various departments working toward a goal, trying to get the activity - I mean can we ever get this wealth down to the lower

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third? Can we ever cut our deficits? And I mean unless something like this - there never - it's very depressing, from the Treasury standpoint, because I can't, I mean, see that within a - we can cut expenses very much, I can't see that we're going to change the unemployment very much, I don't see that we're going to be very much better off. Agriculture is going to ask for constantly more money. I mean we're just going around and around, and I just wondered if we couldn't take a fresh look at this thing, and the possibility really of building up this productivity. What would the people working for the Government have to do to build this up to reach it, and what's the goal we want to shoot for?

That is very briefly what I want.

Ezekiel: Probably the most important single problem the New Deal has.

H.M.Jr: And we've never attacked it all together, Ezekiel, not all working for one. And so often we're all tripping over each other; we may be doing something that hurts you, and vice versa. And there's never been a group which has all worked ..... Henderson's afraid of price inflation, somebody else is afraid of something else.

But if we said, "Well, this is the goal we want to shoot for. Now Morgenthau, don't worry about increased taxes; we'll get them for you, because we get them for you through additional income and things like that."

See what I mean?

Henderson: You say that only through increased national income are you going to get a reduction in the deficit and a repayment of any of the debt.

H.M.Jr: Well, that, gentlemen, is what I asked you to come for, and I'd like you to - if you would just talk about it, and you can - if you would talk as freely as you feel.

White: Why might we not start in with some examination of the picture of anticipated incomes at the various levels, the distribution of that income, and the yield of those taxes? I know that Gardiner Means

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has made some studies and has some brief picture that might start the ball rolling in that direction. Then we can ....

Means:

I think most of all - I think the thing is that the very act of getting some measure of agreement as to what the level of national income, if we had full use of resources - what that level would be, would be a coordinating influence of tremendous importance.

We have done some studying very similar, I think, to that done in the Treasury, in which we have tried to arrive at the figure at which we'd have full employment. This is the chart that corresponds probably with the material you have. On the left there, the actual employment in '29 and in '35, converted, taking the part-time employees and making them the equivalent of full-time. Then two lines, almost on top of each other, which represent the amount of manpower that would be absorbed - could be expected to be absorbed at different levels of national income, using 1935-36 prices. Most of the members of the Industrial Committee are familiar with this chart, so I don't think you need to pass it around.

When at the left of the chart is the available manpower, and we come out with the figure of about 90 billion at 1935-36 prices. If prices went up back to 1929 levels, it would be 105 billion. So that 100 billion is probably within the range.

H.M.Jr: Within the range.

Means: With further work by your (Currie) board and our board, we could probably narrow the margin down to the point that the figure was a hundred billion, or somewhat over or somewhat under, under this, that or the other condition.

H.M.Jr: Already I've heard some people murmuring about this thing going too fast: prices. I mean I'm just going to slaughter the first person that says so publicly - I mean that the thing is going too fast.

Means: Yes, the distance that still remains to be gone is great.

H.M.Jr: It's tremendous.

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- Means: Tremendous. And the implications are that in terms of easing up the increase in profits in industry, the increase in profits in wages, in taxes - tax receipts....
- Ezekiel: Of course, the things that are in danger of going too fast are the things like the increase in the price of copper as the demand increases, when as a matter of fact their costs are falling. If industries like that continue to jack up their prices, to get a larger and larger margin of profit, they can soak it off long before it reaches present levels.
- H.M.Jr: Have you people made any calculations of present factory capacity of this country? I mean can it produce or will they begin to have to add to plant?
- Means: We went at it a little differently, and we said, "What's the consumption and what's the manpower in different industries that would be absorbed?"
- H.M.Jr: Would you explain that, because I haven't thought of it along those lines, and nobody's explained it to me that way.
- Means: What we're trying to do is say, if we had a national income of a hundred billion, such as you suggested, how many people would be employed in this, that or the other industry; what would each industry be called on to produce: how many pairs of shoes, how many million yards of cloth, how many tons of coal? And in those terms we worked out as a very preliminary undertaking a set of conclusions that point to a building up for the whole economy the amount of activity in different industries.
- What we have not yet done and what we have in mind to do is to try to build up a picture of the amount of new capital equipment that would be called for. We have made one study in the iron and steel industry, where we have tried to figure out at a 90 billion national income just what - a hundred billion national income - what would be the amount of steel that would be called for in each major type of steel production: steel rails, sheet steel, steel wire, what have you. And then we've carried that back through the industry to find out just how much steel production, ingot production, pig iron production, iron ore production, coal

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production for the purposes of making coke, would be required.

And then at each stage we have calculated approximately the amount of new plant that would be called for in addition to the existing plant.

Now, on the basis of data that are available, we can't do that accurately enough to say that for this industry thus and thus is so, but we can have a basis for building up a national figure of the expansion in equipment that would be required.

- Henderson: Let's put it this way, Mr. Secretary, that what you might ask in this group - the first question to be asked is whether or not a productive capacity at the present time is higher, lower, or about the same as '29. My own feeling is that it is not any higher than 1929; it's just slightly less. What would you think, Currie?
- Currie: That's about right. But in the meantime your working population has increased.
- Henderson: Your working population - but I'm talking about physical capacity.
- White: That's exactly the question that the Secretary has asked, as to whether ....
- Henderson: I'm trying - I'm not trying to get into opinions on that, because it definitely relates to his question of how - whether we can get there and how we can get there, and what are the difficulties that are to be encountered before we get there?
- H.M.Jr: And what would the dislocations be, if any?
- Henderson: The dislocations - when do they start?
- H.M.Jr: Pardon me.
- Henderson: We're at about a 65 billion dollar rate of national income right now. Given another - given 72 billion dollars, that rate, you begin to run into difficulties.
- White: Leon, supposing we proceed this way. Let Gardiner

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present some of the material he probably has on income briefly - distribution of that income, which will indicate the amount of savings that we may anticipate at the various levels. Then we can let Currie pick up the ball to take up what will be the demand for capital equipment at the various levels and in the various industries. And then there will emerge from that the beginning of the answers to the questions as to where the dislocations will appear. And then you'll carry on the ball from that. Huh?

