

DIARY

Book 148

October 26 - October 31, 1938

- A -

	Book	Page
Anglo-California Bank (San Francisco)		
Fleishhacker, Herbert: Delano tells HMJr resignation to be handed in immediately - 10/26/38.....	148	16
Financial set-up discussed at 9:30 meeting - 10/31/38...		229
Appointments and Resignations		
Hanes, John W.:		
HMJr tells 9:30 group FDR will appoint Hanes Under Secretary - 10/28/38.....		102
O'Reilly, Mary M.:		
Retires as Assistant Director of Mint - 10/30/38.....		115
a) HMJr's letter - 10/28/38.....		145

- B -

Burgess, W. Randolph		
Speech, "Trade Changes and Monetary Policy," to be delivered at National Foreign Trade Council - 10/29/38...		167
Business Conditions		
Haas memorandum on situation - 10/31/38.....		330

- C -

China		
Resume of military situation - 10/27/38.....		44,143
a) Buck reports.....		50,59,85,120
Countervailing Duties		
See Germany		

- F -

Fleishhacker, Herbert		
See Anglo-California Bank (San Francisco)		
France		
Plane Mission:		
HMJr asks Cochran to show Monnet every courtesy - 10/26/38..		22
Oliphant memorandum on conferences with Monnet - 10/27/38...		94
a) Outline of United States position in accordance with statutes		
b) Explanation of the Trading with the Enemy Act		
HMJr and FDR confer on secret instructions to Cochran concerning conference with Daladier - 10/29/38.....		183
a) HMJr consults Leahy about transmittal of message		186
b) Conversation with Cochran.....		190
c) Cochran's reply.....		192
d) Message to Monnet in New York - 10/31/38.....		
FDR discusses entire situation with Baron de LaGrange, who prefers Morocco to Canada as site for airplane factories - 10/31/38.....		297

- G -

	Book	Page
Germany		
Conference on discrimination against American commerce - 10/31/38.....	148	277
a) Letter from HMJr to Hull attaching memorandum...		282
b) Summary statement on countervailing duties.....		292

- H -

Hanes, John W.		
See Appointments and Resignations		
Hawkey, Richard S.		
Lochhead requests Butterworth to arrange return - 10/26/38.....		27
a) Butterworth comment on work.....		156
Housing		
Lambert outline of plan to interest private capital in construction of low-cost housing		
a) Discussed at HMJr's home; Hanes and McDonald also present - 10/30/38.....		203
b) HMJr discusses plan with McDonald - 10/31/38....		275
United States Housing Authority:		
Conference on tax-exempt feature of local Housing Authority bonds; present: HMJr, Taylor, Bell, Hanes, Oliphant, and Straus - 10/28/38.....		125,317
HMJr expresses displeasure to Straus over letter to FDR before Treasury letter reached him - 10/31/38...		343

- J -

Japan		
White memorandum: "Recent changes in Japan's foreign exchange resources" - 10/28/38.....		153

- L -

Lauer, Edward J., Mrs.		
Smuggling case discussed at 9:30 meeting - 10/31/38.....		238

- M -

National Resources Committee		
Fiscal Committee:		
Conference; present: HMJr, Hanes, Taylor, Haas, Eccles, Delano, and Low - 10/31/38.....		239
Memoranda on projected studies.....		302
Netherlands		
In event of general war, measures to be taken in regard to transactions on the Stock Exchange and liquidation of holdings of American securities - 10/26/38.....		18

- O -

Book Page

O'Reilly, Mary M.
See Appointments and Resignations

- P -

Peoples, Christian J. (Admiral; Director of Procurement)
HMJr's letter suggesting advisability of changing
assignment - 10/31/38..... 148 301

- R -

Reconstruction Finance Corporation
Final subscription and allotment figures of
Series P notes - 10/28/38..... 144
Refugees
Plan of relief for Austrian students - October, 1938.. 178

- S -

Stabilization
Possible joint statement by United States, Great Britain,
and France, as drafted by Monnet, Bernstein, and White -
10/29/38..... 193
Standard Oil Company
Porters, European financial adviser, confers with
Cochran - 10/26/38..... 29
Straus, Nathan
See Housing

- U -

United States Housing Authority
See Housing

- W -

Works Progress Administration
Lonigan charts: Private employment on WPA rolls,
general relief, and WPA employment - 10/28/38..... 146



TREASURY DEPARTMENT
WASHINGTON

October 26, 1938.

Dear Henry:

I am enclosing a draft on which we have all agreed, that is, Hanes, Oliphant, Haas, White and myself. I think it is good. I don't think the document ought to be a long one.

John Davenport is coming down Friday.

I am enclosing another memorandum in lighter vein.

Sincerely,

A handwritten signature in dark ink, appearing to be "W. D. Hanes", written in a cursive style.

The Honorable Henry Morgenthau, Jr.,
Princeton Inn,
Princeton, New Jersey.

Enclosures.

Now that there are so many definite signs that the improvement in business which began several months ago is continuing, it is appropriate to review our objectives with respect to our National economy ~~and to devise if possible additional means for making them~~ *more lasting* effective. As one step in that direction I have decided to appoint under the chairmanship of the Secretary of the Treasury an informal committee on fiscal policy. Other members of the Committee will be the Director of the Budget, the Chairman of the Board of Governors of the Federal Reserve System and the Chairman of the National Resources Committee.

As its first undertaking this committee will study two closely related problems:

- (1) The amount of ~~National income~~ *and the corresponding standard of living which we would expect to enjoy if we were operating in such a way as to make full use of our employable population and our enormous capacity to produce.*
- (2) The proper dimensions, character and distribution, *on broad and general lines, of a Federal budget of enormous income and expenditures suited to the attainment and maintenance of such a level of National income.* *and of the material and productive equipment.*

Our recovery program succeeded in less than five years in raising the National income from a level around forty billions to a level of seventy billions. There progress was interrupted, largely because

- 2 -

neither industry nor the Government itself had yet learned how to deal with some of the economic bottle-necks which retard expansion of National income. Happily, however, we are again steadily forging ahead and leaving the recession behind. The new recovery effort of last spring has brought results. It furnished the necessary impulse to start the wheels of recovery revolving again.

The business gains of the last three months have seldom been equalled in a similar period. We are rapidly approaching our high mark of 1937; but we shall not be satisfied when we have reached it. We shall not be satisfied with anything less than full employment and employment at a full living wage of those who were employed in the past at less than a living wage. This will mean a National income of far more than seventy billions a year. We aim to attain a level of ninety to 100 billions and we intend to go on from there.

~~The development of wider and wider domestic markets for an increasing and ever increasing volume of goods and services goes further than a matter of justice and decent living conditions and opportunity for those who are denied opportunity. It is a prerequisite to lasting prosperity for all. We have seen how the starving of consumption hampers the National economy and curtails opportunities for profit. To find means of thus utilizing on a much broader scale the great resources of human and natural wealth with which we have been blessed is the task to which we must all address ourselves.~~

TREASURY DEPARTMENT

4

INTER OFFICE COMMUNICATION

DATE October 26, 1938

TO Secretary Morgenthau
FROM Mr. Haas

In accordance with your request of this morning,
attached are the following:

- (1) Data on the number of W.P.A. workers, as of
October 22, 1938, together with tables and
chart showing comparisons with earlier
periods;
- (2) A chart and tables showing:
 - (a) The total number of W.P.A. workers, and
 - (b) The Bureau of Labor Statistics data on
total employment, exclusive of agriculture.

October 26, 1938

To: The Secretary
From: Miss Lonigan

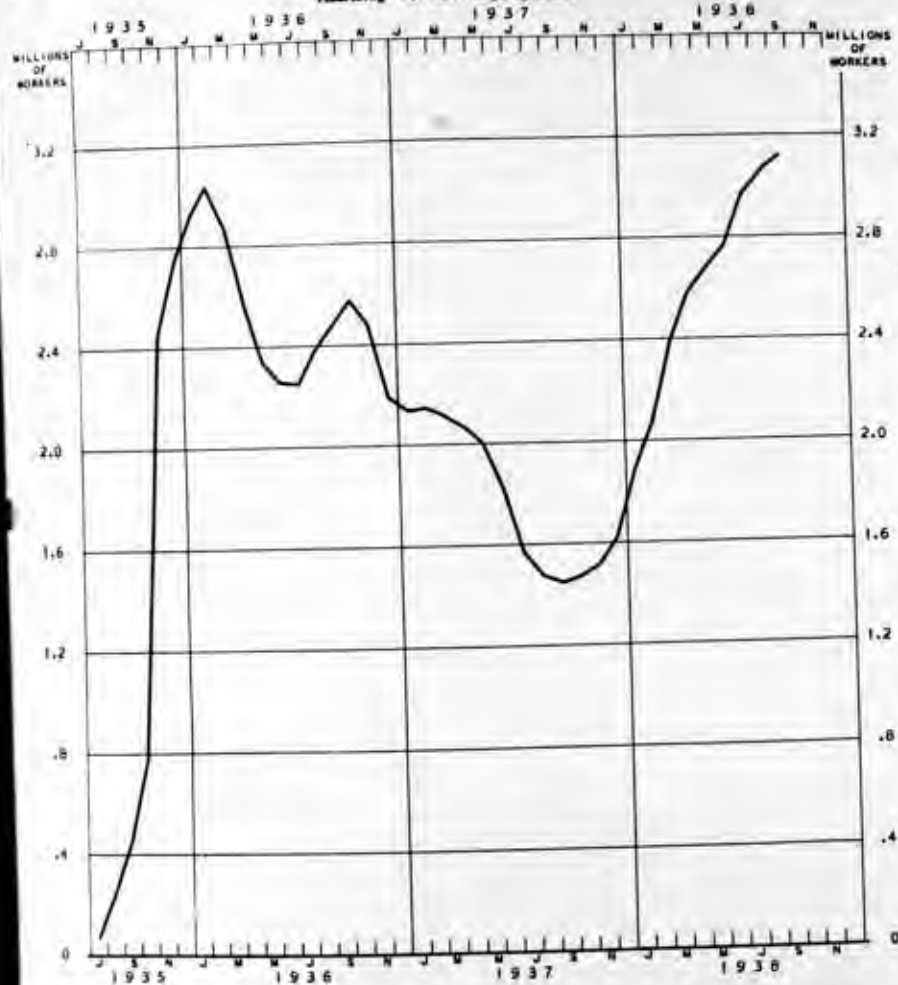
The total number of WPA workers on October 22, 1938 is 3,201,000. The increase during the week from October 15 to October 22, was 34,185 workers.

WPA employment has increased 1,733,000 during the year from October 23, 1937 to October 22, 1938.

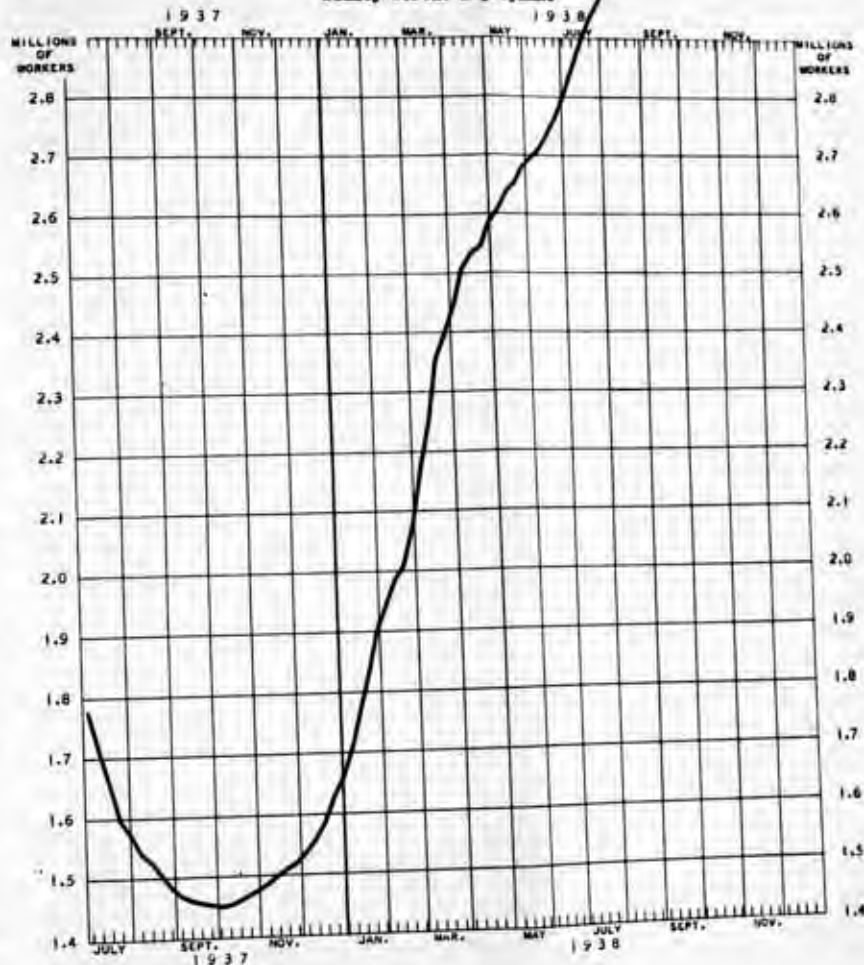
This is the highest number of persons that has ever received WPA employment.

WORKS PROGRESS ADMINISTRATION
Number of Workers Employed
United States

Monthly W.P.A. Employment



Weekly W.P.A. Employment



SOURCE: WORKS PROGRESS ADMINISTRATION

WORKS PROGRESS ADMINISTRATION

7

Number of Workers Employed - Weekly

United States

Week ending 1938	Number of Workers (In thousands)
February 5	1,945
February 12	1,985
February 19	2,009
February 26	2,076
March 5	2,167
March 12	2,244
March 19	2,357
March 26	2,395
April 2	2,444
April 9	2,504
April 16	2,532
April 23	2,545
April 30	2,583
May 7	2,608
May 14	2,638
May 21	2,652
May 28	2,680
June 4	2,695
June 11	2,711
June 18	2,736
June 25	2,767
July 2	2,807
July 9	2,853
July 16	2,899
July 23	2,938
July 30	2,967
August 6	2,996
August 13	3,017
August 20	3,039
August 27	3,067
September 3	3,086
September 10	3,102
September 17	3,114
September 24	3,120
October 1	3,129
October 8	3,136
October 15	3,167
October 22	3,201 <u>a/</u>

Source: Works Progress Administration
a/ Confidential

Regraded Unclassified

WORKS PROGRESS ADMINISTRATION

8

Number of Workers Employed - Monthly

United States

Number of Workers
(In thousands)

1936

January	2,926
February	3,036
March	2,872
April	2,570
May	2,340
June	2,256
July	2,249
August	2,377
September	2,482
October	2,581
November	2,483
December	2,192

1937

January	2,138
February	2,146
March	2,115
April	2,070
May	1,999
June	1,821
July	1,569
August	1,480
September	1,451
October	1,476
November	1,520
December	1,629

1938

January	1,901
February	2,076
March	2,395
April	2,583
May	2,680
June	2,767
July	2,967
August	3,067
September	3,120 <u>a/</u>

Source: Works Progress Administration

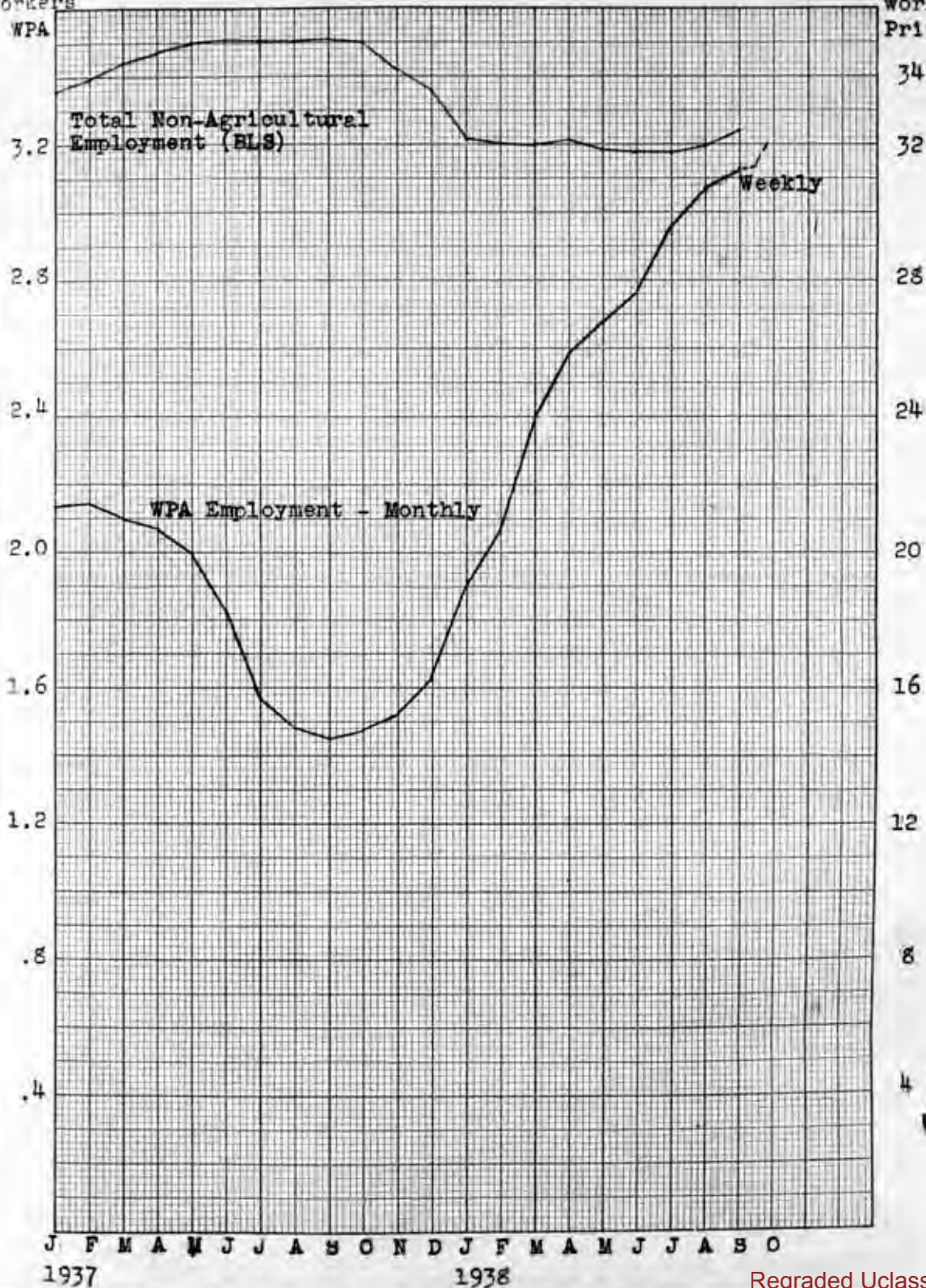
a/ Confidential

PRIVATE EMPLOYMENT AND WPA ROLLS UNITED STATES

9

Millions of
workers

Millions of
workers
Private



TOTAL NON-AGRICULTURAL EMPLOYMENT

UNITED STATES

	Number of Workers (In thousands)
1937	
January	33,596
February	33,923
March	34,411
April	34,683
May	34,993
June	35,062
July	35,034
August	35,039
September	35,106
October	35,020
November	34,233
December	33,589
1938	
January	32,177
February	32,017
March	31,976
April	32,106
May	31,834
June	31,781
July	31,756
August	31,972
September	32,422 <u>a/</u>

Source: U. S. Bureau of Labor Statistics
a/ Confidential estimate

WORKS PROGRESS ADMINISTRATION

Number of Workers Employed - Monthly

United States

Number of Workers
(In thousands)

1937	
January	2,138
February	2,146
March	2,115
April	2,070
May	1,999
June	1,821
July	1,569
August	1,480
September	1,451
October	1,476
November	1,520
December	1,629
1938	
January	1,901
February	2,076
March	2,395
April	2,583
May	2,680
June	2,767
July	2,967
August	3,067
September	3,120 <u>a/</u>

Source: Works Progress Administration

a/ Confidential

TEXT OF A TELEGRAPHIC MESSAGE RECEIVED AT THE CHINESE EMBASSY
CHUNGKING, OCTOBER 26, 1938.

The Military spokesman announced that orderly evacuation from the Tri-cities of Wuhan (Hankow, Wuchang and Hanyang) had been completed yesterday and that a new line of defense had been established outside the area. He then gave the following explanations as to why Wuhan was evacuated when the Japanese were still outside the inner defense line of the Tri-cities. First, China's fundamental policy is based on a prolonged warfare, taking into consideration the whole scope of the military operations. Importance is not attached to the retention or loss of any particular city, but every effort must be made to prolong the warfare so as to wear out the enemy in the very process, and to preserve or strengthen the Chinese capacity of resistance. In the past six months Chinese forces have offered stubborn resistance at the outside defense line of the Wuhan area and have achieved the object of the war of attrition by inflicting heavy casualties on the enemy. Secondly, the significance of defending Wuhan lies in the protection given to the transfer of manpower and material resources from southwestern and central China to the interior. Since the removal of material resources and the evacuation of civilians from Wuhan have been successfully carried out, the duty of protecting the rear is ended. From the point of view of the entire scope of resistance the retention of Wuhan is no longer significant. Thirdly, the Chinese military strategy is based on the principle of retaining the initiative; Chinese forces must always retain the freedom of action and cannot afford to be cornered by the enemy. Having caused great losses to the enemy, and having protected the transfer of manpower and material resources to the interior, it is considered unnecessary to further defend Wuhan, lest the Chinese forces be forced to fight a decisive battle in Wuhan which is contrary to the purpose of a prolonged warfare. Last reason why the Tri-cities is not further defended is that it is the sincere desire of the Chinese authorities to minimize the peril of suffering which confronts the Chinese and foreign residents who cannot find means to evacuate. China's chief concern is to retain the initiative and conserve the fighting strength so that by closely following this policy, the Japanese military strategy may be gradually defeated, and the goal of our ultimate victory may be achieved in the end. Generalissimo Chiang Kai-shek safely left Hankow for yet undisclosed destination from where he will continue to direct further operations.