Means:

A major problem in connection with that size of income is whether we're going to get a saving which has an opportunity to express itself in investment and in the creation of new capital goods which provide buying power and which build up the national income. It is a circle of - a problem of providing a buying power.

We have made some studies derived from the data partly collected by Dr. Lubin's organization and partly by the Bureau of Home Economics on the savings by the various income groups. As you go from the lower income groups at the left up to about \$1,200 to \$1,500 income, family income, you have an actual negative saving; they're using up their bank accounts or their cash on hand, or they're borrowing or buying on time. Beyond that point you have the savings by the various groups that are represented in that chart; represents the aggregate savings by the different groups.

When you get an increase in national income, you get an expansion of the saving as different groups move up to a higher level of income. And on the basis of that type of analysis we have made some very crude first approximations - they're almost guesses - as to the savings that you might expect at a hundred billion national income. They run up into the figures of 15 to 17 billion of savings.

You have a second form of saving by corporations, as they make profits which aren't distributed as dividends, adding another perhaps two to three billion. And then you have their fund which they credit to depreciation, various funds which in order to insure buying power on the part of the public have to be expended in capital formation, in building new plants - plant and equipment.

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- White: What does that total?
- Means: That total - I'm hesitant to give any total, because this type of analysis only progresses to a point where it begins to suggest answers rather than give them.
- Henderson: You mean what's the ....
- Means: 24 to 30 billion.
- White: Yes, I just wanted some rough idea.
- Means: Somewhere in that range - 24 to 30 billion.
- White: 30 billion.
- Ezekiel: That's net saving, above maintenance and depreciation?
- Means: No, it includes about five billion of maintenance and depreciation.
- Ezekiel: That's really the amount available for capital expenditure, not capital formation. Capital goods expenditure.
- Means: Capital goods expenditure. Gross expenditure in business. That doesn't take account of your durable goods purchased by consumers, like automobiles, but it takes care of housing, residential housing.
- And one of the problems of insuring that full national income is making sure that that 24 to 30 billion dollars has an outlet in the way of capital investment. Either that sum must be invested in plant and equipment or it's going to constantly - the effort to make that saving on the part of individuals is going to impede, is going to diminish buying power as effectively as if the individuals simply received money and buried it.
- So the problem there is to clarify those figures. The second one is to find out how that saving is likely to express itself as an opportunity to invest.
- H.M.Jr: I was going to say: going back over history, have we had cases where excess savings has so to speak bogged down the economy?
- Means: We haven't really had data enough in the past to answer

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that question.

Henderson: Well, that was the conclusion of the Brookings study, certainly. That was their conclusion, certainly.

Elliot: '29 was a bogging down.

Henderson: That '29 was distinctly a problem of investment of excess savings.

White: Up to now they've explained the series of depressions on those grounds, but they've never had the data which has enabled them to give proof that would satisfy pretty careful observers, so they have had to fall back on reasoning rather than supporting it with evidence. But in the last recession there's a good deal more evidence available which points to that. I think you've got some figures, haven't you, Currie, on the last five years?

Henderson: Wait a minute before we pass on from that, Harry. You say that - it depends on whom you say that it didn't satisfy - the Brookings analysis. I think the thing that could be said about the Brookings analysis is not that it didn't satisfy, but that their estimates were entirely too generous as to what was the volume of savings, volume of over-savings. And since it was too generous, they were called upon to explain how that amount of saving got dissipated and they got into some ludicrous explanations on that. But most people did not reject the Brookings analysis as to the idea of an excess of savings seeking investment at that time, particularly in terms of the physical expression of it, in terms of Chrysler buildings and Empire buildings, the mad demand of insurance companies, the expression in the stock market, bidding up of stocks and things like that. I mean I want to put - I wanted to put that point in, because I think it is germane to - when you come to the last period, to see what Currie has done.

Jean: Look, Leon, I think it's very important, the point you're making there; namely, that the Brookings statistically have not established it; they have theoretically established it. There are a lot of people have established it could happen, and I don't think anybody had a ....

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- Henderson: They've established a statistical pattern which wasn't a good one; Harry's right in that. Idea of 15 billion dollars or something like that was just a hocus-pocus that wouldn't stand up.
- Means: I think it is very possible that their conclusion is right. I don't think it is statistically established. Answering that that it hadn't been established.
- H.M.Jr: May I ask you, at this stage of 65 billion, have you any estimate what the national savings are?
- Means: Probably make them. I haven't sat down and tried to make them.
- Henderson: It's probably around eight billion dollars, exclusive of depreciation account. Eight billion dollars of real savings, exclusive of depreciation account, which would run to four to five billion dollars.
- H.M.Jr: Well now, I'm asking - I don't know.
- Lubin: Over 20 percent - that's too high.
- White: You've got from '35 ....
- Ezekiel: Six billion in '35, '36, and the national income 10 to 20 percent higher. Seven to eight billion would sound reasonable.
- Henderson: I would say it's not more than that.
- Currie: I have some indirect evidence here that the volume of savings is pretty - was pretty large in 1937. I don't know if I've shown any of you people yet - just work I've been doing this last - short time, just very recently, in my section.
- Henderson: Before you go on to that - I mean, for the Secretary's purposes, on the over-savings question, there was no - there is no doubt, is there, Lauch - it may be six, it may be eight, but there was an excess of savings over real investment.
- Currie: Logically you can't get away from this: any time the income is falling, there must be an excess of savings over investment; when income is rising, it is the

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opposite. But logically all through from 1929 right to '33 there was an excess, and this last year there's been.

Means: Logically it's established. In statistical fact and substance I don't think too much weight ....

H.M.Jr: I'd want to - I mean may I just raise my finger and say, "I'll pass, but ..."

White: "With reservations."

H.M.Jr: "... that doesn't mean I accept it."

Currie: There's a lot has to be explained.

Henderson: You'll come in if anybody bats.

H.M.Jr: I'd like - just like to pass.

Means: What we need is a lot more work on this.

Currie: On this '37 situation there's an evidence of probable over-saving. Then I think this chart bears on it. I don't think I have enough to go around; if you people can share that.

(The chart referred to was entitled "Consumer Expenditures and Total Income Payments Other Than Interest and Dividends")

Consumer expenditures of wage-earners - I've correlated this with consumer income, exclusive of interest and dividends, and it runs very closely all right from '29 right on.

But, you see, what happened in '37 - we know from other sources there that despite the fact that installment credit was built up to levels in excess of '29 in '37 - an increase - and despite the fact there was some three billion addition to inventories, nevertheless your consumption did not keep up with your income there in '37; in fact it slumped off and leveled off. And then, of course, the slump came. In other words, I'd say that you'd have to have about two billion or three billion or four billion more investment to increase income sufficiently to sustain that rate of increase in

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consumption that was going on from '33 up to '37.

Lubin: May I ask a question there, Lauch?

Currie: Yes.

Lubin: In '37, judging by these figures, your income was exceeding expenditures by approximately, oh, a hundred million a month roughly? A little over two hundred million a month?

Currie: Yes.

Lubin: Which is two and a half billion a year. Then the difference between that and total savings was what was paid out in dividends and interest?

Currie: If I put the dividends and interest in here and retained earnings, you see, which is also part of the national income, there would have been a marked divergence between your dotted line and your consumption. The dotted line, your national income, including the amount retained by corporations, would have gone up steadily here, but consumption would not have kept pace with it.

Lubin: I see.

Currie: So even in 1937 there was evidence of the trouble that's going to be ahead of us.

H. S. Jr.: Do you mind if I kind of come back again to - I mean just for a minute sort of bring it back?

Currie: This is your meeting. Go ahead.

H. S. Jr.: It's all of our meeting, but I want to get as much help as I can.

In getting back to this thing that Mr. Means was talking about, the question of savings and the rest, have you correlated this to Government expenditures - if you want a pump-priming or anything else? I mean have you the relationship to pump-priming that the savings and national income bear? Have you done that? Because that's where I come in.

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Means: We discussed that at our last meeting, and Dr. Currie ...

H.M.Jr: That's the meat.

Means: ... is having his people work on that.

Elliot: Currie's got it.

Currie: This chart (another chart) is - I tried to measure ...

H.M.Jr: I'm not trying ....

White: The significance of that first chart that he just showed - it really should follow the other. That should come first, the one you have in your hand now.

H.M.Jr: I just feel - little bit too detailed for the moment.

Currie: You probably have seen this chart before, Mr. Secretary. It is an attempt we have made - Dr. Viner initiated it at the Treasury, then I continued it after I went to the Federal Reserve - to get a smooth measure of the current contribution to buying power made by the fiscal policy of the Government. And as you notice that very sharp slump in '37, which helped explain ....

Means: Will you explain your curves first, Lauch?

Elliot: What are these lines?

Currie: The lower lines are the difference between the top two lines, you see.

H.M.Jr: Now, receipts - this is Government receipts?

Currie: Yes.

H.M.Jr: And the top is ....

Currie: Adjusted expenditures.

H.M.Jr: Meaning you take off what?

Currie: I take off refinancing.

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- H.M.Jr: Do you take out Social Security?
- Currie: No, the appropriation to Social Security ....
- H.M.Jr: But the contribution.
- Currie: ...but not out-payments on Social Security. That's included.
- H.M.Jr: That's the difference?
- Currie: Difference, that's right. Then I've tried to smooth out the income tax payments and interest payments - see, they're smoothed over a three-months period.
- Then I tried to take the agencies' actual expenditures and collection of Social Security taxes in the field rather than when the Treasury collects them every quarter, you see.
- H.M.Jr: I see.
- Currie: It's plainly the cash deficit, adjusted smoothly.
- Means: It's really a net contribution; comes either from Government borrowing or from a reduction in the Treasury balance.
- Currie: Yes, that's right.
- Now, I think that sharp fall from '36 to '37 had something to do with the flattening of income shown in the other chart.
- H.M.Jr: I see.
- Currie: But I'd like to draw your attention to the fact of how well income has kept up in '38. Production went completely to hell, just slumped right off - one of the sharpest falls we've ever had. Despite that, income kept up and consumption kept up. I think that's attributable to your rise in adjusted expenditures in the Government.
- Henderson: Production for consumer goods didn't have the tremendous drop that you had in all production....
- H.M.Jr: And the other thing, ....

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Henderson: ....which is a fortifying statement to the net contribution to activity.

Currie: In other words, if you keep up buying power of wage-earners, people like that, you keep up consumption.

Henderson: Yes.

Means: And opportunities for investment.

Currie: This chart illustrates the difference in this last recession from 1929. I've charted there - I'm sorry, I haven't got any copies - the compensation of employees from mining, manufacturing, construction, on the one hand, and from public service on the other. And in 1929 the mining, manufacturing, and construction is very high in relation to public service. In this last recession we have been coming up steadily: public service, relief, Social Security payments; and we have actually increased, and if you include farm benefit payments and some of the construction in there, the governmental - state, municipal, local and Federal - is now more important at the current moment than all of mining, manufacturing, construction, as a source of income to wage-earners.

Elliot: Every time we get into one of these things, it makes me wonder how far the human brain can go.

Currie: Is it as bad as that, Charles?

Elliot: No, I mean, as to how far - everything that you gentlemen say at all these sessions shows more and more problems of administrative judgment, and how in the dickens we're going to have enough brains in any group such as this, or any other combination in years to come, that can make these decisions, I just don't see.

Lubin: Charles, let me ask you a question. Who did it last year, ten years before that - ten years ago, twenty years ago?