Wednesday
October 26, 1938
11:43 a.m.

HMJr: Yes.

Preston
Delano: I'm just calling back to supplement your conversation with me yesterday about Mr. Jones' talk about the Anglo.

HMJr: Yes.

D: Jones called me this morning.

HMJr: Yes.

D: And said that he had been in touch with Herbert Fleishhacker.

HMJr: Yes.

D: And Herbert Fleishhacker was now going to place his resignation before the Directors -

HMJr: Yes.

D: - immediately, to be effective at their pleasure.

HMJr: Yes.

D: And I said that this office had two things in mind about that situation.

HMJr: Yes.

D: The first was that we felt that because of the publicity that had been attendant upon these Lazard Freres trials -

HMJr: Yes.

D: And also because of the very serious things that are in our examination report -

HMJr: Yes -

C: - we felt that the sooner that Mr. Fleishhacker could be physically detached -

HMJr: Yes.

- 2 -

D: - from that bank the better off we'd feel.

HMJr: Right.

D: That was number one. The second one was that we felt very strongly here that we wouldn't, if our opinion were asked, advise the Secretary of the Treasury to put any money in that bank -

HMJr: Yes.

D: - until such physical separation take place.

HMJr: I'm with you a hundred percent.

D: Yeah.

HMJr: I'm getting a little bit fed up on it.

D: Yes.

HMJr: And -

D: No, he protested a little bit on that.

HMJr: Who?

D: Jesse did.

HMJr: Oh, to hell with - with that. I mean Ah - the sooner that that fellow is - to use your language - is physically separated from that institution the better I'll feel.

D: Well, I - I thought it was good to nail in those two points of view.

HMJr: And I'm with you - I'm with you a hundred percent.

D: Well that's fine. And I - I do -

HMJr: And I personally am very anxious to get this thing cleaned up this week.

D: So am I.

HMJr: And I told the President about it and I told him that I thought it was going to be cleaned up this week.

- 3 -

D: Well, it looks now as if it will. Although, Jesse comes back and says that, "Well, even if we do put the Government money in there before he is physically separated we have a management clause and all that sort of thing..." No, that wouldn't satisfy me, Mr. Secretary.

HMJr: Ah - I'm not - ah - look, I'm with you a hundred percent - I want that fellow out - lock, stock and barrel.

D: Fine.

HMJr: No, I - I - and I'm very emphatic.

D: Well, that's fine.

HMJr: And -

D: And I feel so strongly about it myself that I would - I would personally say to you -

HMJr: Yes.

D: That I would very much regret it to have you ask the R.F.C. to put money in that institution -

HMJr: Well, I won't.

D: - until he was out.

HMJr: I won't - I won't ask for one cent.

D: I really think it would be a very grave error.

HMJr: Well, we're together - and they're going to meet on Thursday, aren't they?

D: Yes. They are.

HMJr: Well that fellow should be out by Thursday night.

D: Well. Fine.

HMJr: And I'm sick and tired of it and - and ah - and ah - he - the fellow should be out by Thursday. And it should be announced and should be in Friday morning's papers that he's out.

D: That's the way I feel about it.

HMJr: He should be - I'd like to see it in Friday morning's paper.

D: Well I'm so pleased you feel that way about it, Mr. Secretary.

HMJr: And I won't budge one inch.

D: Fine. There's one other complication.

HMJr: Yes.

D: Last night Cy talked to Sedlacek out there.

HMJr: Yeah.

D: And Sedlacek said that there had been some bucking on the part of Herbert, who was now threatening not to resign and all that sort of thing.

HMJr: Well, he thinks he's getting support from here.

D: Well, he - ah - if he is why it's very regrettable and I -

HMJr: Tell him if he wants to bring on - on him the complete collapse of that institution all right but that - then he's going to do it.

D: Well, if that - if Sedlacek asked this question of Upham - that if the Directors would ask us - ask the Comptroller's office whether we held the position that Mr. Fleishhacker should immediately terminate his ah - his connection with that bank would we respond yes. Now my disposition is to say yes.

HMJr: Absolutely.

D: I see no reason for dodging that issue.

HMJr: Ah - and - and if you want to you - instead of using - if you want to, instead of using the words - "the Comptroller of the Currency" you can use the words, "the U. S. Treasury feels that way."

D: Fine.

- 5 -

HMJr: That makes it all inclusive.

D: That's right. And I'll -

HMJr: I would say that that is the way the Treasury feels.

D: Right.

HMJr: Now that - that puts us both in the same boat.

D: Well, we'll exert just as much pressure from here as we can.

HMJr: Well, you can - you can say that that is the way the Treasury feels.

D: Well, if I'm asked then by wiring there I'm going to say that.

HMJr: Yes. The Treasury feels that -

D: I'll say the Treasury feels that way and I'll sign myself as Comptroller of Currency.

HMJr: Right.

D: All right, sir.

HMJr: Thank you.

D: Goodbye.

HMJr: Goodbye.



DEPARTMENT OF STATE
WASHINGTON

October 26, 1938

In reply refer to
EA 856.5171/13

~~CONFIDENTIAL~~

The Secretary of State presents his compliments to the Honorable the Secretary of the Treasury, and encloses for his information a copy of confidential despatch No. 501 dated October 7, 1938, from the American Minister at The Hague, Netherlands, which replies to the Department's telegraphic inquiry of September 28, 1938, as to measures which might be taken by Netherlands authorities in the event of general war in Europe in regard to transactions on the stock exchange and liquidation of holdings of American securities.

Enclosure:

No. 501 of October 7,
1938 from The Hague.

Department of State

BUREAU
DIVISION

EA

ENCLOSURE
TO

Letter drafted

ADDRESSED TO

TREASURY

No. 501

The Hague, Netherlands,
October 7, 1938

SUBJECT: MEASURES WHICH MIGHT BE TAKEN BY NETHERLANDS
AUTHORITIES IN THE EVENT OF GENERAL WAR IN
EUROPE IN REGARD TO TRANSACTIONS ON THE STOCK
EXCHANGE AND LIQUIDATION OF HOLDINGS OF AMERICAN
SECURITIES

CONFIDENTIAL

The Honorable

The Secretary of State,
Washington.

Sir:

I have the honor to acknowledge the receipt of the Department's strictly confidential telegraphic instruction No. 78 of September 28, in the above entitled matter. At the moment of its receipt the imminence of the outbreak of a general European war was happily much less acute than it had been in the days immediately preceding, and continued progressively to recede into the background. Accordingly, in view of the spirit of the Department's instruction, I

have...

have not made direct inquiries of Netherlands fiscal authorities as to what they might have done in the contingency of a general war breaking out, but for future contingencies - which, I trust, will not materialize in any foreseeable future - the following summary of views of local bankers and brokers is set forth.

It was generally expected that in the event of war breaking out the Stock Exchange would have been closed for a few days. Various bankers understood that in this eventuality the Minister of Finance, upon the recommendation of the Stock Brokers' Association, would order the Stock Exchange to close for from three days to a week; the question of its being closed for a longer time would necessarily be somewhat dependant upon the action taken by other exchanges, primarily New York, in countries not immediately involved in the war. As indicated above, however, the general expectation was that the Amsterdam Exchange would not remain long closed. As regards a comparison with 1914, it may be pointed out that it is estimated here that in that year marginal stock loans amounted to somewhere between three hundred and fifty and four hundred million guilders, whereas today they are estimated to be little, if any, in excess of thirty-five to forty million guilders.

As regards the liquidation of holdings of American securities, as indicated above these are now in far stronger hands than in 1914. During the black days of last week, when it was apparent that only most unexpected developments would....

- 3 -

would prevent the outbreak of a European war, while there was naturally little buying and prices fell substantially on thin sales, there still was an absence of heavy liquidation or of panic or distress selling. Accordingly, the consensus of opinion is that had war broken out such liquidation of holdings of American securities as would have taken place would have been affected, without panic or heavy distress selling, in a normal and orderly fashion upon the reopening of the Amsterdam Stock Exchange. Further obvious factors leading to this view are the existence of the huge gold reserve of the Netherlands Bank, the sound and very liquid condition of other banks in this country, and the heavy volume of idle private funds seeking even moderately profitable investment.

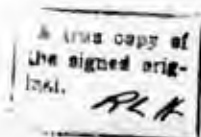
Respectfully yours,

George A. Gordon.

File No. 851.7/711

In quintuplicate

GAG:ekd



RECEIVED

October 26, 1938

22

My dear Cochran:

This will serve to introduce Mr. Jean Monnet, who has been over here on a very secret mission.

The occasion may arise when Mr. Monnet may wish to communicate with me. I hereby authorize you to extend to him every courtesy and, furthermore, I wish that you would cooperate with him fully if and when the occasion arises.

With kind regards,

Sincerely yours,

Mr. H. Merle Cochran,
First Secretary,
American Embassy,
Paris, France.

FEDERAL RESERVE BANK
OF NEW YORK

OFFICE CORRESPONDENCE

DATE October 28, 1938.CONFIDENTIAL FILESSUBJECT: TELEPHONE CONVERSATION WITH
BANK OF ENGLAND.FROM L. W. Knoke

Mr. Hawker called me at 10:35, Mr. Bolton being away on a week's vacation. "Although the general impression in London is that sterling will go down, news from the United States in recent days have somewhat pushed sterling up. These news are rumors about further dollar devaluation; reports that Mr. Morgenthau has expressed the opinion that sterling is too low for America and that he is not satisfied with the present level and with the speed with which sterling fell. All this has unsettled the market a little during the last two or three days and brought out a few buyers of sterling. However the market is so thin that any offering of dollars or bidding for dollars would easily effect the rate a half point or more. We continue to buy spot against forward dollars in order to put some sterling into the money market which has shown signs of tightness since the crisis late in September. We are accordingly buying spot dollars and selling them forward for the first fortnight in December when interest falls due on the War Loan and funds in the market become more plentiful as a result thereof. If, therefore, you see our balances alter, you will understand what has happened."

"As far as the franc is concerned, everything has been quiet until this morning when Cariguel lost \$1,000,000. This loss is attributed to an announcement over the radio from Paris that the French Minister of Commerce would propose at the Radical Socialist

FEDERAL RESERVE BANK
OF NEW YORK

OFFICE CORRESPONDENCE

DATE October 28, 1936.

CONFIDENTIAL FILES

SUBJECT: TELEPHONE CONVERSATION WITH
BANK OF ENGLAND.

L. W. Kneke

- 2 -

Conference scheduled for the end of this week in Marseilles, a closed economy for France which was promptly interpreted as meaning exchange control, as far as the foreign exchange market is concerned. However, conflicting reports continue to emanate from France as to what Daladier is likely to do under his plenary powers and a good deal of disappointment seems to prevail in Paris over the fact that he has done nothing so far. Some people seem to feel that the Radical Socialists are beginning to lean more to the center. Everybody seems to be in a state of suspense and awaiting further developments in Marseilles this week. Meanwhile, the franc is very quiet except for odd spasms such as this morning when Cariguel suffered the greatest loss of foreign exchange in several weeks."

With reference to developments on this side, I told Hawker that business in the foreign exchange market was very quiet and extraordinarily uninteresting. The tone for sterling seemed a little better here, rumors regarding devaluation not affecting our market at all. Nevertheless I thought, I said, that such rumors were bound to come up from time to time especially after Congress meets when probably efforts would be made by the same group which had been so active in 1935 to bring about further devaluation of the dollar to the 50¢ level. What the ultimate outcome of these efforts would be I couldn't, of course, guess. I referred to talks I had previously had with Mr. Bolton from time to time about a

FEDERAL RESERVE BANK
OF NEW YORK

OFFICE CORRESPONDENCE

DATE October 26, 1938.

CONFIDENTIAL FILES

SUBJECT: TELEPHONE CONVERSATION WITH
BANK OF ENGLAND.

L. W. Knoke

- 3 -

supposedly heavy speculative short position for sterling in this market. As far as our banks were concerned, I said, I didn't think there was any such speculation. I had before me the total figures of all our reporting banks which showed less than \$7,000,000 short in sterling, 50% of that being hedged by gold holdings in London. The highest this short position had reached in recent months had been \$15,000,000 in the middle of August at which time, however, the sterling position had been hedged 100% by gold holdings in London. I was now studying figures furnished by commercial and industrial firms about which I would talk to him some other time.

I inquired whether in addition to the £1,500,000 gold shipped from Buenos Aires on October 22, regarding which he had cabled us on October 17, there were other amounts coming forward. Hawker replied that at the moment this shipment was the only one but that they might be shipping another £1,500,000 within the next week or so, possibly on the Northern Prince on November 5, and that he would cable us directly when this matter was settled. In reply to my question, Hawker stated that this was gold they had bought from the Argentine Central Bank against sterling payments in London.

LWK:KW

JR

GRAY

Berlin

Dated October 26, 1938

Rec'd 2:04 p.m.

Secretary of State,
Washington.

572, October 26, 6 p.m.

No. 28. FOR TREASURY FROM HEATH.

Following yesterday's announcement that the third Reich loan of 1938 had been oversubscribed and would be issued in the amount of 1,850 million marks the Finance Ministry today announced that 4- $\frac{1}{2}$ % Reich bonds would be offered in exchange for Austrian internal and foreign bonds.

As regards internal Austrian issues there were about 1,200 million shillings worth of bonds outstanding at the end of 1937. This would necessitate the issuance of some 800 million marks of Reich conversion bonds.

WILSON

KLP:WWC

REB

TELEGRAM SENT

GRAY

October 26, 1938.

4 p. m.

EMBASSY

LONDON (ENGLAND)

653

FOR BUTTERWORTH FROM TREASURY.

QUOTE Refer your No. 1243, October 25, Secretary of the Treasury desires Hawkey arrange to return to Washington before end this year. Suggest you consult with Hawkey and if you think it would prove of value for him to remain in England for, say, another month for additional experience, please make necessary arrangements. Lockhead. END QUOTE.

HULL
(HF)

CL:HF:LMN

REB

GRAY

London

Dated October 26, 1938

Rec'd 4:15 p. m.

Secretary of State,
Washington.

1250, October 26, 6 p. m.

FOR TREASURY FROM BUTTERWORTH.

The dollar opened offered at 4.77 and has fluctuated during the remainder of the day between that figure and 4.77 7/8. At the latter level the British authorities intervened to check any further appreciation of the pound. 159 bars were sold at gold fixing at 145 shillings 9 pence of which 54 were married and a considerable part of the remainder was supplied by the British fund. Due to a report that the French Minister of Commerce would advocate at the forthcoming meeting of the Radical Socialist Party the institution of a controlled economy in France the franc has been fairly heavily offered today.

KENNEDY

NPL

EMB

PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Paris, France

DATE: October 26, 1938, 5 p.m.

NO.: 1818

FROM COCHRAN

At noon today I was visited by Mr. Porters, who is now the European financial adviser to the Standard Oil Company, and formerly was resident manager of the Bank for International Settlements. He insists that the British do not want to seek trade advantages through sterling depreciation. It is his belief that the British are genuinely desirous of achieving a stable rate that can be maintained in the face of armament expenditures, the unfavorable balance of trade and the unhappy international situations. Porters emphasized the heavy losses undergone by the British equalization fund in their efforts to prevent too much of a decline in the pound. He laments the passing of dollar and gunboat diplomacy and believes that both the British and the Americans have been too trustful of their neighbors and maintained too loyal attachment to ideals that cannot be achieved.

Porters said that when he sees economists used importantly for originating vote-getting ideas, labor as the best currency backing, and barter turning out to be a most effective trading method, he feels that revision is needed in the great democracies with their supplies of gold and their old ideas of commerce, in order to meet

the

- 2 -

the aggressive competition which is being so formidably presented by the totalitarian states. It is his opinion that the war debt question should be settled, and that the Anglo-American trade agreement expedited; he believes the European situation would have developed quite differently if the war debts had been adjusted and a trade agreement consummated before August.

Today the Paris exchange market was nervous as a result of the report that a plan for "oriented economy" would be advanced for France at the Marseille conference by the Minister of Commerce Genten; the market interpreted this as including control of exchange. There was also weakening of forward franc. Important sales of dollars against sterling and gold by Swiss Bank Corporation. Some dollars also sold by Bank of Indo-China. At five o'clock I visited at the Bank of France; the French fund by that time had lost one million pounds because of the aforementioned report, and in spite of moving the rate to 178.80 (it was 178.74).

My contact told me that he is convinced there has been no official desire in London to see weakening of sterling, for in the first place, he said the British knew such a policy would gain nothing for them. Secondly, if the pound deteriorated, British prestige would be further

- 3 -

further weakened and in the present circumstances this is certainly not desired. Third, the British are anxious to keep on their market the foreign holdings that are still there, and by inspiring confidence in a strong pound is the only way this can be accomplished. My friend is furthermore considerably aware of the defensive steps taken by the British control; he believes this should be sufficient to convince one of the good intentions of the British. He said that while today is the best day experienced by the British control for some time, it only regained 47 millions of the 600 or 800 millions lost recently.

In the actual circumstances, my friend said he was not unhappy to see stories of possible devaluation of the dollar cause dollar weakness, which helped the pound a little. However, he does not expect devaluation to \$.50, and would be greatly disappointed if the American authorities took such action. My friend said he is convinced that if our limited authority were used in this direction, the British, who have unlimited authority, would immediately keep pace or even go beyond the limit we could go. The world's currencies would then follow this lead, and ~~the~~ such degree of international stability as has been achieved would be thus destroyed. The United States would therefore have nothing but a book profit on the dollar out.

END MESSAGE.

WILSON.

EA: LWW

Regraded Unclassified

REB

PLAIN

London

Dated October 26, 1938

Rec'd 5:05 p. m.

Secretary of State,
Washington.

1251, October 26, 7 p. m.

FOR TREASURY FROM BUTTERWORTH.

Three months ago though the recession in British business activity was continuing the June rise in the New York stock market had influenced stock prices in London as indicated in No. 653 of July 26, 6 p. m. and though the indices of British business showed no corresponding improvement the influence of possible American recovery was an important factor in the British trade outlook. At that time the two questions were (1) was American recovery really underway and (2) what would be the final outcome of the disturbed situation in Czechoslovakia?

Now that both these questions are considered to be answered in a manner which should give some stimulus to the British trade outlook, two new uncertainties have arisen which make the prospect as difficult to predict as ever. They are (1) what will the new armament and defense measures cost and how will the cost be met, (2) how much
and

REB

2-#1251, From London, Oct. 26, 7p.m.

and what manner of interference with business will the arms program entail?

The fundamental financial problems facing Great Britain remain as outlined in the memorandum "The British financial outlook" prepared last June. The magnitude and the cost of the new armament plans are still unknown; the following facts give an idea of what is envisaged: (a) the pre-crisis air program called for 2375 front line planes by 1940 while it is generally believed that Germany can now put 10,000 planes in the air; (b) the army program includes the mechanization and modernization of practically the whole existing structure of the regular army and a large part of the army in India amounting altogether to about 10 divisions. It also includes rearming and equipping with mechanical and modern implements the entire territorial army which is to be made over from 12 infantry divisions (1918 style) and 2 anti-aircraft divisions (still unequipped) into 9 new style infantry divisions, 1 mechanized division, one mobile division, 5 anti-aircraft divisions and a large number of very expensive units such as a tank battalion, anti-tank regiments, light anti-aircraft regiments et cetera. The already extensive naval program will probably not be greatly enlarged though some speed-up may increase the rate

REB

3-1251, From London, Oct. 26, 7 p.m.

rate of expenditure. Finally with regard to air raid precautions an official of the committee on Imperial defense stated in confidence that to ensure adequate safety for the civil population several hundred million pounds could be spent.

These few facts point not only to expenditure of an order not fully faced but also to the inevitability of a considerable degree of dislocation of industry and trade whether deliberate measures of regimentation are taken or not.

The course of American recovery especially as it influences the British export trade may have a considerable effect on this phase of the problem. Were it not for the condition and importance of the export trades which was emphasized in No. 1128 of October 5, 5 p. m., a period of relative slackness in heavy industry might be welcomed in the face of so great a forced public works program. But the fact is that any alleviation of the arms task which might follow from relative slackness in commercial competition for labor, capital, and raw materials, would be offset by the added necessity for deliberate and perhaps drastic measures to maintain the export trade if no expansion in world markets was forthcoming.

For

REB

4-1251, From London, Oct. 26, 7p.m.

For the time being the British financial and business communities show every sign of being unable to forecast and to plan in the face of the uncertainties as to armament financing and the encroachment of that program on industry and trade. The stock market remains uncertain and restricted; policies of investment cannot be formed and business developments are shelved. Indices of general business activity remain largely unchanged except for the obvious reflections of the crisis such as higher railway and cable traffics, sharply curtailed building plans, et cetera.

The short term international political outlook is receding in importance as an immediate influence on markets, and even American recovery from which much is hoped is now looked upon more as an alleviating factor than as a positive reason for optimism because the armament task and its implications dominate the whole picture. From all quarters it is assumed that the country's military strength must be brought into line with that of possible enemies. Though in post-crisis speeches Government spokesmen have reiterated the Prime Minister's hopes of disarmament discussions the necessity for Britain to back diplomacy with armed strength has been repeated in all statements made by Cabinet Ministers. For example Lord Halifax said: "But if this country is to play
play

REB

5-1251, From London, Oct. 26, 7p.m.

play its full part with others in securing peace it must be able to speak with equal weight. One-sided armament and one-sided disarmament are both impossible and give no help to peace. Therefore we must take all measures -- already taken months ago by continental countries -- that are essential to our strength and our safety". This conviction seems moreover to be practically universal and the present temper of the city like that of the country seems to be one of stern determination that the startling deficiencies in British military strength shall be made good efficiently and quickly. For there is widespread indignation at the evident inefficiency of armament and defense preparations so much so that Inskip as Minister for the Coordination of Defense has been characterized as the worst appointment since Caligula made his horse a Roman Consul.

The city is pre-occupied with discussions of probable plans for increased taxation and for the raising of Government loans with possible measures to influence the direction of investment. The establishment of a Ministry of Supply is now almost taken for granted though nothing is known as to the extent of the powers which may be given to any such body. There is almost universal advocacy of a registration scheme

REH

6-1251, From London, Oct. 26, 7 p.m.

scheme which would measure and analyze man power for productive and defence purposes.

Both press and government are taking the line that the armaments task will require painful sacrifices. Lord Halifax said that "If we are to make more swift progress with the re-equipment of all branches of our defensive power it is certain that this can only be achieved by the readiness of all people and all interests to make great sacrifices to the common end (. . .) for some the sacrifice will be of money (. . .) of others it may be necessary to demand sacrifices in other forms".

Politicians have used such phrases as Lord Baldwin's "I would mobilize industry" while the importance of the export problem is receiving wide attention as evidenced by the special meeting of the Association of Chambers of Commerce, committees of which are now engaged in drawing up a report to be presented to the Government. The federation of British industries has urged a three deker tariff and the suggestion of Keynes (No. 1114 of October 8, noon) has received wide comment and there are many who believe that Britain should negotiate for a greater balance between the amounts she imports from and exports to individual countries. A recent speech of the Parliamentary Secretary
of the

REB

7-1251, From London, Oct. 26, 7p.m.

of the Department of Overseas Trade indicates that the Government is considering the fundamental problems of the export situation. After stating that every possible method of improving the competitive position of British exports must be explored he said "among these methods I am convinced that one of the most important is to devise effective machinery to enable industries in this country to speak on equal terms with competing industries abroad". He also referred to the sacrifices made by Germany and to the need of a united front of employers and employees not only of export but of sheltered industries and stressed the necessity for advances in efficiency and for organization for export if the high standard of living and social services are to be maintained and export trade improved.

But all this discussion like that concerning the armament and finance problems offers too vague a basis on which to make any predictions.

The government revenue and expenditure returns for the half year ended September 30 indicate a probable short fall in revenue of some £20 to £25 million with business activity at its present level but because of comparatively liberal estimates for civil expenditure and debt charges and because
any

REB

B-#1251, From London, Oct. 26, 7p.m.

any defense expenditure in excess of the budget estimates can be met out of borrowed funds the budget proper need not show a deficit for the year. The £90 million to be spent from borrowed funds however will certainly be exceeded but by what amount no one is prepared to predict even in the roughest way so that the size of the real budget deficit for the current year remains totally uncertain. Furthermore, the increase in total expenditure in the next financial year is sure to be even larger though no one presumes to suggest a figure at present. Reports on the costs of "closing the gaps in Britain's defenses" said to be already in the Prime Minister's hands but it is believed that the country will hear no details until sometime after Parliament reassembles next month. Nor are there likely to be any announcements throwing light upon the degree of interference with trade and industry that will be considered necessary until the Cabinet has had the opportunity of getting, through the forthcoming by-elections and from Parliament, the feel of the country's temper. No one expects anything in the nature of full Government control of industry. But those in the city who are facing the implications of such an armament program as now seems required are of the opinion that a considerable

REB

9-#1251, From London, Oct. 26, 7p.m.

considerable degree of interference will be inevitable if Great Britain is successfully to compete in this period of "armed peace" nevertheless it seems probable that the present Government will make haste slowly and reluctantly in any such direction.

In any case it would seem that the full impact of the speed up in the armaments program will not be felt for some months.

KENNEDY

CSB

See Page 2

41

PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Paris, France
DATE: October 27, 1938, 4 p.m.
NO.: 1828
FROM COCHRAN.

Today there has been continued pressure on the franc. The French stabilization fund had to intervene to reduce three months discount against sterling from 4 3/8 to 4 1/8, and to hold a rate of around 178.83 for spot. There has been considerable fluctuation in the pound, and the belga has today been the strongest currency. Last night the Belgian official discount rate was reduced from 3 to 2 1/2 per cent, and a good amount of sterling was gained by the Belgian National Bank. Today large amounts of dollars have been sold by Lazard, which through Montagu and the Amsterdamsche Bank has purchased sterling.

The October 20 statement of the Bank of France showed discounts down 913 million francs. Circulation was down 2 billion 862 million francs. There was an increase in deposits of 1 billion 914 million francs. No change in advance to the State. Coverage was 40.69 versus 40.41.

There is indication that subscription to Treasury bonds is continuing, since the Treasury deposit account has risen from 1637 million francs. Heavy amounts of Treasury paper are now being carried by the banks, which have started again this week to seek such large discounts thereon that

- 2 -

a reminder of their quotas had to be given by the Bank of France. Money is tight, under present circumstances. The convention developments at Marseille have not cheered the market. Operators are worrying about the gossip that Marchandean is having so much difficulty in the Government that Reynaud or Patenotre may soon succeed Marchandean as Minister of Finance, and then it is likely exchange control will be introduced.

In today's issue of Journal Official was the announcement of the Treasury's offer to convert into one-year Treasury bonds the 1933 five-year five percent bonds which mature on the twenty-ninth of November; these bonds would bear the current rate of interest. Interest would be paid on the new bonds from the day upon which the exchange is made.

Today's speech at Marseille by Premier Daladier was known in Paris too late for the bourse to be influenced thereby. Daladier in his speech (omission) all Government charges in ordinary, special and other budgets for 1939 at 102 billion francs; 66 billions was given as normal Government receipts. Daladier emphasized the necessity of augmenting the national production and income so that there would be a rise in tax receipts which in turn would reduce the deficit in the budget. He did not give any indication of any direct financial or monetary measures which might be expected as a result of specific decrees.

LWW

END MESSAGE.

WILSON. Regraded Uclassified

REB

GRAY

London

Dated October 27, 1938

Rec'd 4 p. m.

Secretary of State,
Washington.

1257, October 27, 6 p. m.

FOR TREASURY FROM BUTTERWORTH.

One. The volume of trading in the dollar sterling exchange has continued small but the tendency today has been more erratic. The dollar opened at 4.77-7/8 with the British authorities buying some dollars and very gradually moved to 4.77 despite checking official operations. Furthermore gold fixing was unusually large, 369 bars being sold at 145 shillings 7 pence of which some 200 were supplied by the British fund. The franc was again offered and there are indications of a renewal of some gold hoarding by French nationals.

Two. I showed Hawkey your telegram 653, October 26, 4 p. m. He feels and I think rightly that another month in London would not be of justifiable value and therefore plans to sail on the WASHINGTON November 4.

KENNEDY

CSB

RADIOGRAM

U.S.S. CANOPUS
(Hongkong)
October 27 1938

NICHOLSON
Spagent
Washington D.C.

Today following telegram sent to Lin Sen, Chiang Kai Shek, and Sun Fo
by Madame Sun Yat Sen, Madame Liao Chung Kai, Eugene Chen, Hau Chien,
former Minister of Justice, and others:

"Spokesman of military affairs commission has declared that evacuation of Wuhan inspired by strategic considerations and would not effect determination of National Government to carry on war of resistance. This is decidedly expression of unanimous desire and will of Chinese people. We support strongly and fully this stand of Government. However, we direct attention of Government to declaration concerning peace which to bewilderment of entire nation has been made by Wang Ching Wei to Reuters. Strangely, it was made on day that Canton fell. Such an utterance is not only contradiction of clearly expressed determination of Government to resist enemy but makes for weakening of confidence and frustrating of war attrition. Let these peace traffickers be dealt with. It is feared that during past fifteen months National Government has failed clearly to inform nation of its fundamental policy. We submit following measures for immediate enforcement: (1) Strengthening of central political structure (2) Adoption of Dr. Sun Yat Sen's foreign policy of cooperation with Soviet Russia (3) Mobilization of strength and resources of masses (4) Appointment of outstanding military commanders for defense of Kwangtung. We can overcome danger confronting nation only by coordination of political and military activities and by democratic centralization of national power which will enlist internal support and external assistance. The national crisis compels us to unseal our lips. We hope our words are not in vain."

Major Matsutani of staff of command of Japanese forces in South China arrived Hongkong yesterday for purpose of explaining Japanese program in South China. He intimated at press conference that Japanese will open up South China for business if and when British ready to deal with those in authority Canton.

CAMPBELL

WASHINGTON, D.C.

October 27, 1938

Replying to your cablegram 25th fall of Canton due to misjudging probability of Japan's hesitancy in affronting British by South China invasion and lack of adequate defense preparations on the part of Generals Yu Han-Mou and Wu Teh-Chen (stop) Public anger is greatly aroused and attitude of foreign Powers is rather cool (stop) Realizing the difficulty in holding two extensive fronts the Military Authorities have decided to withdraw from the Wu-Han area and concentrate the entire strength to hold the new line south of Yo-Yang (Yochow) and north of Shaokuan on the Canton-Hankow Railway (stop) Land and water routes between Kwangtung and Kwangsi have been blockaded leaving only Kunming-Haiphong route open so it is most important that Yunnan-Burma route be immediately equipped for urgent use (stop) Rumoured peace negotiation and third power mediation entirely without foundation.

*See 1938 14a
South China*

WASHINGTON, D.C.

October 27, 1938

The military situation in Wu-Han area was greatly affected by the fall of Canton. For strategic reasons our armies completed evacuation from the Wu-Han cities. Our main forces remain intact and have been orderly withdrawn to a new line of defense. Agents of Japan are active secretly in seeking peace channels.

Financial situation, because of the Government's efforts, remains stable. Central Government leaders are calm. Morale of the people is good.

From H. H. Kung



HEADQUARTERS

ADDRESS THE COMMANDANT, U. S. COAST GUARD
AND REFER TO HQ.

TREASURY DEPARTMENT

UNITED STATES COAST GUARD

WASHINGTON 27 October, 1938.

SECRET

From: Spagent, Hongkong, China.
To : Secretary of the Treasury.

Message from Mr. Campbell.

Re your telegram whereabouts of Buck, he advised us on October 15 that he was proceeding in few days from Chungking to Chengtu. Have not heard from him since. We are endeavoring to locate him and will advise as soon as possible.

SECRET

October 27, 1938

My dear Admiral Leahy:

The Secretary has asked me to thank you for your memorandum of October 26th, transmitting a despatch received from Commander Overesch, the Naval Attache in China.

He was very interested in having this information.

Sincerely yours,

H. S. Klets
Private Secretary

Admiral William D. Leahy, U.S.N.,
Chief of Naval Operations,
Navy Department,
Washington, D. C.

*'Confidential' marked on
envelope by Mrs. H.*

copy refer to initials
and No.

NAVY DEPARTMENT
OFFICE OF THE CHIEF OF NAVAL OPERATIONS
WASHINGTON

26 October 1938

MEMORANDUM FOR THE SECRETARY OF THE TREASURY

The following despatch received from Commander Overesch, the Naval Attache in China who is now in Hong Kong, is quoted as being of interest:

"Yuhanmu, representative of Generalissimo in Canton Area, is dumb and not a traitor according to the professed belief of Soong and other Chinese. The conditions were misrepresented to the General Chiang-Kai-Shek by the Military who are loyal and they point out that no troops have been left by their leaders. Wangchunhui, Foreign Minister, now at Hong Kong. The fall of Canton was unexpected Soong admits. A special Emissary who had been sent to salvage 70,000 dollars in silver from the China Bank failed to arrive Canton in time."

William D. Leahy

Yunnanfu, Yunnan,

27th October, 1938

The Honorable

Secretary Henry Morgenthau, Jr.,

Department of Treasury,

Washington, D.C.

Dear Mr. Secretary,

I enclose reports typed from notes sent me by Dr. Buck
from Chungking.

Respectfully,

Enid Saunders

Enid Saunders
Secretary to Dr. Buck

I N D E X

	<u>Page</u>
Interview with Dr. H. H. Kung	1
Interview with Minister Wong Wen-hao	4
Interview with Chang Teh-chi	5
Fall of Canton	7

October 23rd, 1938

To Secretary Morgenthau

From J. Lossing Buck

INTERVIEW WITH DR. H. H. KUNG

Fall of Canton

Dr. Kung stated that he did not yet have full information as to the exact reasons for the quick fall of Canton, but that he attributed it to the following factors:- "Japan's assurance that she would not attack Canton, and therefore over-confidence on the part of the Cantonese authorities; the transference of the best Cantonese troops to the Hankow front; the wide distribution of the remaining 70,000 troops under Yu Han-mou, because of the long Kwangtung coast line; and the difficulty of concentrating these troops quickly at the point of attack.

"The withdrawal was either on the initiative of Yu Han-mou, or upon orders from the Generalissimo, with the purpose of conserving the Cantonese forces for fighting at more strategic points rather than suffer losses when it was evident Canton could not be held."

Publicity in China on United States Treasury's Assistance

I again took up with Dr. Kung the question you raised with me in Washington about wanting the Chinese people to know of America's assistance through the silver purchases. Dr. Kung stated that as a result of my previous conversation with him on the subject, he had wired K. P. Chen to obtain from you the kind of statement you would like to have released, and as yet he has received no reply. Dr. Kung wants this from you as he is afraid he may

say too little or too much. He does not want to embarrass you in any way, but he welcomes the opportunity of making your help better known to the Chinese people.

Public opinion is, apparently, that Russia has given the most help. It would be very beneficial to Sino-American relationships if the Chinese, at least, were aware of the extent of the assistance the United States Treasury has rendered.

International Situation

Dr. Kung also touched on the international situation. He stated:-

"The French have given us a lot of difficulty about the transportation of military supplies through Indo-China. They are afraid of Japan. The Japanese alliance with Siam makes the Indo-China government nervous, and the French know that if Japan wishes to take Indo-China there is no way by which they, acting alone, can prevent it. Therefore the French are naturally interested in the combined action of the Powers. We are disgusted with the French attitude. Did you see by today's news that the French Ambassador to China had been appointed to Russia, without naming his successor? The French Ambassador took a strong attitude toward Japan, and the transfer probably means a weaker policy toward Japan.

"The British attitude in Hong Kong has been much more decent, and very helpful to us in the matter of shipments.

"Recent reports of England placing herself on a war basis, and of new appropriations in the United States for self-defence, indicate that the Powers still do not realize that peace is impossible without collective action. It is not until the Powers get together and have these policemen that any nation can close its doors at night and rest in a feeling of security."

October 21st, 1938

To Secretary Morgenthau

From J. Lossing Buck

INTERVIEW WITH MINISTER WONG WEN-HAO, MINISTER OF ECONOMIC AFFAIRS

I asked Minister Wong: "What are the important projects of the Ministry?" He replied: "That is not an easy question to answer.

"We are developing a good gold mine in Sikong, and copper and tin mines in Yunnan. We have, and are still transporting, large quantities of industrial machinery from the war areas. This machinery has enabled us to set up 30 small industrial concerns in the environs of Chungking. We are now transporting 120,000 tons of machinery from Hankow. This is an almost impossible task, as the limited means of transport have 60 per cent or more of their carrying capacity assigned to the military. Fortunately the foreign owned ships have no such limitation, and by special arrangement these ships help to make the task less difficult.

"There is an alcohol plant in Shensi redistilling liquor. There is another small plant in Chungking. A few small sugar refineries have been established. There is one paper pulp mill in Chungking."

Minister Wong is personally more interested in mining and industry than in agriculture. This interview was at a dinner, and he had to leave for another dinner party before I could raise specific questions about agriculture.

October 21st, 1938

To Secretary Morgenthau

From J. Lossing Buck

INTERVIEW WITH CHANG TEH-CHI, EXTENSION SPECIALIST,
NATIONAL AGRICULTURAL RESEARCH BUREAU, CHINESE COMMUNIST AREA

Mr. Chang visited the Chinese Communist headquarters in Shensi, and travelled in the province in the Hwang Shan area, to locate cultivable land. He states:-

"The people have been well organized by occupational groups. These groups elect representatives for the election of the hsien (county) magistrate. The communist organization has a secretary with each magistrate, who is very influential in determining policies, and for this reason there is some doubt as to the extent of control of the people's organization.

"Taxes as such have been eliminated, and contribution substituted. The poor are paying less, and the rich more, than under the taxation system. The ability of a person to pay is determined by his neighbors, since in Chinese society a neighbor's wealth is well known.

"Justice is administered by a judge, and all cases pertaining to the public are held before the public, and with opportunity for the public to present evidence on either side of the case.

"As yet few practical projects of an industrial nature have been initiated. The most self-evident one is the 'Spring Plowing Movement'. Plowing is begun early, and a farmer after his plowing is finished must loan his animals to his neighbors who have no animals.

"There has been some trouble between the troops of the Central Government and those of the Red Army, but the situation is better now.

"In some hsien there are two magistrates, the one appointed by the Shensi government, and the other by the people's organizations. The former has little power.

"Students from all parts of China are being trained by the thousands, in the so-called two universities, and sent to the front. These students are not necessarily communists, but they want to do something, and the communist organization provides ways and means. They may later still be used by the Central Government, and most of these students are not primarily communists in their political beliefs, although, of course, they are subjected to communist training."

October 23rd, 1938

To Secretary Morgenthau

From J. Lossing Buck

FALL OF CANTON

Public reaction to the fall of Canton is one of a great shock, and, as one friend expresses it: "We are ashamed to look each other in the face." The general feeling is that there must have been treachery or gross inefficiency.

Mr. Yang, Principal of a Quaker High School in Chungking, and himself a prominent Szechuen leader here, expressed himself freely in a group of which I was a member. He enumerated all the weaknesses of the Chinese people. He said: "The Chinese must distinguish between desire for a thing and ability to attain the object in mind. One great fault of the Chinese is the inability to see a thing through to the end. Too much dependence is put on words, and personal influence built up by one's friends and relations, rather than through actual accomplishment.

"Yu Han-mou should never have been given the position of command in Kwangtung as a reward for his turning over to the Central Government. He is not a capable person."

Yunnanfu, Yunnan,

27th October, 1938

The Honorable

Secretary Henry Morgenthau, Jr.,

Department of Treasury,

Washington, D.C.

Dear Mr. Secretary,

I enclose reports typed from notes sent me by Dr. Buck
from Chungking.

Respectfully,

Enid Saunders

Enid Saunders
Secretary to Dr. Buck

RECEIVED AT SECRETARY'S CORRESPONDENCE DIVISION
OCT 28 1938

I N D E X

	<u>Page</u>
Interview with Hsu Mo, Vice-Minister of Foreign Affairs	1 - 4
Sino-Japanese War	1
Soviet Russia	2
France	3
England	3
League of Nations Action on Article XVI	4
The United States	4
Interview with Dr. Francis Pan, Personnel Director, Ministry of Communications	5
Chengtu Rumours	6
Conversation with Mrs. Francis Pan, Wife of Personnel Director, Ministry of Communications	7
Conversation with Mrs. Paul Whang, Wife of a Secretary to Han Li-Wu of the British Boxer Indemnity Fund	8

1

October 20th, 1938

To Secretary Morgenthau

From J. Lossing Buck

INTERVIEW WITH HSU MO, VICE-MINISTER OF FOREIGN AFFAIRS

Sino-Japanese War

"The fall of Hankow and Canton will not bring about a capitulation of the Generalissimo's regime as is anticipated by Japan, any more than did the fall of Nanking. The Central Government, with the Generalissimo as it's leader, will continue; of this we are certain.

"We expect if Hankow and Canton fall that Japan will begin to consolidate her position, to unite the various puppet regimes, and to obtain their recognition by her allies, Germany and Italy. At the same time we expect she will make overtures of peace, but on terms unacceptable to China.

"On January 16, 1938, the Japanese Cabinet, with the Emperor's approval, took the irrevocable step of refusing to recognize the Chiang Kai-shek regime. Several times the Japanese have unofficially conveyed to us that if the Generalissimo would resign peace would be a simple matter. China cannot let the Generalissimo go. Ninety-nine per cent of the people want him as their leader, and China needs him. A much simpler way for Japan to save her face would be for Konoye to resign and his successor announce that the January 16th resolution was the work of another man, but now we are adopting a different policy."

Soviet Russia

"The Russian military advisers were not employed until after the German military advisers were withdrawn. Probably this move came as a great surprise to Hitler. The Russians have sent a good many so-called technicians. This is only natural, since Russia is supplying us with considerable equipment. How good they are as technicians, and what they are doing, I do not know. The Russians are very difficult to deal with. They always seem suspicious. We have to watch them carefully.