White: They just did it a little worse.

Lubin: It was just done pell-mell. You let a million judgments operate in industry and look what you got out of it.

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- White: I think the significance of that first chart needs to be brought out a little more clearly now in relation to the other chart.
- Currie: I think the significance of the thing - well, there are various things you can draw from it, but the really important thing is that it's the first time that I've seen a statistical demonstration of the fact we have all believed up to now, that consumption follows buying power.
- Means: Buying power - not from your dividends.
- Currie: Wage-earners' and farmers' income. That's what it really represents.
- Ezekiel: I wonder, Leuch, if you could also make another interpretation of it, that despite the ability of private business or despite the lack of ability of private business to reinvest the current savings, the fact that government was stepping into the gap and making these expenditures made it possible to have a continuous expansion in activity, even though private business was not itself making the necessary expenditure, necessary investments, to balance savings.
- Currie: Yes. Yes, I think that one chart leads logically to the other: your contribution by your government to buying power and the increase in incomes and increase in consumption.
- Then I have other charts, if you care to see them, showing the follow-up of private investment behind consumption.
- White: You mean private investment follows consumption.
- Currie: Up to 1937 there was far more follow-up than generally appreciated.
- Ezekiel: It's a result, not a cause, in other words.
- Means: Showing the same relation between industrial activity and new investment in plant and equipment on the part of industry that existed in prior years.

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- Currie: These are our estimates of capital expenditures - on the dotted line - of mining, manufacturing, and construction; this is the index of production; and it followed with a lag of one year, you see, right through here. And when the index of production got up to the 1928 level, which is here, capital expenditures on the part of mining and manufacturing got up to the 1928 level.
- H.A.Jr: Amazing thing, though, is that, contrary to what we are always told - that when there is a demand for private investment Government bonds go down - if you put your Government bond chart right here, your Government bond chart goes right along, so it proves that isn't true.
- Currie: That's right. And England went through a relative boom, for England, with no increase in interest rate.
- H.A.Jr: You're always told that when there is a demand for private capital Government bonds go down. Well, the low was right there, when I went into the Treasury.
- Currie: That's right. And they were going up, with that dip in '37, of course.
- H.A.Jr: You know, if I could just throw out one other thing at you, then you've got what I've got in my mind. It's this: this thing which you are talking about here, what these Government expenditures do, I suppose is why some people would like to see this continued - continue to spend a lot of money, and without increasing the taxes. And that sleight-of-hand is getting more and more difficult.
- And I just thought I'd throw out some figures, which you people may be entirely familiar with, but I had them done for this thing; and that is this: in 1939 the Federal Government - this is what we call, for a better name, "pump-priming" - WPA, PWA, general public works, CCC, emergency public works, this year, on a budgetary basis would total three billion 660 million dollars. And the local contribution - also these are rather rough - a billion one. Or we get a total figure of four billion 760 million dollars. Now, that includes an estimate of 500 million dollars additional for WPA after March 1. So we arrive at a figure of four billion 760 - I mean local and Federal. I don't know whether

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these figures are new or not.

Currie: Well, I've attempted to do something like that from your side, Mr. Secretary. You see those pencil lines, very timid?

H.M.Jr: These are available; I had these done. But I mean three billion 660; local, one billion one: we arrive at four billion 760 million.

Now, in asking myself - trying to either cut down expenditures or get the deficit smaller, there's just two things you can do: either cut down expenditures or raise taxes. Or a third thing, and I don't think that the third proposition has been explored sufficiently and I want to throw that into your mind, and that's the public works expenditures which do not appear in the budget. And I've got some figures here. Expenditures for public works. Well, under the Housing - the total construction under Housing, which does not appear - we get Title One, obligations incurred, roughly, 670 million. And the insurance and modernization loans, 95 million - insurance and construction loans. New construction and existing: new construction is 693 million, existing is 745. Rural Electrification, 58 million. United States Housing Authority - these are all obligations incurred - 202 million.

Now when you get down to the new things, you have modernization loans, 670 million; Rural Electrification, and United States Housing. You get Home Owners Loan on new construction, 95 million. And then when you look at the A.F.C. on this, it's just very, very little.

Renderson: I'll be sure that that one is right.

H.M.Jr: What I'm getting at is ....

Waite: What does that total?

H.M.Jr: He didn't total it.

Mesns: Sounded like four and a half billion.

Waite: Sounded like two.

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H.M.Jr: It's all on pieces of paper. I just got it last night.

Henderson: As you used to say in the Army - "skip."

H.M.Jr: The point is, it's very little. These alternative figures are open to you gentlemen. But if the only - as I say, there are three - we have three alternatives, as I see it - four alternatives - well, three, really, for next year, in the sense that you could either cut expenditures, raise taxes, or you could look to these non-budgetary expenditures - I mean which do not appear in the budget, but would be a substitute. And then in the meantime, what I think is the over-all thing is this increase of the income.

I wanted to let you men know how I was thinking; take it, tell me what's wrong with it, and then come back and see if you can't do something with it. Because it seems to me - now, I'll give you an example. You take, for instance, this so-called all-weather highway they did in Pennsylvania, which is a toll highway. You could duplicate that twenty times over. And it doesn't appear in the budget - 135 million dollar toll highway.

Now, there's so many things which could have been done, but the brains of the Administration either - if they've been working, they haven't been effective. And I should think you could develop two or three or four or five billion dollars worth of that sort of work to take the place of the things that we have to raise taxes for, and ease the budget picture, but - I'm being very frank about it, not beating around the bush - as an alternative.

But each one of these things - I mean somebody is interested in housing, and they get a whole group down, and now they raise the money - it's very incidental. I mean they take it perfectly for granted. But if Mr. Straus should do 800 million dollars, it's very, very important, and from the budget picture it's very important. And of course, as far as this budget is concerned, he's in the budget for 27 million and that's all. But if there are other things like that which could be built up and things which start much quicker than anything which is started, and which you can also stop ....