"The German advisers were very satisfactory, faithful and loyal. The chief German adviser was very anti-Hitler, and at first refused to return to Germany. His idea was to give up his German citizenship and spend the rest of his life in China. He was dissuaded from this plan.

"Soviet Russia has demonstrated very plainly that she will not fight unless she herself is attacked, and therefore China has little more to hope from her than the equipment she is sending us, but which we must pay for under rather unfavorable terms. Japan realizes now that Russia will not fight unless attacked, so she is using troops formerly stationed in Manchukuo for the Canton attack.

"We are very careful to go only a limited distance with Soviet Russia. We have made no concessions to her. All her dealings are directly with the Central Government. None are with the Eighth Route Army. When you go to Lanchow you will see a lot of Russians there."

France

"The French in Indo-China have given us a lot of trouble over the transport of military supplies through Indo-China. They have done everything possible to check these shipments, using one pretext after another. They have also openly admitted that Japan threatened to bomb their railway and take possession of Hainan Island if military supplies were shipped over their Indo-China railways to China."

England

"The Chamberlain policy in England, with the recent concessions to Germany, leaves us with no hope of assistance from her. I happened to be in Hankow when this settlement was made, and I conferred with a number of Generals of our army. I advised them to be ready for an attack on Canton because I felt the Japanese would realize that England's action on the European situation made it plain that she would not interfere if Japan should attack Canton. Most of the Generals did not believe the Japanese would attack Canton for this reason. Now my prediction has come true.

"England has a very short-sighted policy. It is to "salvage" her China interests, and she is negotiating with Japan in the hope of saving something. We have communicated with her, stating that her interests will be best conserved when the whole Sino-Japanese problem is settled. She has replied that in any negotiations with Japan she will do nothing to the disadvantage of China."

League of Nations Action on Article XVI

"The individual countries have interpreted the action to be optional for each country as to application. Both France and England have said: 'If the United States will apply it we will do so.' But the United States is not a League member, why should these countries refer to the United States? The least these countries could do would be to take the same attitude the United States has adopted in regard to shipments of planes, and bring pressure to bear on the exportation of munitions to Japan, so that such shipments would stop. We are quite distressed and discouraged over such an attitude on the part of France and England. We see little hope for much material assistance from abroad, unless it should be from the United States."

The United States

"I feel that the United States could take further steps which would assist China without involving itself in war. We still hope and feel that America will be the country to help bring about a peaceful and lasting settlement of the Sino-Japanese issues. It seems to me that an international conference might be assembled with Japan as a participant, for the purpose of bringing about a settlement. The Generalissimo is much interested in America, pays much attention to American relations, and is still pinning his faith on America as the country which will be most instrumental in assisting China out of her difficulty.

"Of course, he, like myself, greatly appreciates the assistance rendered by the silver purchases."

October 18th, 1938

To Secretary Morgenthau

From J. Lossing Buck

INTERVIEW WITH DR. FRANCIS PAN, PERSONNEL DIRECTOR,
MINISTRY OF COMMUNICATIONS

"The recent transportation conference accomplished two things:-

- (1) the recognition of the importance of the transportation problem, and
- (2) the realization that it's adequate solution requires very large sums of money.

"The Chungking-Chengtu Railway is to be completed only part way, as we do not have materials to build the entire line.

"We are tired of dealing with the French. I hope the Americans will help us with a railway. We would like to cooperate with them.

"I am leaving tomorrow for Hankow to attend Hankow's funeral. (October 19th. The Minister, Chang Chia Ngau, also left today. He returned yesterday from a trip to Kunming.)

"Our Chinese Foreign Office officials are not realistic enough in dealing with the Sino-Japanese issues."

October 20th, 1938

To Secretary Morgenthau

From J. Lossing Buck

CHENGDU RUMOURS

Some of the University of Nanking men from Chengtu tell me there is a widely circulated rumour in Chengtu that the Chinese Communists and the Japanese are in league to oust the Generalissimo's regime. This is the wildest rumour I have yet heard, as it is utterly impossible. Hsu Mo, Vice-Minister of Foreign Affairs, had not heard of this rumour, and he suggested that it might have been started at the instigation of certain Szechuen generals who hope that it might be true.

7

October 20th, 1938

To Secretary Morgenthau

From J. Lossing Buck

CONVERSATION WITH MRS. FRANCIS PAN, WIFE OF PERSONNEL DIRECTOR,
MINISTRY OF COMMUNICATIONS

"What is going to be the end of the Sino-Japanese hostilities ?
We are afraid that with the fall of Hankow people will become discouraged
with the present regime, and that the Japanese may be able to obtain some
able personalities to assist the puppet regimes."

October 20th, 1938

To Secretary Morgenthau

From J. Lossing Buck

CONVERSATION WITH MRS. PAUL WHANG, WIFE OF A SECRETARY TO HAN LI-WU
OF THE BRITISH BOXER INDEMNITY FUND

"There are two rumours, one that we will be back in Nanking by Christmas, because with the fall of Hankow the Powers will intervene and say: 'Now, you two Oriental babies, stop your quarelling, settle your differences thus and so'; the other is that China will side with Russia and become entirely Red. The Lord pity us if the latter should happen."

Yunnanfu, Yunnan,

25th October, 1938.

The Honorable

Secretary Henry Morgenthau, Jr.,

Department of Treasury,

Washington, D.C.

Dear Mr. Secretary,

I enclose reports typed from notes sent me from Chungking by Dr. Buck. Unfortunately these were first mailed to Hong Kong, but I had left for Yunnanfu before they arrived, and in posting them to me here much time was lost.

Respectfully,

Enid Saunders

Enid Saunders
Secretary to Dr. Buck

RECEIVED
SECRETARY'S OFFICE
OCT 27 1938
8/38

I N D E X

	<u>Page</u>
Motor Road from Yunnanfu to Kweiyang (Province of Kweichow)	1
Motor Road from Kweiyang to Chungking	4
Transportation Conference in Chungking	5
Currency in Kweichow	6
Kweichow Province	8
Kweiyang (Capital of Kweichow Province)	10
Interview with Governor Wu Ting-fang of Kweichow Province	11
Interview with Y. T. Tsur, Member of the Kweichow Provincial Government	13

September 29 to October 1, 1938

To Secretary Morgenthau

From J. Lossing Buck

MOTOR ROAD FROM YUNNANFU TO KWEIYANG (PROVINCE OF KWEICHOW)

I made this trip in a Ford V-8 provided by the Southwestern Transportation Company. The Chinese chauffeur is an experienced driver, and has driven over most of the roads in southwest China.

The motor road between Yunnanfu and Kweiyang is 655 kilometers in length. The section from Yunnanfu to the Kweichow border, a distance of 243 kilometers, is much better than the Kweichow section. The average speed over the Yunnan section was 24 miles per hour, with careful driving. The Kweichow section is extremely mountainous and the road very uneven. The many curves, and the uneven surface permitted a speed of only 15 miles per hour, and even this speed was uncomfortable. The whole road is of crushed stone, but in the Kweichow section the stones were not crushed finely or evenly enough, and formed the surface without sufficient foundation.

The Kweichow section for a distance of 100 kilometers before reaching Kweiyang is better than the section through the more mountainous part, and permitted an average speed of about 18 miles per hour. A sparse population and a consequent shortage of local laborers is one of the reasons why the road was not better built, through the mountainous section of Kweichow. This part of the road is very winding - up and down mountains, one after another, without seeming to reach any place.

During the whole distance I met or passed 58 trucks, mostly of the Southwestern Transportation Company, and 18 buses, some of which were loaded mostly with goods rather than passengers. Soon after leaving Yunnanfu I passed a fleet of nine trucks, transporting two dismantled Russian tanks, which had arrived by rail at Yunnanfu. I met eleven empty trucks on the way to Yunnanfu. I saw one badly damaged overturned truck at one of the turns in the road, two other trucks which had had an accident, and two buses which were having engine trouble. The buses are a decrepit lot. "White" trucks are of three and one-half ton capacity, and are giving better service than the Dodge trucks. Four trucks on the way to Yunnanfu were carrying new aeroplanes. The remaining trucks were carrying goods of various kinds. Most of them were covered so that the nature of the goods could not be determined from observation.

As to the improvement of the road, there is some difference of opinion between the Ministry of Communication, the Kweichow Provincial Government, and the transportation companies, as to who should supply the funds. Mr. Wang, Kwaiyang representative of the Southwest Transportation Company, states that he is advocating that his company should pay part of the cost.

Mr. Wang also told me of his progress in training and management of chauffeurs for motor trucks. At first it was necessary to use rather incompetent chauffeurs. Another problem with management of chauffeurs has been smuggling of opium, and sometimes of other goods, but this situation has been remedied. Mr. Wang was trained in the University of Pennsylvania, and is apparently handling his work quite well and in the right spirit.

Yesterday I saw his motor truck station, which had fifty trucks in it. A fleet of 23 trucks had already left the station early the same morning. Mr. Wang is also solving the problem of trucks returning empty to Yunnanfu. One way is through cooperation with the Post Office in moving large amounts of accumulated parcel post. I saw three such trucks yesterday, loaded with parcel post in front of the Post Office.

Taking everything into consideration, I find that the Southwestern Transportation Company has done a comparatively good piece of transportation organization with conditions as they exist in China.

Mr. Wang stated as I left that the last two of the 30 Russian tanks received at Kunming had been safely transported to Changsha. It is quite evident that war materials for the Central Government are being transported over the French railways, although a veil of secrecy prevails among the French and Chinese in Indo-China regarding these shipments.

October 4 and 5, 1938

To Secretary Morgenthau

From J. Lossing Buck

MOTOR ROAD FROM KWEIYANG TO CHUNGKING

This motor road, a distance of 486 kilometers, is fairly well constructed. Six bridges are being replaced with better and more permanent stone bridges. The surfacing is somewhat uneven, but on straight stretches 25 to 30 miles an hour was possible with a 1933 Ford car. On the road I saw 28 trucks and 22 buses. It took two days to make the trip, although a few people do rush through in a long day of about twelve hours, with dangerous driving.

5

October 7th, 1938

To Secretary Morgenthau

From J. Lossing Buck

TRANSPORTATION CONFERENCE IN CHUNGKING

A transportation conference is in session in Chungking, at the instigation of Dr. Kung.

T. S. Miao, Director of the Foreign Trade Commission in Chungking, attended the first session. He said that Minister Kung in his opening address referred to your helpfulness to, and interest in, China.

October 2nd, 1938

To Secretary Morgenthau

From J. Lossing Buck

CURRENCY IN KWEICHOW

I talked with the Manager of the Central Bank in Kweiyang, and I made observations en route through the province.

Orders were issued on July 1, 1938, for people to exchange all silver coins for Central Government notes, but the magistrates interpreted the order as being lenient enough to still permit circulation of silver coins. Consequently new orders have been issued, effective October 1, 1938. I found these orders being put into effect in An Nan hsien where I stayed over night. Even new subsidiary nickel coins have been distributed along the highway, and I found them acceptable. In one town I changed a dollar bill for these coins.

In addition to silver dollars there are fifty-cent Yunnan pieces of iron and silver in circulation in the western part of the province bordering Yunnan. These pieces are demanded by the Miao people who form the larger proportion of the population of Kweichow. Opium buyers change national notes into these coins to pay the Miao farmers for the opium. They also manipulate the exchange value of these coins so that they are worth twice as much when used to purchase opium as they are when the Miao people later use these coins to purchase merchandise brought in by these same merchants. Opium merchants and others with money to invest are now purchasing opium as the best investment.

They expect the price to rise because of the ban on its cultivation. They do not dare to invest in houses because of possible air raids, land is not considered a good investment, and cereals can be stored for only one year, whereas opium can be stored almost indefinitely.

Mr. Wang is pursuing a policy of gradual withdrawal of the Yunnan coin, just as he did with silver dollars. He found that if he pushed too hard for the collection, the open market price went up. He then adopted the policy of not taking silver dollars at all, until finally merchants in need of paper money to purchase goods at the coast begged him for paper in return for silver. It is quite evident that the silver will be gradually collected. Three million silver dollars and 200 thousand dollars in silver have been collected since the new national currency reform. Two millions are in the process of shipment to Hong Kong, and it will take at least three months to complete the shipments, owing to limited transportation facilities.

October 3rd, 1938

To Secretary Morgenthau

From J. Lossing Buck

KWEICHOW PROVINCE

The population of Kweichow is not exactly known, but it is estimated at about nine millions. The chief occupation is farming. Rice is the chief crop, and is grown in the flats and pockets between the towering mountains. There are also a number of plains, varying from one to fifteen miles in length and a mile or two in width. Corn is the chief crop on the hillsides that can be cultivated. Most of the hillsides are barren of trees, but covered with grass or shrubs. The limestone mountains are more extensively cultivated and more trees prevail. No forests were seen along the road.

Minerals are not abundant. There is considerable coal, and some antimony, gold, and iron, but exhaustive mineral surveys have not been made.

Considerable progress is in evidence through the efforts of the provincial government, of which Wu Ting-fang, the recent Minister of Industry of the Central Government, is Governor. Y. T. Tsur, recent Vice-Minister of Industry and former President of Tsing Hwa University in Peiping, is his right hand man in carrying out various reforms. This progress is evident in education, health, agriculture, communications, control of banditry, training of local officials, military training, and currency reform.

Limited financial resources prevent rapid development. The income of the whole province is only 7.5 million Yuan, of which 5.5 million is a subsidy from the Central Government. The provincial revenues are less than those from most hsien (counties) in the eastern provinces.

En route to Kweiyang I had the opportunity of seeing the magistrate of An Nan hsien in charge of a two months training institute for local village leaders. These leaders were required to bring their own bedding, benches, and tables, and the training quarters were in an old temple. The magistrate was an alert person of about 35, and apparently "right on his job".

I am favorably impressed with the spirit and efforts to meet the situation created by the war.

Cotton goods are almost entirely imported from other provinces, to the extent of ten million Yuan annually, and are very expensive. About 100,000 pounds are estimated to be produced in the extreme southwestern part of the province.

10

October 3rd, 1938

To Secretary Morgenthau

From J. Lossing Buck

KWEIYANG (CAPITAL OF KWEICHOW PROVINCE)

Kweiyang is crowded with refugees. On account of an air raid on the air port and several alarms, office hours of government organizations are from 6 to 8 AM, 3 to 5 PM and 7:30 to 9:30 PM. Many people go out to the hills at 8 AM and return at noon when the danger from raids is considered to be over. Many local people have moved their families to country villages.

Kweiyang is a very interior city, with a shortage of water supply, no modern water system, and insufficient electric light. Considerable building activity is evident, and prices of building materials have increased over 50 per cent.

11

October 2nd, 1938

To Secretary Morgenthau

From J. Lossing Buck

INTERVIEW WITH GOVERNOR WU TING-FANG OF KWEICHOW PROVINCE

Governor Wu imparted the following information:-

"The first and most important problem in the province which is being dealt with is that of opium smoking and production; the second is the health problem.

"Regarding transportation, it is more important to build a railroad from Kweilin to Kweiyang than from Yunnanfu to Szechuen. The most convenient route of transportation is eastward through Kwangsi to Wuchow (in Kwangsi).

"The population of Kweichow is declining because of opium smoking, bad health and tetanus infection of mothers and babies, aggravated by the absence of mid-wives. There is considerable waste land because of the sparse population, estimated at 300,000 acres. (Personally I doubt if there is that much land suitable for agriculture. JLB).

"One of our difficulties in road maintenance is an insufficient supply of picks and shovels. We need tools and machinery of many kinds, and we cannot even make our own until we have the proper equipment.

"You have now visited us in the rear of the fighting lines, and you have seen that we have enough to eat and to wear to maintain a minimum standard of living.

"Now that the League of Nations has applied Articles 16 and 17 against Japan, I hope the United States will also make a concrete expression of its opposition to Japanese aggression and apply economic sanctions against Japan. A bold and firm expression would be a great help in deterring Japan. We Chinese had hoped for such action before now, but the present time seems to be the most advantageous to take action, as it will involve the least risk to American interests with Japan. We know Americans are sympathetic with us, but we would appreciate the American government taking a more clear cut and a firmer stand against Japan rather than maintaining its passive attitude.

"At the beginning of the war I estimated that Japan would break if she spent more than ten billions on this war. She has already spent two-thirds of this amount. We are fighting almost entirely with our blood, as we do not have the equipment such as has Japan. The situation is very critical, and we desperately need the assistance of England and the United States in bringing economic pressure against Japan."

13

October 1st and 2nd, 1938

To Secretary Morgenthau

From J. Lossing Buck

INTERVIEW WITH Y. T. TSUR, MEMBER OF THE KWEICHOW PROVINCIAL GOVERNMENT

Y. T. Tsur is a man of ideals and a will to accomplish reform. He states that considerable progress has been made in the province though the people are very backward and improvements cannot be rapid, but that they can move steadily ahead.

He feels that the war will be a long one, and he does not see just how it can end. He hopes there will be a concrete expression from other nations like the United States and England, supporting China and opposing Japan. He feels that unless other nations take such a step, China's chance of driving out the Japanese is not very good.

Mr. Tsur, like Governor Wu, apparently belongs to the group who would have favored some compromise with the Japanese rather than have a war. He however admires the spirit and courage of the Generalissimo in launching out on a task the end of which cannot be foretold.

Mr. Tsur realizes and appreciates the help of the U. S. Treasury in buying silver, but states the degree of this help is realized only by a few.

Orders have been issued to every magistrate to completely suppress the growing of the opium poppy. Every smoker is supposed to have a licence for his pipe and is subject to arrest. Owing to difficulties of enforcement there are still many smokers without licences. Opium smoking houses are also

licensed, but all will be closed within a year. Opium smoking is to be stopped entirely by the end of 1940.

Yunnanfu, Yunnan,

27th October, 1938.

The Honorable

Secretary Henry Morgenthau, Jr.,

Department of Treasury,

Washington, D.C.

Dear Mr. Secretary,

I enclose copies of reports typed from notes sent me by Dr. Buck from Chungking. The originals are being mailed you via Air France, while these are to go on the Clipper from Hong Kong.

Respectfully,

Enid Saunders

Enid Saunders
Secretary to Dr. Buck

INDEX

	<u>Page</u>
Interview with Dr. H. H. Kung	1
Interview with Minister Wong Wen-hao	4
Interview with Chang Teh-chi	5
Fall of Canton	7

October 23rd, 1938

To Secretary Morgenthau

From J. Loessing Buck

INTERVIEW WITH DR. H. H. KUNG

Fall of Canton

Dr. Kung stated that he did not yet have full information as to the exact reasons for the quick fall of Canton, but that he attributed it to the following factors:- "Japan's assurance that she would not attack Canton, and therefore over-confidence on the part of the Cantonese authorities; the transference of the best Cantonese troops to the Hankow front; the wide distribution of the remaining 70,000 troops under Yu Han-mou, because of the long Kwangtung coast line; and the difficulty of concentrating these troops quickly at the point of attack.

"The withdrawal was either on the initiative of Yu Han-mou, or upon orders from the Generalissimo, with the purpose of conserving the Cantonese forces for fighting at more strategic points rather than suffer losses when it was evident Canton could not be held."

Publicity in China on United States Treasury's Assistance

I again took up with Dr. Kung the question you raised with me in Washington about wanting the Chinese people to know of America's assistance through the silver purchases. Dr. Kung stated that as a result of my previous conversation with him on the subject, he had wired K. P. Chen to obtain from you the kind of statement you would like to have released, and as yet he has received no reply. Dr. Kung wants this from you as he is afraid he may

say too little or too much. He does not want to embarrass you in any way, but he welcomes the opportunity of making your help better known to the Chinese people.

Public opinion is, apparently, that Russia has given the most help. It would be very beneficial to Sino-American relationships if the Chinese, at least, were aware of the extent of the assistance the United States Treasury has rendered.

International Situation

Dr. Kung also touched on the international situation. He stated:-

"The French have given us a lot of difficulty about the transportation of military supplies through Indo-China. They are afraid of Japan. The Japanese alliance with Siam makes the Indo-China government nervous, and the French know that if Japan wishes to take Indo-China there is no way by which they, acting alone, can prevent it. Therefore the French are naturally interested in the combined action of the Powers. We are disgusted with the French attitude. Did you see by today's news that the French Ambassador to China had been appointed to Russia, without naming his successor? The French Ambassador took a strong attitude toward Japan, and the transfer probably means a weaker policy toward Japan.

"The British attitude in Hong Kong has been much more decent, and very helpful to us in the matter of shipments.

"Recent reports of England placing herself on a war basis, and of new appropriations in the United States for self-defence, indicate that the Powers still do not realize that peace is impossible without collective action. It is not until the Powers get together and have these policemen that any nation can close its doors at night and rest in a feeling of security."

October 21st, 1938

To Secretary Morgenthau

From J. Lossing Buck

INTERVIEW WITH MINISTER WONG WEN-BAO, MINISTER OF ECONOMIC AFFAIRS

I asked Minister Wong: "What are the important projects of the Ministry?" He replied: "That is not an easy question to answer.

"We are developing a good gold mine in Sikong, and copper and tin mines in Yunnan. We have, and are still transporting, large quantities of industrial machinery from the war areas. This machinery has enabled us to set up 30 small industrial concerns in the environs of Chungking. We are now transporting 120,000 tons of machinery from Hankow. This is an almost impossible task, as the limited means of transport have 60 per cent or more of their carrying capacity assigned to the military. Fortunately the foreign owned ships have no such limitation, and by special arrangement these ships help to make the task less difficult.

"There is an alcohol plant in Shensi redistilling liquor. There is another small plant in Chungking. A few small sugar refineries have been established. There is one paper pulp mill in Chungking."

Minister Wong is personally more interested in mining and industry than in agriculture. This interview was at a dinner, and he had to leave for another dinner party before I could raise specific questions about agriculture.

October 21st, 1938

To Secretary Morgenthau

From J. Lossing Buck

INTERVIEW WITH CHANG TEH-CHI, EXTENSION SPECIALIST,
NATIONAL AGRICULTURAL RESEARCH BUREAU, CHINESE COMMUNIST AREA

Mr. Chang visited the Chinese Communist headquarters in Shensi, and travelled in the province in the Hwang Shan area, to locate cultivable land. He states:-

"The people have been well organized by occupational groups. These groups elect representatives for the election of the hsien (county) magistrate. The communist organization has a secretary with each magistrate, who is very influential in determining policies, and for this reason there is some doubt as to the extent of control of the people's organization.

"Taxes as such have been eliminated, and contribution substituted. The poor are paying less, and the rich more, than under the taxation system. The ability of a person to pay is determined by his neighbors, since in Chinese society a neighbor's wealth is well known.

"Justice is administered by a judge, and all cases pertaining to the public are held before the public, and with opportunity for the public to present evidence on either side of the case.

"As yet few practical projects of an industrial nature have been initiated. The most self-evident one is the 'Spring Plowing Movement'. Plowing is begun early, and a farmer after his plowing is finished must loan his animals to his neighbors who have no animals.

"There has been some trouble between the troops of the Central Government and those of the Red Army, but the situation is better now.

"In some hsien there are two magistrates, the one appointed by the Shensi government, and the other by the people's organizations. The former has little power.

"Students from all parts of China are being trained by the thousands, in the so-called two universities, and sent to the front. These students are not necessarily communists, but they want to do something, and the communist organization provides ways and means. They may later still be used by the Central Government, and most of these students are not primarily communists in their political beliefs, although, of course, they are subjected to communist training."

October 23rd, 1938

To Secretary Morgenthau

From J. Lossing Buck

FALL OF CANTON

Public reaction to the fall of Canton is one of a great shock, and, as one friend expresses it: "We are ashamed to look each other in the face." The general feeling is that there must have been treachery or gross inefficiency.

Mr. Yang, Principal of a Quaker High School in Chungking, and himself a prominent Szechuen leader here, expressed himself freely in a group of which I was a member. He enumerated all the weaknesses of the Chinese people. He said: "The Chinese must distinguish between desire for a thing and ability to attain the object in mind. One great fault of the Chinese is the inability to see a thing through to the end. Too much dependence is put on words, and personal influence built up by one's friends and relations, rather than through actual accomplishment.

"Yu Han-mou should never have been given the position of command in Kwangtung as a reward for his turning over to the Central Government. He is not a capable person."

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE

October 27, 1938

TO Secretary Morgenthau

FROM Herman Oliphant

For your information -

Mr. Monnet first came in to see me as you suggested at 2:00 P.M. on October 25. I saw him alone, and the interview did not last long. I allowed him to take most of the time stating to me the plan, and what he had in mind. I attach as "Document No. 1" the memorandum which I had before me on which I talked when I outlined to him what, under the statutes, the United States was authorized to do, indicating that I was merely stating what it could do, not what it would do.

He asked to see me again to get the answers to any questions that might arise in his mind, and to continue the process of familiarizing himself with the subject. I saw him on October 26 at 4:00 P.M., and had Mr. Bernstein in with me in order to give him the background in case we have later to work the matter up. Most of this discussion was devoted to the practical problems that would have to be dealt with - such as how a practical distinction between flight capital and legitimate business investments could be worked out.

Pursuant to your request, I gave him, at this interview, an un-water marked, typed statement of the American law ("Document No.2"). A copy of this is attached.

He again asked me to give him any time I could spare today, and he came in at 12:30. We talked for twenty minutes with Bernstein present, and reviewed his own statement of the plan which he had worked out in Mr. Bernstein's room following our talk yesterday.

He asked for more time, and it was arranged for him to come back today at 4:00 P.M. to discuss the matters, some legal, some non-legal, and Mr. Bernstein and Mr. White talked with him; the conversation relating, for the most part, to the amount of French capital here.

Herman Oliphant

Attachments (2)

Seamant No. 2.

35

Under Section 5(b) of the Trading with the Enemy Act, as amended ^(and amended by Section 2 of the Act of March 9, 1933, it would seem that) the President, upon declaring the existence of a national emergency¹, could require reports to be filed with respect to all property located in the United States and owned directly or indirectly, beneficially or otherwise, in whole or in part, by a foreigner. He could require that such reports be filed not only by the foreigner who owned the property situated here, but also by agents, custodians, and bailees of the property owned by the foreigner, by American banks, corporations, brokers, insurance companies, and any other person in this country indebted to or holding property for the account of, or having custody, possession, or control of any property belonging to, any foreigner or anyone suspected of being a foreigner. Under the aforesaid statute, fines of up to \$10,000 and imprisonment up to ten years, or both, could be imposed for failure to file such reports.

It could be required that the reports show the name, address, and nationality of the foreigner owning the property; the form in which the property is held, for example, bank deposits, corporate securities, etc.; the value of such property; and, if the property was acquired after, for example, March 6, 1933, the date such property was acquired and the nature of the transaction by which it was acquired. Within a fixed period of time, say three days, after any such property is transferred or disposed of, reports would have to be filed showing the details of such transfer or disposition.

An alternative, clearly authorized, would be to provide that, beginning 60 days hence, or some other convenient period, immediate detailed reports of all foreign transactions would be required. This might well result in a considerable exodus during that period.

Information thus obtained by this Government could be made public and hence be made available to foreign countries interested.

Although we would not be on as firm legal ground to require the aforementioned type of reports vis-a-vis nationals of less than all foreign countries, it could be argued that the same statute authorizes the President to require such reports where the property situated in this country is owned (a) by a Frenchman, for instance, or (b) by a national of any country which is a member of the Tripartite Arrangement. With respect to the last-mentioned alternative, it might be appropriate for each of the three senior partners or the six partners of the Tripartite to agree to furnish on a reciprocal basis information relative to the holding of property within its borders by the nationals of the other members of the Tripartite. If such an arrangement were to be entered into by the Tripartite members, it would give further legal support to the President's requiring the filing of such reports.

¹ The President declared the existence of such an emergency in connection with the foreign exchange Order of January 15, 1934, which Order is still in full force and effect.

- 2 -

I am still studying whether the powers of the Federal Reserve Board, the Comptroller of the Currency, the FDIC and the SEC could be invoked in support of requiring the aforementioned reports.

It is to be noted that the foregoing suggestions relate to things which could be done by the President without further authority from the Congress. In addition to the foregoing, other steps could be taken with the approval of the Congress. For instance, a convention could be entered into with France for the reciprocal exchange of information relative to the holding in each country of assets by nationals of the other country. Such a convention would have to be approved by the Senate. It might also be possible to enact legislation imposing taxes on transfers of property in this country by foreigners, or increasing the income tax which foreigners would have to pay, etc.

It might also be possible to require an increase in the bank reserves held against bank deposits belonging to foreigners.

Under Section 5(b) of the Trading with the Enemy Act of October 6, 1917, as amended by Section 2 of the Act of March 9, 1933, the President is authorized, without again declaring the existence of a national emergency¹, to amend parts of the present Executive Order of January 15, 1934, relating to foreign exchange and the Regulations of November 12, 1934, so as to require reports to be filed with respect to all property located in the United States and owned directly or indirectly, beneficially or otherwise, in whole or in part, by a foreigner. Such legislation would appear to authorize the requirement that such reports be filed not only by the foreigner who owned the property situated in the United States, but also by agents and bailees of the property owned by the foreigner, by American banks, corporations, brokers, insurance companies, and by any other person in the United States indebted to or holding property for the account of, or having custody, possession or control of any property belonging to, any foreigner or anyone suspected of being a foreigner.

The statutes would also seem to authorize the requirement that such reports show the name, address and nationality of the foreigner owning the property; the form in which the property is held, for example, bank deposits, corporate securities, etc.; the value of such property; and, if the property was acquired after, for example, January 31, 1934, the date such property was acquired and the nature of the transaction by which it was acquired; and that within a fixed period of time, say three days, after any such property is transferred or disposed of, reports be filed showing the details of such transfer or disposition.

Under the aforesaid statutes there is authority to impose fines up to \$10,000 and imprisonment up to ten years, or both, for failure to comply with the statute and orders and regulations issued thereunder.

There would be authority for the United States to make public information contained in such reports and foreign countries interested in such information could thereby obtain the same.

Such statutes would seem also to authorize the President of the United States to limit the requirement of such reports with respect to property in the United States owned by nationals of that particular country, or of those particular countries, in relation to which there were problems of an emergency nature having to do with foreign exchange or capital movements, or in relation to which there were special arrangements dealing with problems of this type. Action of the limited sort just indicated, under all ordinary circumstances, would, within the frame of the statutes, contemplate reciprocal action by the countries cooperating with the United States in dealing with such problems of exchange or capital movements. If the other two original parties to the Tripartite arrangement were the countries at instance, an agreement of all three, to furnish on a reciprocal basis information relative to the holdings of property within their respective borders by nationals of the other members of the Tripartite, would be contemplated.

1. The President of the United States declared the existence of such an emergency in connection with the Executive Order of January 15, 1934, regulating foreign exchange and in connection with the Bank Holiday Proclamation of March 6, 1933, both of which are still in effect.

October 27, 1938.
4:15 p.m.

38

HMJr: Hello.

Operator: Mr. Lambert.

HMJr: Hello.

Lambert: Hello.

HMJr: Henry Morgenthau, Jr.

L: Yes, sir.

HMJr: How are you?

L: I'm fine, thank you. How are you?

HMJr: I'll give you three guesses as to what I did this morning.

L: Well, one is that you went over to Europe, the other is you went to California and the third is that you saw my houses.

HMJr: You're right.

L: Well, it looked for a minute like I wasn't going to get it, didn't it?

HMJr: Have you heard I was there?

L: Yes, I knew you were there.

HMJr: You knew I was there.

L: I'll tell you, just by an accident, because **Dager** was talking to Riefler and because he wanted to come up and see him and he just mentioned that you'd been there during the day and that - one chance in a million that I happened to be in the room when he was talking to him. And he also said that you were upset about the tanks and I said, "Well - what - it's very unfair to judge a picture until the painter is finished and of course **those get all planted out.**"

HMJr: Well, that's only a very minute detail.

L: But I wish you'd been there tomorrow because one of the apartments, tomorrow night, will be completely furnished, by Macey, so that we can see what could be done by a young couple and will look very attractive, and - you know - show the possibilities of it and they'll have - they're

- 2 -

coming down with a bunch of furniture tomorrow.
Did you get inside?

HMJr: Oh I spent an hour there.

L: Oh, you did, really.

HMJr: Yes.

L: Well do you think, as a first attempt, for a standard material, they're so bad?

HMJr: Now look, I'm tremendously enthusiastic.

L: Well, that's fine.

HMJr: I'm tremendously enthusiastic, and I - now that I've seen it - everybody tells me that you've revised the plans since I've seen you, but nobody tells me what you've done.

L: Well, I sent you a copy of the revised plans. I sent them over to Hanes the other day - I didn't want to bother you, but I sent a copy to Hanes to distribute to you in which we now have, I think, all of the objections ironed out on taxes and I can tell it to you in two seconds -

HMJr: No. I'll tell you what I'd like you to do. Are you going to be free Sunday night?

L: Yes, indeed. I'm - I'm going - to be here in Washington.

HMJr: Washington.

L: In Washington. Yes.

HMJr: Well, I'll tell you what we'll try and do. At any event if you'll come to the house for supper, I'd like very much to have you, I'll try to get hold of Hanes and try to get hold of Stewart Macdonald.

L: That's fine. And what time?

HMJr: Seven-thirty and you needn't - ah - business clothes.

L: Yes. At seven-thirty on Sunday night.

HMJr: I mean do you want **Dager** or not.

L: I'd like him, it's quite unnecessary.

- 3 -

HMJr: It's unnecessary as far as I'm concerned.

L: Yes. All right, sir. And then we'll - then I'll leave it to you - you try to get hold of Hanes.

HMJr: I'll get hold - if Hanes is in town I'll get hold of Hanes and Stewart Macdonald.

L: I see.

HMJr: And then I - I want to find out - now that I've seen it, I want to help all I can.

L: Yes. Well, that's fine because I think we've got it fixed up now so that practically all the objections are ruled out, and - it came about after our conversation at dinner with you - you said "Get busy and fix this so that it hasn't those objections," and we've all the plans which, I think, you will agree and most everyone we've talked to about it, in fact everyone has - abolishes all those objections and yet accomplishes exactly the same result.

HMJr: Of course, we - you know it can be built under existing authority.

L: What?

HMJr: They could be built -

L: Oh, yes. But that's a clumsy -

HMJr: I understand.

L: The trouble is that I have to - while I'm getting that authority together to sign the papers, I've built the house.

HMJr: I understand.

L: And it simply won't work in a broad general sense.

HMJr: But I -

L: But I - I'm very pleased that you like the houses, because they're built by - Win probably explained to you - by an excellent contractor, all union labor -

HMJr: Yes.

- 4 -

L: And they're - they will look better when they've been lived in a little bit.

HMJr: Well, they were putting up the wallpaper.

L: Oh, they were.

HMJr: Yes, they were.

L: Oh, I see. Yes.

HMJr: Well, I'm very enthusiastic and I want to help all I can.

L: Thanks every so much, Mr. Morgenthau, then, and I'll be there on Sunday night.

HMJr: Right.

L: Thank you.

HMJr: Goodbye.

GROUP MEETING

October 28, 1938.
9:30 A. M.

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

H.M.Jr: I think you will all be very much pleased to know that the President has decided to appoint Mr. Hanes Under Secretary.

(Applause)

Your speech was beautiful.

Hanes: Do I have to make a speech?

Oliphant: How about it? (Laughter)

H.M.Jr: That's that.

I've got a couple things I'd like to clear. Would somebody explain to me why I should sign Helvering's request that, as I get it, all Departments should have income tax information available. Does that give any Department blanket permission - Mac, have you read this so you can explain it? Any Department, without coming to me, can get any income tax information?

Hanes: I think that is confined to the S. E. C; I believe they have been making requests

H.M.Jr: That is all right, but I gathered that any Departments can get it.

Hanes: I think it is only by specific request.

- 2 -

H.M.Jr: Mac, read it, and I'll come back to it. Do you mind?

The other thing here is a letter from a former United States Grand Juror congratulating Internal Revenue on getting this Abe Joseph, at Newburgh.

It's funny. I called Mac this morning and I got him between the bed and the shower. (Laughter) I could hear his teeth rattling over the telephone.

Lochhead: Was he going back to bed after the shower?

H.M.Jr: I don't know. Well, let's ask him. Anyway, what I - after waiting half an hour he found a pencil, and this thing - I'm suggesting you bring down - I'd like to bring down the fellows that did this particular thing - Theodore Dreesen, (Elton) Keating, and Donald Isolds (?) of the Alcohol Tax. See? I have signed it; I thought you might like to have them come down.

McReynolds: I've got a case - coming down on the Customs case; I've called the boys.

H.M.Jr: Dan, on - listen, Steve, don't - ...

(Mr. Kieley comes in.)

Well, I just didn't - I didn't know any way - all right.

And the other thing, Wayne, your good friend, Eugene Sloan is trying to kid me. He gave me a statement yesterday - the other day, when I asked for it - on a redemption of half of one per cent. He figured it against the whole business. Now he gives me figures from March; it is nine and four-tenths per cent, but I still say he's kidding me, because it's running almost at twenty-five per cent this month - almost twenty-five per cent, because we have taken in this month, roughly, about twenty-five million dollars; we redeemed almost five.

Taylor: I think you do have to compare it with the total amount outstanding.

H.M.Jr: True, but four million in twenty-two days is very - (words misunderstood) - redeems.

- 3 -

Do you mind just taking a look at it. It couldn't - couldn't we, as a sample, write a hundred people and ask them why - couldn't we just take a hundred people, just at random, and ask them why they are doing it? We could send people to interview them. Wayne, I'd like to send some people to interview them. You can use - well, any one of them.

Taylor: Just use the local people; there are a lot of them.

H.M.Jr: Why not ask the postmaster to interview them, go and talk to them. Let's just interview a hundred people at random.

Bell: It isn't out of line, Mr. Secretary; last year

H.M.Jr: If you do it that way it's all right, but four million is

Bell: Yes, but the same period last year ran five million one; this year it ran five million fifty, twenty-five days; last year, as a total, fiscal year, eighteen million four; this year, twenty-five million three, but on the volume of a hundred twenty-two for last year, and a hundred forty-eight for this year. It's running very close.

H.M.Jr: If you don't mind, I'd still like Taylor to come. (To Mrs. Klotz:) Let Mac read this letter.

That's all I've got. I read the Fleishhacker thing, and Mr. Jones called me at o'clock last night to tell me about it. He was very much pleased, sort of; I got the idea - thought he arranged to have Herbert Fleishhacker resign. I didn't argue with him. (Laughs)

Oliphant: (Laughs)

H.M.Jr: And I don't - we'll let him go out that way; it's all right with me.

Dan?

Bell: I have nothing.

H.M.Jr: I see it was in the paper this morning, that after the President inspected the airport - great secrecy. I haven't heard at what time; I'm

- 4 -

asking. You're coming here at eleven, aren't you, for Straus?

Bell: Yes sir.

H.M.Jr: Let's see, there is Bell here, Hanes will be here, Taylor, will you be here?

Taylor: Yes. I've got to go over to this ten o'clock meeting I told you about, with Archie.

H.M.Jr: If you could get your - this is particularly your bailiwick, and I'll have to do my home work in front of Straus; I won't have a chance to be prepared.

Oliphant: It's eleven o'clock?

H.M.Jr: Yes. Eleven. I'll just have to do my home work in front of you fellows.

(Mrs. Klotz speaks low to H.M.Jr.)

H.M.Jr: Oh, and on Glen Martin; there's a chance that the President might see him Saturday, so if you could put him on notice, so to speak. Glen Martin.

Hanes: (Nods "Yes.")

H.M.Jr: All I'd say to Glen Martin is, "Don't get too far away from the telephone Saturday and Sunday." It may be I'll want to see him - something like that.

Hanes: All right.

H.M.Jr: Huh? So - I mean so he doesn't fly out West or something.

(Nods to Mr. Lochhead.)

Lochhead: The exchanges are quiet. I thought that (broad-tape clipping) was interesting. Japan made a protest to France about shipping.

H.M.Jr: Yeah. Steve?

Gibbons: (Nods "Nothing.")

(Mrs. Klotz speaks low to H.M.Jr. He nods "Yes.")

- 5 -

Gibbons: Nothing. The Coast Guard, I told you they had the site fixed up - site for the War Department - for that radio station. It's only on a five year basis. Now

H.M.Jr: Well

Gibbons: Mr. Manning, in Mr. Oliphant's office thinks that there is a chance of getting the money from a 1933 P. W. A. allotment.

H.M.Jr: No, they have tied that up in a bow knot.

Gibbons: You want to go through on that five year basis.

H.M.Jr: You can't get any of that money; it's in the President's vest pocket; he's going to hang on to that for dear life - for buying land. You can't get a nickel of that. Is that right, Dan?

Bell: Yes. Take the five years; that's permanent.

Gibbons: The Budget wouldn't let the appropriation go in the Budget before; it is only twenty thousand dollars. Get Congress to give us the twenty thousand; we've got the land from a private individual.

H.M.Jr: Well, work it out, anyway.

Gibbons: If you want to wait sixty days

H.M.Jr: I'll leave it to you.

Gibbons: Five years from now some fellow from the War Department might say, "Well, you've got to get out."

Bell: That's all right, they can't put you out over night. The Department of Justice has been occupying Leavenworth Army Prison on a year basis, and they've been trying to get them out for fifteen years.

Gibbons: Well, it's just a question of sixty days; I think Congress would give it to us. We'd have had it if they'd let it go in the Budget before. Danny thought we should take it from the Public Parks.

H.M.Jr: I'd do what Danny says.

- 6 -

Gibbons: O. K. I didn't want to go ahead with it unless you knew about this five year arrangement.

H.M.Jr: Oh, I should worry about that.

Bell: I don't mean to get it through Congress; they are not going to appropriate money to buy land around Washington when they own more than half the city.

H.M.Jr: Well, we've been at it for how many years?

McReynolds: Three years.

Oliphant: Our technical needs might be different at the end of three years.

H.M.Jr: Incidentally, this new radio they've put in this Lockheed plane is a marvelous thing. They've put a new one in - a hundred fifty pounds, and it's much more efficient. Talking by voice yesterday, oh, a hundred, two hundred - well, let's see - Philadelphia - well, over a hundred miles. It's the same machine, only modified, that Bendix developed for Hughes on his trip, and with the outfit, the whole things, two machines, this does the work - one machine - and lightens it by a hundred fifty pounds. We were over Philadelphia; we were talking to the field in New York ...