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szekiel: Would you consider a fifth alternative there?

H.W.Jr: I'm just throwing the thing - all I'm trying to do is let you people take a look in my mind. Being as honest as I know how. I'm groping, I'm trying to think of something else, instead of just sitting back and putting a wet bandage around my head, going to bed with a budget headache, which I've had for four years. I mean I'm trying to be just as frank as I can be. I hope there are fifth and sixth alternatives. And I say you fellows are very hungry over there in Agriculture. And I'm afraid a billion three won't do it; it may take two billion three, I don't know.

szekiel: I was wondering if, in addition to your public - the expenditures that don't appear in the budget, you would be at all interested in considering the kind of budget separation that they have made in Sweden, where you separate the investment expenditure from the current account expenditure and handle it just like a corporation does: cover your investment expenditure by an annual charge.

Whits: The Secretary has been through that quite a lot; he's familiar with that expenditure classification.

H.W.Jr: If you don't mind, I think that's what Dewey accused Lehman of yesterday - the bookkeeping operation.

szekiel: Every corporation in the country runs its accounts that way.

Lubin: That isn't going to prevent people who want to show you up running a deficit from saying, "Under the old system, here's what the deficit is."

H.W.Jr: I mean they could transfer the books back to the old system.

But if you could come in through your good roads bureau, the thing we talked about and I worked like "d" on three years ago: a trans-continental highway, when Mr. Roosevelt had the idea he was going to build villages along and cities and the whole thing - and then something just happened, it was scrapped. But I mean a trans-continental highway could very easily take two billion dollars. And - I mean those

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kinds of ... I mean I don't say I'm - I'm not going to throw it aside, but I don't think the Swedish method is going to get us what we want, and I don't think it would keep people from ....

- Henderson: You really haven't got five, six, and seven alternatives. You've only got three. These other things are bookkeeping expedients.
- H.M.Jr: That's what I - that's what I thought.
- Henderson: That's what this one is.
- Elliot: Haven't you got another: this philosophy ...
- H.M.Jr: I don't know whether you agree with me, but I think the Swedish thing is merely bookkeeping.
- Henderson: You've got to either increase taxes, cut down expenditures, or increase the national income.
- Carrie: There's a fourth.
- Henderson: I want to be shown before you get into any quaternion areas.
- Elliot: I think there's a philosophy of choosing the type of expenditures that has a fast turnover and thereby reflect themselves ....
- Henderson: They reflect themselves in national income. Any increase or decrease is bound to reflect itself in national income.
- Elliot: It is whether you're thinking primarily of increasing national income or primarily of increasing velocity.
- H.M.Jr: I'm trying to think of some way to get enough wealth so it really can be distributed and get down to the lower third, so we can get rid of these 12 or 13 million people, give them a decent living, so they can be healthy and get some of the good things out of life that we've been talking about for five years and haven't given them.
- Elliot: I think, Mr. Secretary, you'll find this group unanimously agreed that the goal of a higher national

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income is the right approach.

H. S. J.:

We've been talking about the lower one-third for five years. We said we'd give everybody a job; we've never given everybody a job. We've got, Dr. Parran says, at least three million people now underfed, undernourished; we're not doing anything about it; at least three million people. And I don't know how many millions of people don't get any medical care. Now, all of these things, when you get through and done, I can't see any other way: we've just got to get more money distributed. But I don't think you can do it through the Treasury. Now, I mean that's - I mean we've gone, I think, about as far as we can through the Treasury; and soon, I think, if we go much further, we'll just have trouble. What I'm trying to do is to find some way before this trouble comes, that's all. And I don't know any other way than to create more wealth.

White:

To support your thesis, Mr. Secretary, that it may be necessary to resort to the type of things that you're speaking of, I think Currie has got some figures, some estimates of the amount of capital that has been required in the past and how much is likely to be required in the future, which seems to indicate that there's going to be quite a discrepancy between the amount of capital which will be seeking investment and the amount of capital which will be demanded. But I think the figures he has - you might spend a minute or two merely indicating them, which will throw greater emphasis on the search for methods such as you have just suggested.

Currie:

Well, I wouldn't say much more for this than that it is illustrative of the type of problem we have to face in the next three or four years. What I have done here is to find out how much capital investment - money spent in the production of durable goods, consumers' housing, in the 20's was necessary to generate the national income that took place in the 20's. And I came out there with a proportion of about 22 percent of gross capital formation, public, private, in housing and in durable producers' goods. That is, business capital of around 18 billion corresponded with the national income of around 78 billion in the 20's; that came to about 22 percent.

Now, if that same relationship should prevail in the

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future as it has in the past - and incidentally that's the precise proportion that also prevailed in 1937, that 22 percent - for a hundred billion national income we need 22 billion capital formation.

H.M.Jr: New?

Currie: New.

H.M.Jr: Each year.

Currie: Yes.

Ezekiel: Net capital. Not net - gross. Six billion of that would be the account for depreciation.

Means: That checks with my figures very closely.

Currie: Now, that indicates to me - what we might do there is just in the realm of research, of studies to be instituted - is to try to estimate our expectation of how much probability is there when you survey the field of public housing, public expenditures on housing and business expenditures - how much prospect there is of getting up to 22 billion, and if not, what are the alternatives? Now, the alternatives are, as you just mentioned, either that the Government spend more directly through the budget, or do it - or you've conceded a bit by having Government corporations issue Government debentures, which I think is an excellent suggestion; or change this relationship that prevailed in the 20's, increase consumption relative to the national income.

White: By giving larger incomes to the lower third.

Currie: That's right.

White: Taking more away from the top group through taxes.

Currie: Now, unfortunately, we have regressed, I should say, in that direction this last year. We have taken off the tax on undistributed profits and tax on capital gains - the larger part. We have instituted payroll taxes for Social Security account, and pretty heavy tobacco and liquor taxes.

H.M.Jr: About 60 percent on consumers. About 60 percent on

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consumers, isn't it?

Currie: Yes.

So apparently from my figures here in '37 we haven't really changed this proportion - apparently a gross capital formation of about 22 percent of the national income.

Henderson: What you're suggesting, Lauch, is - you've got two things in consideration in that alternative. One is the question of leaving more at home to be spent by consumers, which is a change in your qualitative tax.

Currie: You can increase consumption relative to your national income without running an unbalanced budget.

Henderson: That's right; we're on a long-term regression on the amount of savings anyway.

Lubin: In that surplus of income over expenditure, how much is for Social Security so far, first nine months?

Currie: I haven't got the figures at hand.

Lubin: Is it very great? With the unemployment compensation, there won't be much margin, will there?

Currie: Actually this year there's been an increase in the unemployment insurance list. But some states I didn't get aren't paid yet.

Lubin: That's true, there has been an increase, but the net is relatively small as compared to last year.

Ezekiel: The old-age is the big thing.

Currie: The old-age is the big thing.

Lubin: Last year all income, no outgo, but this year ....

Currie: This year, if we're accumulating a fund on unemployment insurance, what are we going to do in a very good year?

Lubin: The reason for that is, some states weren't in.

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- Currie: But most of the important ones are.
- Lubin: And you want to remember, too, that the period in which you can earn your benefit had not been completed by a great number of workers. The system is still new.
- Means: In March it was at the annual rate of a net saving of approximately 800 million. I think that's low compared...
- Lubin: Is that all Social Security or ...
- Means: That's for all Social Security.
- Lubin: That includes old-age, which is the big factor.
- Means: Yes.
- Ezekiel: I had the figure in mind approaching just barely under a billion dollars.
- Means: I think that with a hundred billion it would go up to a billion and a half each year.
- Currie: I may say, in connection with this 22 billion figure, which I think will probably be necessary if we're going to have a national income of a hundred billion, that one of the people on my staff has been working for the last two years examining the prospects in the durable goods field one by one, right through utilities, railroads, housing - what you could really expect on the basis of full employment there, and it leaves a deficiency, we can't - we don't get up to that.
- Means: So what is involved is making people save less or finding some way to get those savings converted into useful equipment for the country, through the Government or through corporate development.
- Henderson: Does anybody ever mention the propensity to consume, or is that too matter-of-fact?
- H.M.Jr: I think most of the people in the room helped on that price statement which we helped the President to get out, which is still good, I think, isn't it?
- Henderson: Yes, still good; and somebody's going to be looking at it one of these days when the national income starts to going up.

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- H.M.Jr: Well, what I was thinking about is this. Once we get our facts and are pretty sure of ourselves - I mean I think this needs a selling job. I mean if we could - the possibility of getting the President to sound out, getting people thinking in terms of a hundred billion. And if we could be awful sure of our facts and prepare the thing, it wouldn't be out of the realm of possibility to get him to maybe make a talk about it, if we could get him convinced that this is the thing, you see, get everybody. What I want - if we're right: that's the first thing I want to make just as sure as I can, that we're right, that this is the way to think, rather than just to increase taxes or cutting down expenses.
- Henderson: Well, I don't think you'd find a bit of doubt on that in this group. Do you, Harry?
- White: Well, I think what the Secretary has in mind you'd agree with, Leon, and that is that this statistical data, or this factual information, must be pushed to the point where it is convincing to any reasonable man. And then once that is so ...
- Henderson: What I meant is that that's the enigma which he has got for himself.
- White: Oh yes.
- Henderson: I mean such studies as we have made would indicate it.
- H.M.Jr: What I'm getting at is this. Supposing the President or somebody should make a speech along these lines. We'd want to be awfully sure that the economics of it is absolutely sound, and that... Somebody says, "Well, it's impossible, they can't get a hundred billion. You can't get it in the United States. Not enough people, not enough national resources" - or this or that or the other - "just can't be done." You know? And that's what I'm asking you fellows, whether you'd put your brains to work, see, can it be done? I mean is it a healthy thing to look forward to?
- White: There are a lot of bottlenecks that crop up.
- H.M.Jr: Is it a healthy thing for the country? I mean considering all the component parts that go into the fabric

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of this country, is it a healthy thing?

- Means: A very nice problem of timing in there. In studying the iron and steel industry, we concluded that next year they couldn't finish the iron and steel that would be called for by a hundred billion national income. It would take them about two to three years to increase their equipment to the point where they could carry that load. On the other hand, as a goal two years, three years hence, that hundred billion would be a perfectly feasible goal.
- White: Well, since there's no danger of reaching it this year or next year, Gardiner, there wouldn't be any problem.
- Means: But that would be one of the things that's got to be kept in mind. You can't jump from 65 to 100 overnight. Someone has got to work out a program which involves, let us say, an 80 billion income next year, and a 90 billion the year after, and 100 billion the year after; some progression, whatever ....
- Aliot: And what the bottlenecks are, and where you'd have to put pressure on to solve it.
- Means: Is your progress going to be held up by lack of electric power or by lack of steel?
- White: Means has been working about two years, Mr. Secretary, on just that problem. There's a lot of work been done, but still in a rather preliminary stage. But it's just that very problem.
- H.M.Jr: well, there are two things, Harry. There is that, which you might say is a longer-time study. But the other thing, which is a matter of almost days: can we produce one, two, three, or four billion dollars worth of projects which could be financed outside of the budget?
- Currie: I've been thinking of what you just said.
- H.M.Jr: See? That's a matter of days. The other thing is a matter of maybe months. But of days - I mean can I take out of my hat several billion dollars worth of projects like - as good projects as slum clearance and that sort of thing?