Gibbons: Floyd Bennet.

H.M.Jr: Floyd Bennet, by voice.

Gibbons: By voice, huh?

H.M.Jr: By voice. Harry?

White: (Here is) Something that might interest you - particularly the date.

H.M.Jr: What is it? Oh - why didn't you say so?

White: What's that? Well, it's self-explanatory - the date on there.

H.M.Jr: Look; Harry hands me a letter written September 24, signed by Gibbons, asking the State Department, as follows:

"It will be appreciated if you will furnish this Department at your earliest convenience with any information available concerning discriminations against American commerce in Manchuria, North China, or Japan, which now exist or recently occurred, whether such discriminations result from activities of Japanese authorities or otherwise.

"This information is urgently needed for a study now receiving the active attention of this Department."

The point that Harry makes is that we are blocked at every turn in getting this thing; - couldn't understand it.

White: That's a little stronger than I'd put it.

H.M.Jr: That's the way you put it to me.

Oliphant: That's about it.

White: I simply had a hard time getting the information at first - considerable.

H.M.Jr: You were blocked at every other turn?

Klotz: (Laughs)

H.M.Jr: (Laughs) Well, anyway, he thinks it is very significant that we wrote this on September 24, and on October 6 the State Department issued - wrote this letter, which is in today's papers, to Japan. He thinks it is a coincidence.

Taylor: It's a pretty complete one.

H.M.Jr: So we can forget about that.

Oliphant: It makes this thing doubly (speaking low) response which we will be sure to get. With that in mind, I rushed the thing, with the idea of having it ready for you today in case you might want it further.

H.M.Jr: Well, the Japanese won't answer it today. I wouldn't touch it until Monday. Anything else?

Oliphant: It makes a natural out of the thing.

H.M.Jr: Harry doesn't believe it, but you can talk to him. Am I again misquoting you?

White: I am sorry, I didn't hear what Oliphant said.

H.M.Jr: Well, you fellows better get together.

(Nods to Mr. Hanes.)

Hanes: I've got two matters here, from the Department of Internal Revenue. Harold Graves wants to make a change in the Illinois District. He wants to put Minnesota and North Dakota and South Dakota in that District. This one is one you asked for the other day. I borrowed it.

H.M.Jr: Oh, you borrowed it. Give them both to Mac.

Anything else?

Hanes: No, that is all.

H.M.Jr: Wayne?

Taylor: Remember, I talked to you on the telephone about this Cuban report, and a couple of other things there. I'd like to have some time to talk to you about that before - no immediate hurry about it.

H.M.Jr: Well, what I'd like to do, I'd like to sit down with you and Pierson, and get that whole picture of Central and South America - would that - Cuba be included in that?

Taylor: No, the Cuban one is a special case.

H.M.Jr: Well, you make a note, Mrs. Klotz - Cuba - and then Jones said he'd like to kind of join us when we talk to Pierson, too. Why don't we - if we are free next Tuesday for lunch, have Pierson, Taylor, Jesse Jones

Taylor: I think he's going up to New York for this Foreign Trade thing they are having. I don't think he will be here Tuesday.

H.M.Jr: Don't think he'll be here Tuesday? Then, Taylor, on the whole picture, I think it might be better for him to sort of get his report ready; I don't

think he's quite ready with it yet. Will you tell him, when he's ready I'd like to see him. But Cuba, you want to do anyway? I thought if we waited until after election, and it got a little colder, I'd have to go down myself and look at it personally.

Taylor: That would be a nice place to go.

H.M.Jr: I'll match Steve to see which one of us goes.

Gibbons: What country?

H.M.Jr: Cuba.

Gibbons: Very nice.

H.M.Jr: Very nice.

Gibbons: Probably get Herman in on that too.

H.M.Jr: Anything else, Wayne?

Taylor: One of the things they are going to suggest is a type of special mark, or the equivalent of that for this purpose, and I think we probably - if that's what they are going to suggest, why, probably we'd probably get into some trouble on it.

H.M.Jr: Cuba?

Taylor: No, this is this refugee business.

H.M.Jr: Well

Taylor: I guess the best thing to do is just listen.

H.M.Jr: Well, Harry's going with you?

Taylor: No, Archie and Johnson.

H.M.Jr: Good. Well, you'll have to bring me up to date because I am absolutely cold on it.

Taylor: I don't know anything more than I told you, which I got over the telephone.

H.M.Jr: Any time you want to go.

George?

Haas: I have nothing this morning.

H.M.Jr: George, that last memorandum you prepared for me on the one Lonigan gave me, is of October 22?

Haas: That is right.

H.M.Jr: The President has that, so will you give me another one, please?

Haas: Uh huh. That chart I gave you that time is just rough.

H.M.Jr: I am giving it back to you. Ask me why afterward.

Taylor: (Starts to leave; talks to Mr. Oliphant at door.)
(H.M.Jr. and Mr. Haas hold low conversation.)

Haas: I did the best I could.

H.M.Jr: It's not good enough.
(Points to Mr. Gaston.)

Gaston: I suppose you noticed about the death of Alma Gluck here.

H.M.Jr: It's in your hands; I don't know a thing; I'm leaving it with you, Wayne.

Hanes: Wayne.

H.M.Jr: You take who you want; the matter is in your hands.

Gaston: I don't know whether you knew or not that Marsha Davenport, who is Russell Davenport's wife, is Alma Gluck's daughter. ~~Marsha~~ ^{Marcia} Davenport

Klotz: (Low) Is that the Davenport

Gaston: ~~Marsha~~ ^{Marcia} Davenport is Alma Gluck's oldest daughter, and is the wife of Russell Davenport, the Editor of Fortune - the brother of John Davenport, who is doing this article.

H.M.Jr: What do I do?

Gaston: Nothing. I thought you might be interested in knowing it.

H.M.Jr: Thanks. That is, Davenport - the editor's wife is Alma Gluck's daughter?

Gaston: That is right. She writes under the name of ~~Marcia~~ Davenport.
Marcia

H.M.Jr: Well, they were married in Baltimore, by the Mayor of Baltimore, weren't they?

Gaston: I don't know.

H.M.Jr: Yeah.

Gaston: I think she's the oldest daughter, who is the daughter of Gluck and not of Simpless.

Klotz: That's right. That's right. She writes.

H.M.Jr: And she's the wife of the Editor of Fortune.

Klotz: She wrote (not understood) - very amusing.

H.M.Jr: Well, are you people coming tonight?

Gaston: At seven fifteen.

H.M.Jr: That is Gaston, Lockhead, White, and Davenport, at seven fifteen, on the Fortune article.

Gaston: I have a letter to you from Ed Flynn, as Commissioner General of the New York World's Fair, and he tells you that after the first of the year they are going to begin to broadcast over the radio, a series of eleven themes, and one of them is "Finance and Credit."

H.M.Jr: Schemes?

Gaston: Themes. One is "Finance and Credit," and they want you to speak thirty minutes on Government activities on Finance and Credit, and they will write the speech.

H.M.Jr: Did you tell them what I charge for thirty minutes?

Gaston: No, but I might quote a figure on what you charge for delivering somebody else's script.

H.M.Jr: You tell the Attorney General

Gaston: The Commissioner General.

H.M.Jr: that I thank him - no.

Gaston: Not even on your own script?

H.M.Jr: No, I don't have to go up there. I promised the Press Club next time I spoke I would speak to them.

Gaston: This is a radio broadcast which I assume will be broadcast from Washington.

H.M.Jr: No.

Gaston: No - suits me.

In connection with savings bonds, here is a report that Jim Bryan handed me to hand to you, which he proposed - the material he proposes to use in a new booklet.

H.M.Jr: All right. Going strong, huh?

Gaston: The only other thing I have is this question of the document that the President might use in regard to

H.M.Jr: I wouldn't give it to him before Monday.

Gaston: And shall we get together and discuss it today?

H.M.Jr: Will you call the meeting?

Gaston: I will.

H.M.Jr: Is this note too confidential for me to read to this meeting?

Gaston: I don't think so.

H.M.Jr: This is from Mr. Gaston to me. This is triple confidential:

"Sandy Kline tells me they had a big day with Dan Roper at his press conference. He gave out three good stories:

1. Steel price concessions.
2. Re record balloon expansion by the Bureau of Standards.
3. Fish can climb the Bonneville Dam.

"The fish story stood up, but (A) the Bureau of Standards denied the balloon record; (B) Commerce Press Relations asked that the stories read, 'Steel price stabilization,' not 'concessions.'"

I read this to a friend of mine last night, who was at the house, and he said he had been at the Bonneville Dam, and said that the fish did not climb it; he said the only fish that could go up is an eel.

I'm going to give this to the President. I think it's marvelous.

(Several talking at same time.)

Bell: We have only spent six million dollars for the fish ladder.

Gaston: My private reports are that the fish can climb.

H.M.Jr: He said he was there and he said they can't.

Gibbons: Where is that?

Gaston: Bonneville. Roper's press conference.

H.M.Jr: Got any other good stuff, Herbert?

Gaston: Nothing more.

H.M.Jr: Send me more stuff like that; it's good for my liver.

(To Mr. Oliphant) Yes sir?

Oliphant: That is that thing for your file. Attached copy.

H.M.Jr: Thank you. Is that all.

Oliphant: (Nods "Yes.")

McReynolds: This is all right.

H.M.Jr: What does it do?

McReynolds: Well, the only thing it does that you can't do now is, it makes it possible for the Departments to get - specifically the Securities-Exchange to get returns for use in hearings before their Commission. Now they are limited to hearings on prosecutions and things of that sort. It won't change the procedure at all with respect to the method of getting them. They still go through - every one of those requests goes over my desk.

H.M.Jr: Now we are going to have a big staff at ten o'clock. The principal thing of this is a goodbye meeting for Miss

Klotz: O'Reilly.

H.M.Jr: O'Reilly. This is her last.

Oliphant: Is this her last?

McReynolds: This is the last.

Bell: Tomorrow's her last day.

Klotz: I hate to see her go.

(Telephone rings.)

H.M.Jr: I'll find out, Dan, when we expect

(Answers telephone) Hello. Hello. Yes,
Good morning.....

October 28, 1938.
9:58 a.m.

Operator: Go ahead.

WMJr: Hello.

George Harrison: Hello, Henry?

WMJr: Yes.

G: Good morning. This is George Harrison.

WMJr: Good morning to you.

G: About the man we were talking about, making the shift to Harris..

WMJr: Yes.

H: Is it agreeable to you to have us go ahead with that?

WMJr: Give me until tonight, will you?

H: Yes.

WMJr: And - I've just - I talked to him once, but I didn't have the final thing, see?

G: With Harriss.

WMJr: Yes - I'll do it some time today.

H: Yes. I talked to him and it's agreeable with him and I have a man who is just top notch.

WMJr: Yes. Well, give me until tonight, and I - it's my fault, but I've been a little rushed.

G: I see.

WMJr: But I'll -

H: But it's all right, except that you said something about November 1, and I didn't want to - I think it's better to wait until November 15, anyway.

WMJr: Yes.

H: Because if you'll let me, I want to put him on some work here that he'll have to be doing for you.

- 2 -

HMJr: I see.
H: For a couple of weeks.
HMJr: All right.
H: First rate.
HMJr: Thank you.

October 28, 1938.
11:02 a.m.

WMJr: Hello.

Operator: Dr. Burgess.

WMJr: Thank you.

O: Go ahead.

WMJr: Hello.

Randolph
Burgess: Oh, hello, Henry.

WMJr: How are you?

B: Fine.

WMJr: You're calling me I believe.

B: Yes, that's right. In the first place I'll be with you on November 10.

WMJr: Good.

B: Second, I've got to make a speech on Tuesday night Henry, before this foreign trade council.

WMJr: Yes.

B: I'm preceding Secretary Hull.

WMJr: Good.

B: And I've been working very carefully to try to produce something that might be constructive and helpful, and I would be very appreciative if you'd have a minute to look it over.

WMJr: Gosh!

B: That's pretty hard to do I know.

WMJr: Huh.

B: Where are you going to be over the week-end.

WMJr: Here. In Washington.

B: If I - well, may I mail it to your house?

WMJr: Yes.

- 2 -

B: And if you don't get time, why that's all right.
HMMjr: Well, I'll get time.
B: Just a minute.
HMMjr: I'll get time to do it.
B: Well, I hate - hate to bother you with it.
HMMjr: Better put a special delivery, air mail.
B: All right. All right.
HMMjr: 2211 - 30th.
B: 2211 - 30th Street.
HMMjr: Yes.
B: Yes. O. K. Well, I'll do that.
HMMjr: Sure.
B: And I want to do a job on this.
HMMjr: Right.
B: Jar these fellows loose a little bit from their typical trade attitude, you know.
HMMjr: Well, I'll - I'll find time to do it, I'll be delighted to.
B: Well that's very nice, Henry. I'm much obliged to you.
HMMjr: O.K.
B: And I'll be seeing you on the 10th, if not before.
HMMjr: Fine. Thanks.
B: Goodbye.

Yunnanfu, Yunnan,

28th October, 1938.

The Honorable

Secretary Henry Morgenthau, Jr.,

Department of Treasury,

Washington, D.C.

Dear Mr. Secretary,

I enclose reports typed from notes I received from Dr. Buck from Chungking last night.

Respectfully,

Enid Saunders

Enid Saunders
Secretary to Dr. Buck

I N D E X

	<u>Page</u>
Peace Talks	1
Interview with Dr. H. H. Kung	3

October 25th, 1938

To Secretary Morgenthau

From J. Lossing Buck

PEACE TALKS

To continue the war, or to talk peace with Japan, is now being discussed by the Kuomintang party leaders, under the leadership of Wang Ching-wei. One of the questions at issue is to have the Generalissimo resign, and Wang Ching-wei assume leadership to talk peace.

A minority of the public is also talking about the desirability of peace. The most prevalent feeling is that resistance should continue, and that it is an unfavorable time to talk peace.

The sudden fall of Canton has upset public confidence, especially since everyone was confident the Cantonese would offer stiff resistance.

P. W. Taou, head of the Foreign Trade Commission, who has just arrived by car from Hong Kong, remarked in regard to these peace talks: "We have no other alternative than to talk peace, since the foreign powers will not help us."

Mr. Li of the Foreign Trade Commission remarked: "We may see a big change in the situation."

T. S. Miao of the Foreign Trade Commission states: "I know the new situation has had a tremendously upsetting influence on our Commission. We cannot do anything now. We can buy and buy until our stomachs are full, but what good will that do us?"

The realization has come that the remaining part of China is practically cut off from the rest of the world, and that the amount of goods which can be exported or imported is only a "drop in the bucket".

October 26th, 1938

To Secretary Morgenthau

From J. Lossing Buck

INTERVIEW WITH DR. H. H. KING

The information collected yesterday relative to peace talks made it advisable to check the information with Dr. Kung. He states:

"Peace talks are always in the air: when the situation is unfavorable to the Japanese their terms are more liberal; when favorable, the terms more harsh. Likewise China, when terms are liberal, feels the internal and international situation is favorable, and therefore is unwilling to consider even more liberal terms. Thus it has been up and down.

"Two weeks ago the Generalissimo wired the suggestion that China's foreign policy and the question of peace should be discussed by the civil organs here in Chungking. The fall of Canton and Hankow has speeded these discussions."

It is quite evident that there may be some radical change in foreign policy, because the Powers have not come to China's assistance. The Chinese now feel there is no hope of adequate foreign assistance, and for this reason they feel they must reconsider their whole policy. Dr. Kung states there is no way of predicting how great a change may develop.

CONFERENCE DIVISION

03V1303A

DEC 1 1998

TREASURY DEPARTMENT
Office of the Director
Internal Security - Civilian Division

RE TAX-EXEMPT FEATURE ON LOCAL
HOUSING AUTHORITY BONDS

October 28, 1938.
11:00 a.m.

Present: Mr. Nathan Straus
Mr. Taylor
Mr. Bell
Mr. Hanes
Mr. Oliphant

H.M.Jr: We've got everybody here who can say "No."

Straus: I'm glad of that.

H.M.Jr: I'm perfectly frank; we're going to do my home work
as we go along. I mean I haven't been prepared. So
if you'll say - you'll get at least a sympathetic

Straus: Well, it's mighty nice of you to give me a chance to
tell the story.

Now look, I jotted down some notes here in an effort
to make the story short, so that I wouldn't take up
too much of your time. And what I want to endeavor
to do is to show you the steps which I went over in
my mind, and have you tell me at what stage I went
wrong.

The law, you gentlemen all know, provided that 90
percent, or up to 90 percent, of the cost of these
projects could be advanced by the United States
Housing Authority, and only up to 90 percent; so
that the other 10 percent had to be raised locally.
Now, the "raise locally" worked out in practice that
you'd have to have the local housing authority sell
their own bonds. In the debates

Bell: Did you have any approval of that 10 percent in any
way?

Straus: No, no.

Now, in the debates on the floor of the House, which
we had checked up, the statement was repeatedly made
by implication that all of these bonds of the local
housing authorities weren't really of any value at
all. You probably recall those debates, in which they
said, well, the Government was paying for these pro-
jects twice, once by making a loan and all over again

-2-

by paying annually the amount of the interest and amortization of the loan. In fact, one of the statements was: "The Government would lose on the 90 percent it buys and the authority won't be able to place the other 10 percent."

Now, when I got the job I visualized my task in respect to the financing aspects as being, first of all, to help the local authorities to sell their 10 percent, because we couldn't get started unless we could do that; and then I sort of dreamed of the possibility of promoting the sale of the larger amount of those bonds than 10 percent by the local authorities, thought perhaps we'd get to 20 percent or 30 percent of local authority bonds.

Now, at that time - and I'd like to get the whole story on the record - at that time there was an enormous seething excitement about this whole thing. My friend Mayor LaGuardia, in fact, came out in the public press and said that it was perfect nonsense to attempt to place the 10 percent of the bonds as I was doing, and he asked that the City of New York be given a first mortgage for its 10 percent of the bonds, the presumption being that the United States Government would take a secondary position for its 90 percent. And of course I refused to do that.

I think the Secretary may have known of that at the time. I don't recall if I troubled him.

H.M.Jr: Yes, I remember that.

Straus: Of course, it seemed to me perfectly absurd. Now we did fight it out, and I am able to say to you today that there isn't a single project held up anywhere in the United States by reason of the inability of the local authority to place these 10 percent of the bonds, without any mortgage, the only security being the project itself and of course the annual payments that are pledged in the Act.

Now I wanted to go, I want to repeat, much farther than that. I wanted to place more of those bonds privately. Of course, I've been in contact with bankers by reason of placing - helping to place the 10 percent; I wanted to prove, first of all, that

-3-

local authority bonds were a good sound investment. Then I wanted - two - to relieve the Treasury, as it seemed to me, of financing projects with a 60-year life; that is, selling something which has a 60-year period of amortization; because I assumed you wouldn't sell bonds for that long a life and you'd have to keep on refinancing.

And then the third thing that I wanted to achieve was - I believed it sound and I still think this is sound - to attempt to channel private funds into worthwhile public enterprise. I thought by this means that you might draw private business into participating with the Government in rehousing the lowest income groups, and that that would be a distinct advantage to the Government and to the whole - oh, what shall I call it - economic picture.

Now, some of this was brought out last year at the hearings on the amendment to the bill, when we got the additional 300 million dollars. And in those debates in the Committee there was a good deal of discussion on tax-exemption as it affected these bonds of the local authorities, and there was even some discussion of whether that tax exemption should or should not be withdrawn. And as the debates of that Committee will show you, it was the consensus of opinion that the tax-exemption accorded local housing authority bonds should be taken up as part or parcel of the whole question of tax-exemption of municipal securities, and not as one particular part of the problem, and that as long as all municipals were exempt there wasn't any reason that these shouldn't be exempt. There was considerable debate on that, the record will show you.

Now I'm coming very near the end of my story. The one embarrassment that I've got in this whole thing, and I'd like you to get my position, is that I don't believe that if all of you gentlemen said to me together, and the Secretary said to me, "Look here, Straus, it isn't a good idea to sell more than 10 - to allow the locality to sell more than 10 percent of the bonds locally" - I don't honestly believe there is anything I could do in the law or in fact to stop it. Hundreds of bankers all over the country know that I've been

-4-

trying to promote this sale and know that the local authorities have been trying to do it. It was written in the Act. And I sort of half thought that I was going to get a lot of admiration for making these bonds, which were supposed to be worthless by their enemies and not to be of too much value by their friends, something which the bankers now are really fighting to get.

Now let me point out four statements, in closing, which I wrote out here.

First of all, these are not Federal securities. They are nothing in which the Federal Government has anything except a most indirect interest. There is no question of Federal financing involved, except so far as the plan will relieve the Treasury of large borrowings.

Second, the method of financing by sale of these bonds to private investors by the local authority, instead of to the United States Housing Authority, is specifically authorized by the statute. It reads on page 8: "Payments under annual contribution contracts shall be pledged as security for any loans obtained by a public housing agency to assist the development of the housing project to which the annual contributions relate." That's the end of the quote.

And finally, that I could not, I don't believe, under the existing statute, stop this method of financing of the 10 percent being extended to cover a larger percentage, even if I wanted to. But do I want to attempt - do you want me to attempt to block a plan to provide all of the financing for public housing by the sale of securities of local authorities to private investors instead of calling on the Treasury to finance public housing? I can tell you that I'm going back to Congress to ask for another 800 million dollars. I said that to the President the other day. That means that a year from now you're going to have outstanding - I don't know, a billion and a quarter, a billion and a half, if I get the authorization, I assume, of these housing loans. Those bonds will run up to 60-year maturity.