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- Currie: I was just thinking, as you were speaking, one possibility you haven't exploited there is the Farm Security loans, which are mostly recoverable and which could be financed in that way.
- H.M.Jr: Farm Security?
- Currie: The rehabilitation loans. That comes right in there.
- H.M.Jr: Well, turn them over to Farm Credit.
- ezekiel: Or give them Farm Credit refinancing.
- H.M.Jr: Yes, I mean we'd - if you just turn them over to Farm Credit, then it takes it out of the budget, huh?
- White: Mr. Secretary, have you got somebody working on the various things - is there somebody working now on the various things that might be handled that way?
- H.M.Jr: No, except that I spoke the other day on this to Ruml.
- White: That's right. That's in the - that's about to be examined, that's right.
- H.M.Jr: No, no - definitely to them. But I'm just going all around the lot, from my standpoint, tonight, and I'm saying we got two things. One is the immediate thing, and Mr. Ruml - I don't know who he gave that to.
- White: He gave it to me, and Means and I were talking it over this morning.
- H.M.Jr: Then he's got that. Then the other thing is, we get back to this longer-time thing: what national income is healthy for the country? Is that a good way - what?
- Means: That's the way to say it.
- ezekiel: You would be interested in projects which would involve new legislation as well as those which could be done under existing authority.
- H.M.Jr: Oh sure.
- White: Well, he did some of that work ...
- H.M.Jr: You (ezekiel)?

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Ezekiel: Last year we got a little groundwork done on that. We dropped it, but I think we could pick it up.

Henderson: I'll give you a memorandum any time you want it.

Lubin: Are you thinking of something that would take 50 or 100 million dollars if through such an expenditure you could get, say, two billion dollars worth of credit expansion?

H.M.Jr: Sure.

Lubin: I'm thinking of some sort of private housing - I mean a project, say, of 500 thousand units, on a \$3,000-per-unit basis, gives you a billion and a half dollar expenditure. If we could get that going by spending 50 million dollars worth of Government money, it would bring that much private construction in the picture.

H.M.Jr: Well, we're spending - best example is the United States Housing - 800 million dollars; in the budget, 27 million.

Ezekiel: You have a continuing expenditure, of course, there.

H.M.Jr: True, but I meant ....

Ezekiel: Immediate effect is very great.

H.M.Jr: Certainly it would be a good investment if we could spend 50 million to get two billion.

Ezekiel: Yes.

H.M.Jr: That's what Lubin asked me.

Currie: Let me draw to your attention, Mr. Secretary, that proposal last spring to accomplish this very thing you're talking about, to set up a Federal Railway Equipment Corporation.

H.M.Jr: I read about it in Kintner and Alsop.

(Hearty laughter)

I mean that's the only time I ever heard about it.

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White: That's not fair. You heard about it before then.

H.M.Jr: All right. Harry's ....

Currie: Maybe I can cover my blushes. That was designed to accomplish exactly what you're speaking of now.

H.M.Jr: Got to have a little fun, Harry.

Currie: Outside of the budget, the main interest ....

H.M.Jr: Everything that happened last year - as far as I'm concerned, I'm more than willing to start fresh.

Henderson: (Laughs)

H.M.Jr: But the great trouble, as far as I was concerned last year, was that - well, as far as I'm concerned, I just never had a chance, so - and I mean ....

White: The problem is still before us.

H.M.Jr: What?

White: The problem is still before us.

H.M.Jr: Yes. The problem is still here and nothing is solved. Nothing is solved.

Ezekiel: But an awful lot of hard work ...

H.M.Jr: Nothing is solved. Just having a four billion dollar deficit solves nothing.

Currie: That's right.

H.M.Jr: And there isn't anything new that we're doing except that. Nothing.

Currie: Just putting more money ....

H.M.Jr: There's nothing new and nothing's solved. We're right back where we were.

White: Yes. It's worse. It's worse in the sense that it's another year.

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- H.M.Jr: I mean nothing is solved, and as I say, I never had a chance.
- Henderson: I don't know, Harry, whether you'd say worse or not.
- White: It's worse in the sense that another year has passed.
- Henderson: You're thinking in terms of the amounts. I'm thinking in terms of experience....
- White: Oh, that's different.
- Henderson: ...and understanding.
- White: No.
- H.M.Jr: That's right.
- White: We've learned a good deal.
- H.M.Jr: And if you get the various economic staffs in Washington all thinking about this, and if we can get, instead of, say, the people always going to the President and saying, "Now give this talk about cooperation between government and business.." - instead of having all these people come down ....
- Henderson: We'll get O'Mahoney and my committee to make those speeches.
- H.V.Jr: Pardon?
- Henderson: O'Mahoney and members of my committee will make those speeches. They're more afraid of us than they are of the President right now.
- H.M.Jr: Well, you compliment yourself.
- Henderson: No, they are; no question about that.
- H.M.Jr: Well, anyway, I do think that - as I said the other day to Mr. Ruml, the reason that this interests me is, at least it hasn't been tried - I mean so that everybody's thinking about it, all the efforts directed that way. And I think from my standpoint it's definitely worth trying.

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- Means: Until one has gone through the process of trying it, one doesn't know whether it will work or not. But it holds to me very great promise.
- Currie: I think we'd all agree here - I think so - that while economically there is no particular reason why you shouldn't increase the national debt year after year after year, actually, politically, feasibly, it's not - we can't go on expecting to just run a deficit year after year; the community is not going to stand for it. Eventually we're just going to have to work out some other way of handling this thing.
- H.A.Jr: The thing from a political standpoint - I think the legislation calls now for 40 or 45 - what is it?
- White: 15 and 25, or maybe - 45 is the total.
- H.A.Jr: Now there's always the danger that we're going to go to Congress and, although Congress votes the thing, in order to make the grandstand play they'll say, "We won't increase it; we just won't give it to you."
- and look what the committee - every "purgee" that wasn't purged is on that committee.
- (Hearty laughter)
- As a matter of fact they are. Every Senator that they attempted to purge is on the Finance Committee, as far as I know, with the exception of Smith. I mean we've got them all.
- White: They're just waiting for it
- H.A.Jr: I mean - and the people - all the press, everybody keeps playing up the fact the public debt is a barometer.
- Currie: That's right.
- H.A.Jr: And it's not a barometer at all. I mean I don't consider it a barometer of anything.
- Ezekiel: Mr. Secretary, in addition to this one proposal that was hammered out last year, the railroad one, which Mr. Currie has mentioned ....