I don't know, gentlemen, but it seems to me that

-5-

we're doing something that should involve praise and admiration and congratulation if we can relieve the Treasury of that entire burden and get the local housing authorities to obtain their funds directly by sale of their own securities.

That's all, Mr. Secretary.

H.M.Jr: Well, I'd like to ask one question. First, I don't understand the statement when you say that you can't stop the local authorities from going ahead and selling the 90 percent locally. I don't understand that. How do you mean you can't stop that?

Straus: What I mean is, I don't see exactly what I would say if a local housing authority chairman came to see me and said, "Look, I can sell 20 percent of the amount of this loan at an interest rate of 2.8, and the USHA are going to charge 3 percent. Are you going to say I mayn't do it?" I don't think there's anything in the statute - I'm not a lawyer, but I'm pretty sure of that.

H.M.Jr: You mean you can't stop it.

Straus: I don't think there's anything in the statute to enable me to stop it. (Secretary leaves room)

Bell: Isn't there a provision in your Act that the subsidy payments shall be charged first with the interest and amortization on the Government loan?

Straus: Not as I understand it. In fact, I'm almost sure I'm right. The Government subsidy is pledged first to repayment of interest on the Government loan.

Bell: That's right.

Straus: Then as - we usually use - I'm pretty sure I'm right on this - secondly for interest on the local loan. Third, for amortization of the Government loan; and fourth, for amortization of the non-Government loan. I'm sure that's right.

Bell: So it wouldn't make any difference whether you took 90 percent or 10 percent, the Government would first get its interest; then, above that, it's on the local one; then amortization of the Government one.

-6-

Taylor: If it were done a hundred percent locally, why, then the Government's charge would automatically disappear, wouldn't it?

Bell: That's right.

Hanes: Does the Government guarantee on these bonds up to 90 percent, as I understand?

Straus: No, sir, the only provision is that the annual payments, the annual subsidy, grant, whatever you call them, pledged in the Act, shall be applied first towards interest on the Government loan. That's right, isn't it? He (Bell) knows more about it than I do. That's correct, isn't it?

Bell: I think that's right. But Mr. Hanes' question went to the amount of bonds you could buy. Take a million dollar project, Johnny. Mr. Straus can buy up to 90 percent of the bonds issued for the - bonds issued for that project; 90 percent of the cost, which would be \$900,000 for that project. And the 10 percent must be raised locally.

Hanes: Yes.

Bell: Now, the question he raises is, why can't the local people raise 70 percent of the money and we only put up 30 instead of 90?

Hanes: Or 100 percent.

Bell: Or 100 percent, as the case might. And if he has to buy 90 or anything less, then he's got to raise the money some way. He either gets it from the Treasury by selling his securities to the Treasury or he sells guaranteed Government obligations in the market.

Taylor: To the full amount. In other words, the piece of paper that he would sell under the - up to the 90 percent end of it, would be a fully guaranteed obligation.

Bell: Yes, both principal and interest.

Hanes: That's what I was getting at.

-7-

Bell: And behind the guaranty would be the subsidy payments, in a sense. So he's right when he says there isn't anything behind these securities except the Government subsidy, because they're not going to produce revenue - even maintain the properties in many cases, I assume.

Straus: In some cases I would say that was true, in other cases it was not.

Bell: Got a few cases

Straus: I wouldn't say in a generalization it was true. Selling these bonds is the Government guaranty of the annual contribution, as we call it, a contribution to keep down rents; but, as Mr. Bell not improperly calls it, a contribution to pay the interest. Is that right?

Bell: I look upon it from the Treasury standpoint as nothing more than a fund to pay interest and sinking fund charges on these bonds.

Straus: I don't think that's incorrect financially. From a housing standpoint, that isn't sound housing. But it is sound financing.

Taylor: That's the way it works out.

Straus: You know, gentlemen, nothing has puzzled me more than the fact that this has run into some kind of an obstacle. That's the reason I asked for this thing. I think some of our people talked to you about it.

Bell: Yes.

Straus: I said to the Secretary, "I want to have a chance to meet the people over there and have them set me right if I'm wrong." But if it isn't a good thing to be able to induce local housing authorities to raise their funds privately and take billions out of the Treasury borrowing up to a 60-year period, well, then I feel sort of hopelessly baffled and confused on this thing.

(H.M.Jr returns)

H.M.Jr: Now, what I'm getting at - if you're correct and you cannot say to housing authorities, "You can or cannot sell as many of these bonds as you want to," aren't you really wasting everybody's time?

-8-

- Straus: I'm very glad you asked that question. May I just say one thing on that, because I knew the question would be asked why I came in here, and I'll tell you, Mr. Secretary. I came in here solely because I didn't think it was right to do - to assist in something that means as large financing as this without informing you of the fact. And you'll see that my original letter is drafted in just that tone, that I believe I should inform you - I believe that the sale of these bonds ought to be, if they're sold in a large block, integrated with your own financing program to a certain extent; and that as large a thing as this - I want to report to you on it and report to Mr. Bell.
- Bell: Certainly when they sell these securities, Mr. Secretary, we should know about it, so it would not in any way conflict with your program.
- H.M.Jr: But let's just get our legal authority. What legal authority - if you don't mind my
- Straus: Yes, fine.
- H.M.Jr: How has - what power has the Treasury got on the 90 percent?
- Oliphant: You mean to prevent
- H.M.Jr: Prevent them being sold - full tax-exempt feature. I mean have we any authority to say he can or cannot sell the 90 percent with the full tax-exempt feature? I mean that's all I'm interested in.
- Oliphant: As I see it now, I don't see that he has.
- H.M.Jr: What? You don't think that we have. You mean that if - let's say the President, wishing to carry out his policy on tax-exempts, should write a letter to the head of the United States Housing and say, "I don't want any of the 90 percent"
- Oliphant: Just refuse to go into this project on that ground.
- H.M.Jr: I mean suppose he writes such a letter.
- Oliphant: Just refuse to go into it.

-9-

- H.M.Jr: The President says, "This is contrary to my policy on tax-exempts. I don't want any sold."
- Ball: The only control Mr. Straus has over it - he just refuses to sign the contract with the local people. He has that control over it.
- H.M.Jr: Sure.
- Taylor: Haven't you in your Act a general power of approval or disapproval of any financial plan which is submitted to you?
- Straus: I don't think, sir - and again I'm not a lawyer - I don't think that we have. I think that all that we have approval of is that we shall achieve the purposes of the Act in location and construction, and so forth. I don't believe there is anything in that that - on which it would not be rather arbitrary for me to take a stand that these local housing authorities could not sell their bonds where they can sell them most advantageously.
- I say to you, Mr. Secretary, on your discussion with the President, whether it fits in with it - that I said to the President the other day - outlined this plan to him, and of course, he didn't get it in detail but he indicated at least that, so far as the general subject of exemption of municipals was concerned, he didn't believe that this type of bond should be discriminated against in any way.
- H.M.Jr: Well, I'd like him to say that in writing. I mean I'm not doubting - it's too important. I mean, you see - I mean, if you don't mind - I mean, it's very nice, the way you say "the local people," but if the local people can sell these bonds for one-half a percent less, or whatever it is, because they're fully tax-exempt, it simply means that we're giving them that additional bonus over and above everything we're doing; we've got to go to another group of taxpayers and get that half a percent out of somebody else, in order to help them build these houses. Now it's just a question whether the President wants to do it. Of course, they can sell them cheaper, but another group of taxpayers have to fork up the additional money which these people are exempt from. And that's the story why they can sell them cheaper.

-10-

Now, does the President, on top of everything that we're doing in order to make it possible to build these houses at five and six dollars a room - does he want to give them an additional bonus of this tax-exempt feature on the full hundred percent of the securities? Now, if he wants to do it after the letter he wrote to Congress, I'll go along cheerfully, because I want to see just as many low-priced low rental houses built as is possible to build, and I won't take second place to anybody. But on the other hand, as fiscal officer of this country, I don't want to fly in the face of the President of the United States.

Now, it's just a question, does he want to give an additional bonus - what is it, a half of one percent? What would it be? What do they sell locally - 15-20 year bonds?

Straus: Bonds so far negotiated for have been in small lots at three and three-quarters percent.

H.W.Jr: But how long do they run?

Straus: They're getting priority now over the Treasury, running 15 years. The present ones are running 15 years. Our plan is to sell 60-years if this thing goes through on a nation-wide basis.

H.W.Jr: Well, whatever it is, depending on the length of the bond, it's just that additional bonus through a tax-exempt feature. Now, if he wants to create 800 million dollars worth of additional totally tax exempt bonds, why - and says that that isn't contrary to his policy, I'll sign it. Isn't that what it boils down to, Herman?

Glissant: (Nods yes)

H.W.Jr: I mean I want to see just as many low rental houses built

Sell: You'd like to see as much private capital go into it, too,

H.W.Jr: And I want to see just as much private capital - it's private capital anyway, whether we go to them or you go

-11-

to them. We go to the investor; it isn't ...

The whole thing - does this letter which the President wrote - have you seen the letter he wrote on tax-exempts?

Straus: No. My whole knowledge of the President's - let me be very careful - was in a conversation of not over ten minutes on the subject recently.

H.M.Jr: Well, if you'd get it, - I'd like to send Mr. Straus a copy, which gives you the President's position on it, position on tax-exempts. Is that on the question of Federal, or does it include the local too?

Oliphant: All.

H.M.Jr: All. And what I'll do is this - I mean this is very important. Based on what you think, we'll write the President a letter and say that you have to raise approximately 800 million dollars under the present authority; that you believe that you can sell these locally; and then we'll fix up a - that if a 15-year bond is sold to a local - if totally tax-exempt, it will be sold at such and such a premium; and that if the Government sold it and it were subject to surtaxes, we'd have to put such and such a premium on the year - we'll use the same yearage.

Straus: Surely.

H.M.Jr: Now, does the President think that he wants to give that additional bonus on the interest rate to assist you in your program? And then he can answer it "Yes" or "No."

Straus: Well, would it be all right to suggest that some statement be made in a letter that this is something done by the municipalities and specifically authorized under the Act?

H.M.Jr: You can see the letter before it goes.

Straus: May I read one thing into this record?

H.M.Jr: You can see the letter before it goes, to satisfy yourself as to what's in the letter.

-12-

Straus:

Can't ask more than that. I want to emphasize one thing very clearly for all of you gentlemen, that my only desire here is to do what's best not only for the housing program, but obviously for the whole Government financing. If the program is sound and meets with the approval of the Administration, I know we'll be able to get more money, and if it isn't sound we oughtn't to get any money. But it just seemed to me, and I do want to get that in the record, that with the impending particularly general need for additional financing, if by this method we could relieve the Treasury of a billion or a billion and a half of bonds that are going to run up to 60 years, it would be doing something worthwhile.

Now may I read four lines into this thing, and then I've finished my story. This is on page 4, Section 5 - I'm quoting now: "Obligations, including interest thereon, issued by public housing agencies in connection with low-rent housing or slum clearance projects, and the income derived by such agencies from such projects, shall be exempt from all taxation now or hereafter imposed by the United States."

H.M.Jr:

Well, just before - Dan, do you want to add anything to what I've said?

Bell:

No, I don't think so. I think this, that if it hadn't been for the letter that the President sent to Congress - this wouldn't have been approved, because I don't think you (H.M.Jr) have authority to approve it, but certainly the Treasury would offer no objection to it. Personally I would like to see it done, if it were not for this question of taxation.

It seems also a very important question in my mind that's been worrying me some - we would carry these guaranteed obligations on the public debt statement as a guaranteed obligation and a contingent liability. To my mind they are a straight public debt obligation. I don't think there's anything behind them except the Government credit, and they're a straight public debt obligation. It's worried me: as to carrying them just as a contingent liability. I'd rather see this done, from that standpoint.

Straus:

Yes, financially.

-13-

Bell: Clear out the picture.

H.M.Jr: Well, I mean - but you'll help prepare this letter so I can give it to the President Monday and I'll try to get an answer for Straus Monday.

Bell: All right.

H.M.Jr: See? What? I mean if between the four of you - if you could prepare the letter for me so I'd have it Monday morning.

John?

Hanes: I haven't anything to add, Mr. Secretary.

H.M.Jr: What?

Hanes: I haven't anything to add.

H.M.Jr: Do you have any feeling one way or the other?

Hanes: No. I was just getting familiar with it. First time I've heard it. I was just asking in your absence whether this resolves itself into a simple guaranty, the same question Danny brought up. And I feel a good bit the way Dan does, that if it weren't for that letter it would be far better, from our standpoint - it would be better to handle it with the localities.

H.M.Jr: Talking for myself, if the decision rested with me, I'd tell Straus, "Sell every dollar you can locally," because if we can get this settled we can settle Lambert also.

Taylor: Exactly the same principle.

H.M.Jr: If it was left to me, I'd say, ...

Straus: ..., "God bless you..."

H.M.Jr: "... sell every dollar you can locally, and we'll give you a laurel wreath - laurel or ivy."

Hanes: If it didn't fly right in the face of that other proposition.

-14-

H.M.Jr: No, I'd say, "Swell," I mean. And I think we can fix up a letter so I can have it at one o'clock, if the President should invite me for lunch on Monday. And I'll show it to him and get - I'll get Straus a "yes" or "No" - see?

Wayne?

Taylor: Only one point involved, and that's the one you've mentioned.

H.M.Jr: And that is?

Taylor: Whether you want to extend the tax-exempt - amount of tax-exempt obligations outstanding.

Oliphant: (Nods nothing)

H.M.Jr: What?

Oliphant: Nothing to add.

H.M.Jr: Who will carry the ball on this to get the letter ready?

Bell: I should think Mr. Oliphant ought to write the letter.

Oliphant: I'll write it if you want me to.

H.M.Jr: Show it to these gentlemen, show it to whoever Mr. Straus wants to see it. And I think we better attach a copy to the President's own memorandum. And simply say that there are 800 million dollars worth of these and that Mr. Straus has in mind to ask for another 800 million, see? And then I'd let Archie or Harris give you a 15-year totally tax-exempt and the 15-year Government bond, and the difference.

Oliphant: Why doesn't Danny draft it - the fiscal thing.

Bell: Foley's been following it pretty closely, and he knows the law.

Oliphant: Well, I can, all right; just as you like. We'll do it.

Taylor: Might add this.

H.M.Jr: Please.

-15-

- Taylor: That I think that chances are there will be a continuing better market, an increasingly better market, for the type of obligation that Nathan Straus is talking about than there might be for this rather peculiar fully-guaranteed one, but particularly, of course, the reason being this tax-exempt feature.
- H.M.Jr: Well, also, I'd like to - when his law comes up for revision or for this additional authority, I'd like to have read into it the same thing we have in Commodity Credit: that the Secretary of the Treasury has the right to approve or disapprove the financing - raising of money of any agency, just the way we have in Commodity Credit. I mean I should have it and want that authority, so there's no question - just the way the new one was written for Commodity Credit. I mean they can't sell anything there without the approval of the Secretary of the Treasury. Isn't that right on the Commodity Credit?
- Taylor: Well, Commodity Credit - that's only when they go to the public, when they sell obligations. The Secretary of the Treasury doesn't have to approve the day-to-day transactions.
- H.M.Jr: No, no, but when they go to the public.
- Taylor: Well, they sell it with our guaranty. That's our - the reason for it.
- H.M.Jr: Well, whatever we have in Commodity Credit - I'd like to have no more, but as much.
- Bell: Well, you have to approve the obligations issued under this Act by Mr. Straus when they're guaranteed.
- H.M.Jr: Well, is that the same thing?
- Taylor: Same thing.
- H.M.Jr: That's all I want.
- Taylor: But if they don't use the Treasury guaranty and have us sell the obligation for them, why, that's up to Mr. Straus.
- Bell: I don't think you want that. That's a local

-16-

H.M.Jr: No, I don't want it. No, just if he You say I have that now.

Bell: Yes, that's in there.

Straus: If that's

H.M.Jr: If the President has me for lunch Monday - if these gentlemen can get this letter ready and you see it, I'll give it to him Monday at one o'clock and I'll have a "Yes" or "No" for you Monday afternoon. And if you ask me, see,

Straus: Yes.

H.M.Jr: If you ask - if he asks me, I'll tell him, following this policy - I'd like to see them bought locally.

Straus: I understand you perfectly, and thanks ever so much, Mr. Secretary.

**FEDERAL RESERVE BANK
OF NEW YORK**

October 28, 1938.

Dear Mr. Secretary:

Events this week, and the current outlook in the new security market, mainly reemphasize points which are already familiar. The market eagerly received two large investment issues. The \$55,000,000 Wisconsin Electric Power Company first mortgage 3 1/2s of 1968, rated Aa and priced to yield about 3.31 per cent, and the \$50,000,000 Firestone Tire and Rubber Company debenture 3 1/2s of 1948, rated A by Moody's, priced to yield about 3.55 per cent, were both oversubscribed and bid up to premiums over the offering prices. Six large issues were all well received during October, making the total of corporate financing \$275,000,000 - the highest since June 1937, of which the amount for refunding - \$306,000,000 - was the highest since December 1936. Now, however, there are no large corporate issues for public offering in registration. One or two large corporate issues may be registered in time for marketing during November, but the only issue definitely scheduled is the \$25,000,000 bonds of the Argentine Government, expected next Thursday.

Reports from the convention of Investment Bankers now in session at White Sulphur Springs, nevertheless, are generally optimistic concerning issues for new capital, particularly by small companies, during the coming year. One small offering this past week has been taken as a hopeful sign. The Carrier Corporation, one of the leading companies in the air-conditioning industry, but which has not had a very impressive earnings record, sold a \$2,500,000 issue of convertible debenture 4 1/2s of 1948 at par, and it was promptly quoted at a 6 to 7 point premium. This company obtained working capital several years ago through the industrial loaning facilities of this bank, and \$1,500,000 of the proceeds of this issue is to repay bank loans. The conversion feature was made attractive, the debentures being convertible for several years into common stock at a price slightly above the current market, and at higher prices thereafter. The reception of this issue, despite its being rated only B, has suggested that similar issues may be readily salable, if potential borrowers feel that they can profitably use more funds.

Municipal bond awards this week amounted to about \$22,300,000. During the month they came to about \$80,000,000.

Yours faithfully,


Alan Sproul,
First Vice President.

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

October 29, 1938.

Dear Mr. Spraul:

On behalf of the Secretary I am acknowledging your letter of October 28th, giving a report on the new security market during the past week.

As you know, Mr. Mergenthau appreciates your weekly letter, and has asked me to thank you for this detailed survey.

Sincerely yours,

H. S. Klotz,
Private Secretary.

Mr. Allan Spraul,
First Vice President,
Federal Reserve Bank of New York,
New York, New York.

RECEIVED

NOV 3 1938

RECEIVED IN THE SECRETARY'S
OFFICE OF THE GOVERNMENT
TREASURY DEPARTMENT

GKT/abc

U. S. S. CANOPUS Oct. 28, 1938.

SPACENT

WASHN DC

To Nicholson from T. V. Soong for presentation to Secretary QUOTE
As conflicting rumors are abroad thought my personal observation
may be of interest to you. Despite defeatist agitation peace
impossible because any terms Japan may offer bound to prove un-
acceptable and would immediately provoke civil war STOP China could
continue launch organized resistance in southwestern provinces
and intensify guerilla campaign thruout occupied territory making
Jap pursuit for final victory a will o'wisp chase UNQUOTE

CAMPBELL

TREASURY DEPARTMENT

Washington

FOR IMMEDIATE RELEASE,
Friday, October 28, 1938.

Press Service
No. 15-13

Secretary of the Treasury Morgenthau today announced the final subscription and allotment figures with respect to the current offering of 7/8 percent notes of Series P of the Reconstruction Finance Corporation.

All subscriptions were allotted in full. They were divided among the several Federal Reserve districts and the Treasury as follows:

<u>Federal Reserve District</u>	<u>Total Subscriptions Received and Allotted</u>
Boston	\$ 1,000,000
New York	183,359,000
Philadelphia	300,000
Cleveland	720,000
Richmond	3,100,000
Atlanta	100,000
Chicago	96,621,000
St. Louis	6,750,000
Minneapolis	775,000
Kansas City	1,697,000
Dallas	720,000
San Francisco	1,720,000
Treasury	300,000
TOTAL	\$ 297,162,000

--000--

October 28, 1938

My dear Miss O'Reilly:

Now that you are leaving the Treasury I want to express something more than that I am sorry to see you go. That is very true and it is a feeling that is shared, I know, literally by all who have been associated with you here.

But beyond that I want to testify to my admiration for the beautiful qualities of character that have shone through your thirty-three years of service and have made you both as a human being and as a servant of the public a person whom it was a joy to have as a fellow worker. We have known your innate integrity, your dignity, your kindness and your quiet and superb efficiency and on behalf of all in the Treasury I thank you for what they have meant to us.

We shall hope to see you often as friends and may God go with you.

Sincerely,

Secretary of the Treasury

Miss Mary M. O'Reilly,
Assistant Director of the Mint,
Treasury Department.