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- H.S.Jr: Which I teased him about.
- Ezekiel: ... there were a couple of other proposals, a lot of work done. One was a general proposal for a road authority to actually go ahead on lower prices, selecting the projects that seemed promising; and a somewhat similar undertaking was at least looked into with respect to housing - large-scale corporation which would get housing costs down to where they would have a very large volume. From your view.... And those were thrown into the discussion last year through that committee of which both you and Secretary Wallace are members, but apparently got no attention at the White House. I wonder whether, in view of the hearing those got last year - whether it would be possible to use the same material over again - or it would have to be reworked to hide the fact it was done before.
- White: well, Ezekiel, it would first have to be presented and re-examined to see whether it fits the present situation, and if it does, irrespective of so much water over the dam - if it's good now or if it can be made good, it will receive a hearing.
- Henderson: Well, why it was rejected last year - why not just walk up to the counter and face the fact the thing was done in a hurry and everything that was new was rejected? The question was of doing something that had a familiarity and had a reasonable chance of getting through fast, which was accepted, and that's the basis on which the cutting was made. You might as well face that.
- H.S.Jr: It wasn't a matter of whether it was good, bad, or indifferent.
- Ezekiel: I just wanted to get the Secretary's view on that.
- H.S.Jr: Well, what I would answer would be this. Instead of having one or two, I'd hope to have a list of 15 or 20 or 25 different projects.
- Leans: That would include things that are now done that could be converted to the other basis, as well as new undertakings.

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H.M.Jr: And then what I would do - if they were given to me, I would do it in the regular way: that they would go up through the budget and give them a chance to emasculate them, everything else; then have them go up to the President in a book, just the way he gets a list of Mr. Ickes' projects. Then the President has them and everybody's familiar with them and everything else.

And I - to answer your question, I think the thing would get a very warm reception if they went through the regular channels, and I for one would do everything that I could to facilitate it. But as I say, I never had a chance last year. I mean I had Mr. Wallace's report, everything else, but I don't think Mr. Wallace's report ever got any consideration. At least, I don't think so.

Ezekiel: It never was read, apparently.

H.M.Jr: I'm quite sure it wasn't read.

Henderson: Depends on who you mean read it.

H.M.Jr: What?

Henderson: I've got it.

H.M.Jr: So have I.

Henderson: I've got it. It wasn't read. I've got it. When the actual thing was put together, I was given that as well as several other things. And there weren't any marks on it. I don't know whether it was read or not, but the basis on which the thing was done was a question of more of the same thing that had been tried before.

Lubin: Of course, you knew you could sell that to Congress.

Henderson: And it had to be sold quick, I mean. And if you go and if you start now - there's a difference between starting in April of a year in which the legislature is sitting and starting in November, coming up to a presentation to Congress. Now, that's the difference that you're in.

H.M.Jr: That's why I'm doing it tonight.

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Henderson: That's the reason why you've got that ...

Ezekiel: I just wanted to clarify ....

H.M.Jr: I think the fact that the thing that was done last year was or was not read - I would say it makes no difference.

Henderson: That's right, that's the point I'm making. When you got to that consideration, no matter how good it was, it couldn't have got in if it were new, and that was the only basis on which it was cut. Most of the stuff was either put in or cut in 15 or 20 minutes, when it really got down to the real decision.

Means: You going to write a history of the New Deal?

Henderson: What?

Means: You going to write a history of the New Deal?

Henderson: No, and I've got an understanding just about like this. I had an understanding with General Johnson....  
... (Mr. Henderson's following remarks were left off the record at his request).

Currie: On this confidential information, what happened there - I was told that Kintner also had that very same thing you had, the whole list of all the projects submitted to the President that time, and that on the back of this railway thing was written in the President's hand: "This has been watered down."

H.M.Jr: "This has been watered down." Well, I'm very interested to see what Kintner and Alsop are writing in three articles for the Saturday Evening Post on what happened during that time, because they did - you see, they'd been around to see everybody, and they couldn't quite make out on a lot of these things what the President's reaction was to them. I'm sure they saw a lot of you people in the room on this stuff, And so, foolishly, I was told - talked to Alsop. He gets on the phone. Every single question was asked very carefully. But each one was like, for instance: "Did the President see Mr. Wallace's report?" That's what was asked the President, see? Each one after the other. He'd gotten

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information which he had heard - there had been a meeting at Wayne Taylor's house - Adolph Berle, Wayne Taylor, and Eccles. He didn't know whether there was a memorandum or not. Well, had the President seen that memorandum?

"Well," I said, "why don't you ask Wayne Taylor? I wasn't there."

But I mean he was checking.... So I'm very curious.

Henderson: I'm curious to see - he was checking with Lube (Lubin) and me. He'd get me on the phone and ask me about something, and hang up, and before I could get over to Lube, right next door, he'd have Lube on the phone and Lube would be ....

H.M.Jr: Those boys are good, though.

Currie: Yes, they're very clever.

H.M.Jr: They're very good. So I'm very curious. And somebody had told them that I had changed and I was for public works. I said, "No. "whoever told you that?"

I don't know if they were checking up on me; but they wanted to know whether I had changed my position.

Currie: When are they coming out, Mr. Secretary?

H.M.Jr: I don't know, but there's a series of three. They checked with you fellows too. They had a lot of that stuff.

Eliot: I think most of this group would say, Mr. Secretary, that this goal of increasing national income - it's not only a healthy operation, but is essential for the health of the patient.

White: That's a good wind-up.

H.M.Jr: Well, if you people would be willing to help me on it, I'd more than appreciate it, because I need all the help I can get. And I've got a very difficult job; it isn't getting any easier.