October 28, 1938

To: The Secretary
From: Miss Lonigan

Attached are two charts with tables

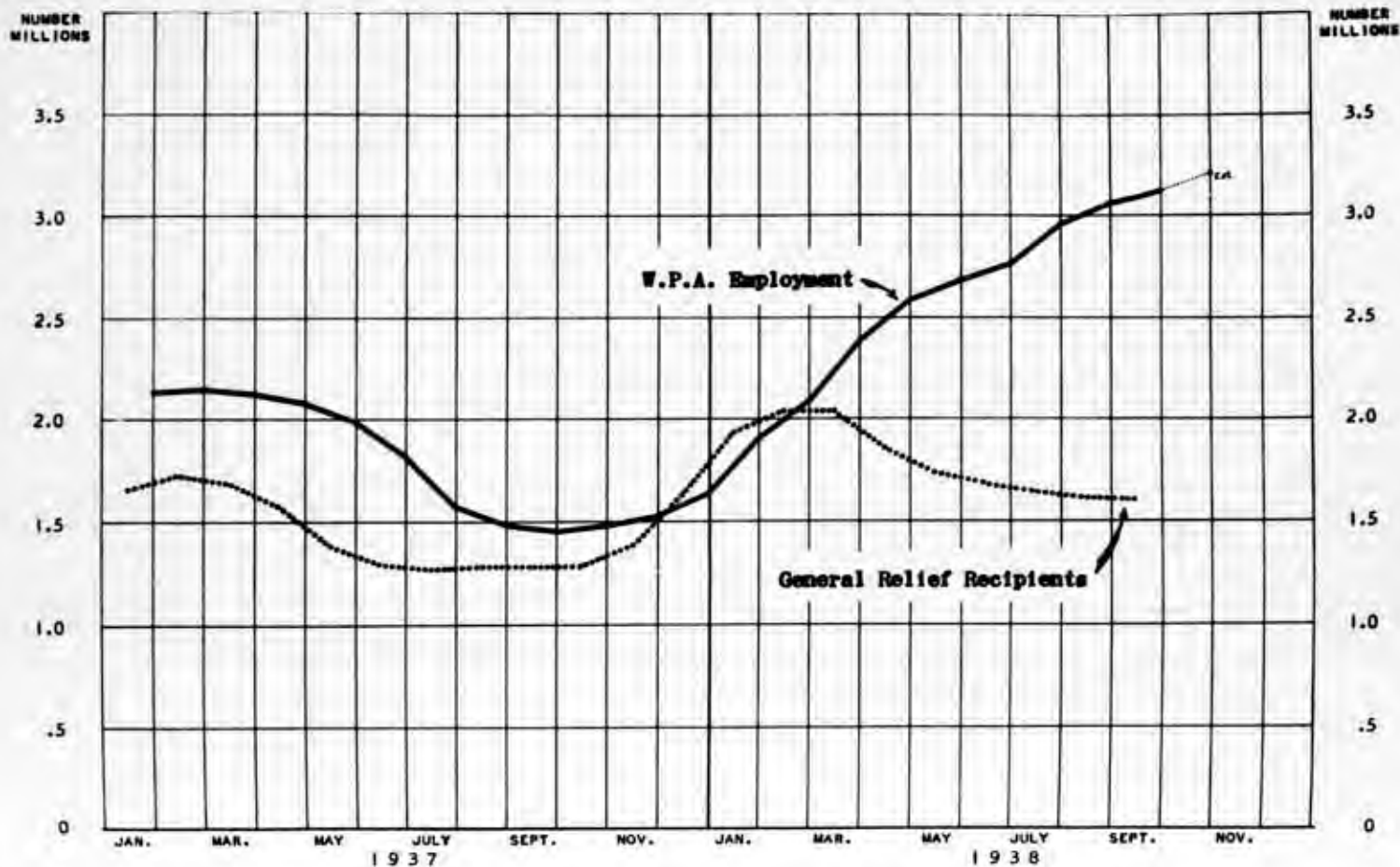
Private Employment and WPA Rolls

General Relief and WPA Employment

I think these may give you the information
you wish.

GENERAL RELIEF AND W.P.A. EMPLOYMENT United States

147



SOURCE: GENERAL RELIEF RECIPIENTS - SOCIAL SECURITY BOARD
W.P.A. EMPLOYMENT - WORKS PROGRESS ADMINISTRATION

Office of the Secretary of the Treasury
Division of Research and Statistics

Z - 236

GENERAL RELIEF AND WPA EMPLOYMENT

United States

	Number of Families Receiving General Relief (In thousands)	Number of WPA Workers (In thousands)
1937		
January	1,659	2,138
February	1,723	2,146
March	1,681	2,115
April	1,563	2,070
May	1,393	1,999
June	1,288	1,821
July	1,267	1,569
August	1,280	1,480
September	1,277	1,451
October	1,280	1,476
November	1,378	1,520
December	1,639	1,629
1938		
January	1,924	1,901
February	2,028	2,076
March	2,029	2,395
April	1,850	2,583
May	1,728	2,680
June	1,683	2,767
July	1,644	2,967
August	1,608	3,067
September	1,600 <u>a/</u>	3,120
October		3,201 <u>a/</u>

Source: General Relief Recipients - Social
Security Board

WPA Employment - WPA

a/ Confidential estimate

PRIVATE EMPLOYMENT AND WPA ROLLS

United States

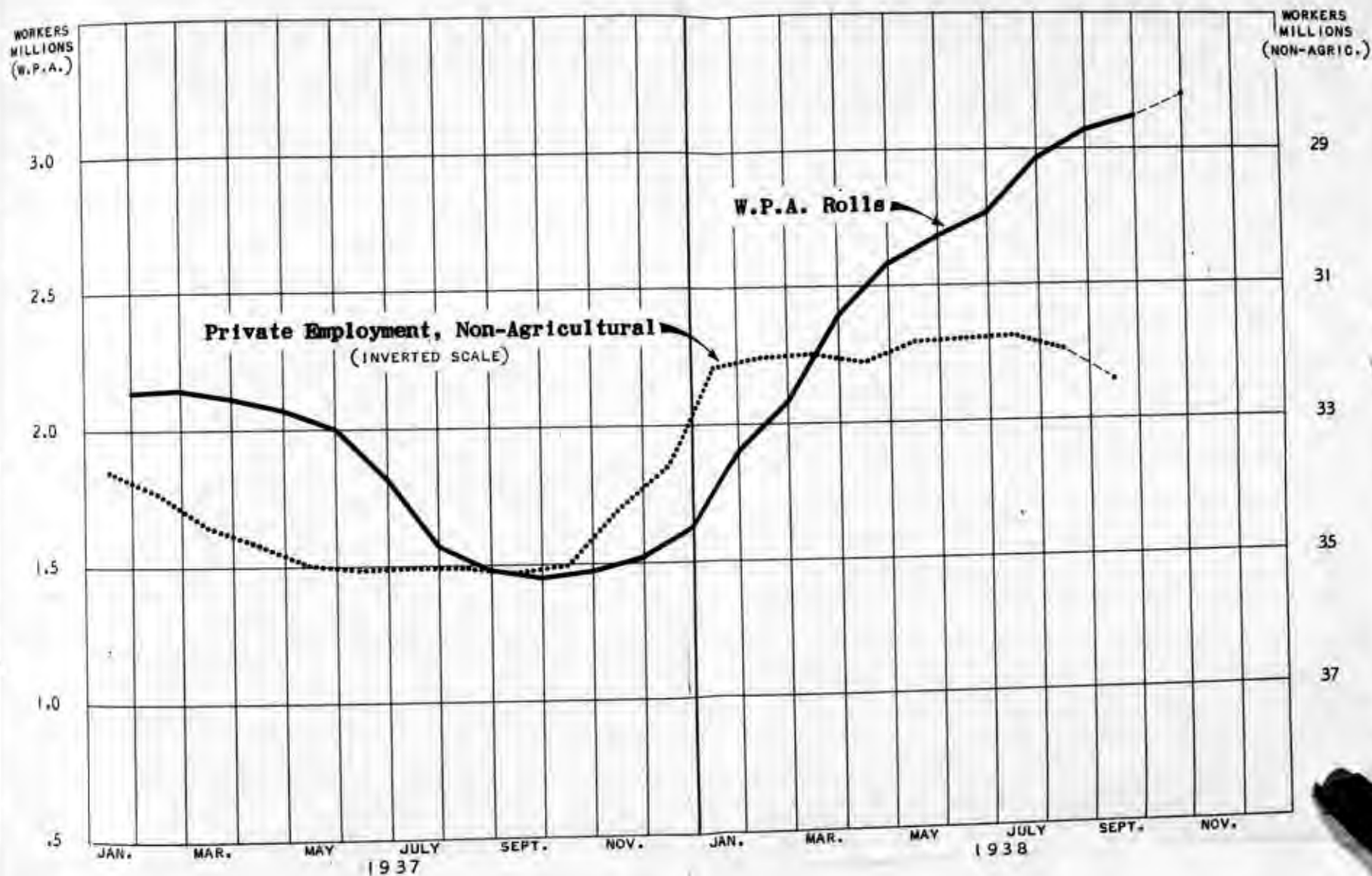
	Non-Agricultural Employment (In thousands)	WPA Rolls (In thousands)
1937		
January	33,596	2,138
February	33,923	2,146
March	34,411	2,115
April	34,683	2,070
May	34,993	1,999
June	35,062	1,821
July	35,034	1,569
August	35,039	1,480
September	35,106	1,451
October	35,020	1,476
November	34,233	1,520
December	33,589	1,629
1938		
January	32,177	1,901
February	32,017	2,076
March	31,976	2,395
April	32,106	2,583
May	31,834	2,680
June	31,781	2,767
July	31,756	2,967
August	31,972	3,067
September	32,422 ^{a/}	3,120
October		3,201 ^{a/}

Source: Total Non-Agricultural Employment - U. S.
Bureau of Labor Statistics.

WPA Rolls - WPA

^{a/} Confidential estimate

PRIVATE EMPLOYMENT AND W.P.A. ROLLS United States



SOURCE: TOTAL NON-AGRICULTURAL EMPLOYMENT - U.S. BUREAU OF LABOR STATISTICS
W.P.A. ROLLS - W.P.A.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

en 151
DATE October 31, 1938.

TO Secretary Morgenthau

FROM Mr. Haas *HA*

[Signature]

Attached are two charts with tables, prepared by
Miss Lonigan.

Treasury Department
Division of Monetary Research

Date.....10/29.....1938

To: Miss Chauncey

Suppose you want this for the
Secretary, or your files.

The letter to the Secretary of
Navy went out this morning by special
messenger.

L. Shanahan

MR. WHITE

Branch 2058 - Room 200

TREASURY DEPARTMENT

153

INTER OFFICE COMMUNICATION

DATE October 28, 1938

TO Secretary Morgenthau

FROM Mr. White *W*

Subject: Recent changes in Japan's foreign exchange resources

1. Available evidence indicates that Japan's drain of foreign exchange assets has been sharply cut.

- a. In August and September, Japan sold \$14 million of gold, and reduced her deposits in this country by \$3 million. (Japan exported \$59 million of gold to the United States in August and September, but \$44 million of this gold remains on earmark.) In contrast, during the first seven months of 1938 Japan sold in this country \$84 million of gold and reduced her deposits by \$35 million, a loss of foreign exchange assets of \$17 million per month.

According to best evidence available the Japanese Empire produces about \$5 million of gold per month. Therefore, her net losses of foreign exchange assets probably averaged about \$12 million per month for the first seven months and \$3½ million per month during August and September. These figures do not include changes in sterling or other non-dollar foreign assets, but we have no information indicating that any substantial change in those categories have taken place.

- b. The indicated decrease in the drain of foreign exchange assets is due chiefly to a sharp reduction in her unfavorable balance of trade.

Both Japan's exports and imports have declined but her imports have dropped much more than her exports. Exports during the first eight months of 1938 declined 20 percent (as compared with the first eight months of 1937) while imports declined 36 percent.

First eight months of
1937 1938
(Millions of yen)

Exports	2,060	1,653
Imports	2,808	1,797

Secretary Morgenthau - 2

The unfavorable balance of trade dropped from 748 million yen to 144 million yen.

These figures, however, exaggerate the extent of improvement in her exchange position. Japanese trade figures include her trade with Manchuria and occupied areas of China, yet Japanese trade with these areas does not substantially add to Japan's foreign exchange. Japan can and probably does obtain some foreign exchange from the trade of occupied areas with third countries. But at present this source yields little if any net surplus to Japan. If adjustment were made for this factor the improvement in her unfavorable balance reflected in Japan's trade figures would be much diminished. In contrast with the total unfavorable balance of only 144 million yen, Japan had an unfavorable balance of trade with areas yielding foreign exchange of 469 million yen, or about \$18 million per month (during the first eight months of 1938).

Though the average unfavorable trade balance with the foreign exchange areas for the first eight months was \$18 million per month, the August figure was only \$6 million. However, this reduction in import excess does not necessarily presage a more favorable trend; it is the usual thing for her unfavorable balance to decrease during the second half of the year.

2. Japan still has foreign exchange resources adequate for a prolonged continuation of the present conflict.

According to our estimates, Japan still has between \$280 - \$300 million of gold and foreign exchange assets, exclusive of foreign securities --- which she may liquidate probably with realizable value of about \$100 million --- and exclusive of the silver holdings of the general public. These last are estimated at \$50 million. The Japanese Government will be able - if necessary - to obtain a substantial portion of that silver for export.

LONDON, October 28, 1938.

My dear Mr. Secretary:

I think I should write to explain the reason why I have not had a talk with Sir Frederick Phillips since the Czech-German crisis was resolved. I have studiously avoided seeing him because it would be impossible for us to talk and not touch upon the exchange situation. I felt that in view of the meetings which you were holding in Washington and the state of the Anglo-American trade agreement negotiations it was desirable to take every precaution not to add any complicating factor: almost anything I said to Phillips, whether in the form of a question or not, might be interpreted, in the given circumstances, as indicative of our attitude - about which, incidentally, I am not altogether sure. Needless to say any advice you may wish to have sent me would be most welcome.

As

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

-2-

As reported in yesterday's telegram R. S. Hawkey now plans to sail on the Washington, November 4. I think I mentioned to you in Antibes that I have been in touch with him from time to time and with the officers of the American banks under whom he has worked. They have all given quite good reports on him emphasizing particularly his interest in and aptitude for foreign exchange. He strikes me as a very nice lad who would thrive and improve with hard work.

Please be good enough to remember me to Mrs. Morgenthau and to your own "McCabes".

With kindest regards,

Sincerely yours,

Lauren B. Stein

REB

PLAIN

London

Dated October 28, 1938

Rec'd 3:45 p. m.

Secretary of State,
Washington.

1261, October 28, 6 p. m.

FOR TREASURY FROM BUTTERWORTH.

1. The Bank of England return for Wednesday and today's Treasury bill rate reflect easier conditions in the money market this week as compared with the situation outlined in No. 1231 of October 21, 6 p.m. A further £3.9 million of notes have returned from circulation and a shift from public to bankers deposits reduced the former by £8.7 million to £25 million and increased the latter by £9.5 million to £100.4 million indicating the release of funds immobilized by operations in support of sterling. The abundance of money brought the clearing banks more heavily into the bill market for both December and January maturities while bill rates dropped and even outside loan money against bonds came down to as low as 1/2 percent as compared with levels from 5/8 to 3/4 percent last week. The average rate for Treasury bills today was about 10S.7 1/2D as compared with 13S. 9D last week.

2. The dollar was rather erratic today opening at
4.76

REB

2-#1261, From London, Oct. 28, 6p.m.

4.76 1/2 bid and going quickly to 3/8. The British authorities then offered dollars at 1/2 and the rate went to 3/4 before fixing. Later the rate moved to 5/8 and then 7/8 but since the New York market opened the rate has remained around 4.76 5/8. The turnover was comparatively small. 254 bars were sold at the fixing at 145S 10 1/2D giving a 1/2D premium at 4.76 5/8. Some of the gold was supplied by the British fund.

The franc has remained around 178.82 with the Bank of France selling sterling but the market was restricted owing to the French holiday commencing tomorrow and lasting until Wednesday. The city considers that Daladier's speech though politically good reveals great financial weakness but awaits the results of the Marseilles party conference.

KENNEDY

CSB

PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Paris, France

DATE: October 28, 1938, 5 p.m.

NO.: 1834

FROM COCHRAN.

At noon today I had a talk with Rueff at the Finance Ministry. The Minister of Finance, Marchandeau, he said would speak at the Marseille Convention sometime during the day. The French financial situation would be analyzed by the Minister, but the Government's specific plans would not be made known. Rueff told me he does not expect the government to take any action over this weekend or before next week's Cabinet meeting. The Marseille Convention will be held through Sunday. Tonight the Paris Bourse and banks will close, and will not open again until Wednesday morning.

Most of the day exchange trading has been inactive in Paris. Operators have been squaring up before the long holiday, and awaiting the outcome of the Marseille convention and some revelation of the plans of the Government. There was disappointment on the market that the speech which Daladier made was not more constructively specific. It was unpleasant news to hear that a budget deficit of 36,000,000,000 francs is anticipated for 1939. To this should be added about 16,000,000,000 for the railways, and so on, which would make a total of at least 52,000,000,000 francs. It is the belief of some of my

- 2 -

financial friends that the Government will go a long way toward making peace with the Germans and the Italians with the view possibly of avoiding some of the anticipated armament expenditures rather than assume the huge task of trying to finance a large armament program of their own.

SECTIONS ONE AND TWO.

BULLITT.

EA:LWW

PARAPHRASE, SECTION THREE, TELEGRAM NO. 1834
of October 28, 1938, from Paris

At 5 p.m. I had a talk with the Bank of France; my friend said that yesterday was a bad day for him. It was rather quiet today until this afternoon. He now figures that he lost around 500,000 pounds for the day.

During banking hours the text of Marchandean's speech was not known; part of the speech has just appeared in the evening papers. Rueff's prediction that it would reveal no plans is confirmed therein. The financial situation during the time Daladier was Premier was reviewed by the Minister. The Minister condemned speculation, hoarding and export of capital. He plead for patience and energy toward progressively improving the finances and currency of France, for which program years will be required.

END MESSAGE.

WILSON.

EA:LWW

PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Rio de Janeiro, Brazil

DATE: October 29, 1938, noon

NO.: 250

Reference is made to telegram of October 23, 1 p.m.
from the Embassy, No. 249.

I am informed by the Exchange Director that during the
week of October 31 the Bank of Brazil will close exchange
for maturities and daily quotas for the whole period
September 16-21,

Inform Commerce.

CAFFERY.

EA:LWW

Paraphrase of telegram received from the Embassy at Rio de Janeiro, dated October 29, 1938.

Secretary of State,
Washington.

250, October 29, noon.

My 249, October 22, 1 p.m.

I have been informed by the Director of Exchange of the Bank of Brazil that during the week of October 31, exchange will close for daily quotas and maturities from September 16, to September 21, inclusive.

Notify Commerce.

CAFFERY.

The National City Bank *of New York*

ESTABLISHED 1819

New York October 29, 1938.

CABLE ADDRESS: CITIBANK

IN REPLYING PLEASE QUOTE INITIALS

Dear Henry:

As to the new issue market, it has been going very well. As you know from other figures the total amount of financing for October has been the largest for a long time, and according to our figures totals \$392,000,000 including both corporate and municipal offerings. The bulk of the offerings has been made up of utility financing, largely for refunding purposes. These have all gone very well and are quoted at premiums.

The principal industrial issue was \$50,000,000 of Firestone Tire & Rubber 3 1/2 per cent debentures offered at 99 1/2 to yield 3.56 per cent. This issue was in tremendous demand and is now quoted at over two points premium over the issue price.

Next week appears likely to be rather quiet. The only sizeable issue is \$25,000,000 Argentine Republic ten year 4 1/2s which you will remember was postponed last summer because of a misunderstanding with the Argentine Government. It looks as though this might come out on about the same basis as was discussed last summer, and that it would go pretty well, though, of course, any foreign financing is still pretty chancey.

I am delighted about the utility building program. If it carries through properly it ought to do a good deal to keep the lift on this business cycle after the heaviest government spending passes next spring. My guess is that the success of this program depends on the ability of the utilities to finance themselves with equity and junior money. They cannot do much of

- 2 -

this to-day, but if the stock and bond markets continue to improve, and if government policy toward the utilities is clarified so that buyers of securities become convinced that the utilities will have a chance to earn a decent profit, there is a good chance that the market will open up for this sort of financing within relatively few months.

Sincerely yours,

W. Randolph Burgess

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

WRB:H

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 to 7/6/38	7/7/38 to 7/13/38	7/14/38 to 7/20/38	7/21/38 to 7/27/38	7/28/38 to 8/3/38	8/4/38 to 8/10/38	8/11/38 to 8/17/38	8/18/38 to 8/24/38	8/25/38 to 8/31/38	9/1/38 to 9/7/38	9/8/38 to 9/14/38	9/15/38 to 9/21/38	9/22/38 to 9/29/38	9/30/38 to 10/6/38	10/7/38 to 10/13/38	10/14/38 to 10/20/38	10/21/38 to 10/27/38	Total fiscal year 1939 to date	
(1) Apples (Dried)	Pounds	14,557	-	-	-	-	-	-	-	-	-	-	-	-	-	3	110	198	166	477 (1)	
(2) Apples (Fresh)	Bushels	5,625	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	477 (2)	
(3) Apricots (Dried)	Pounds	2,990	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	3 (3)	
(4) Beans (Dried)	Pounds	56,800	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	3 (4)	
(5) Beans (Snap)	Bushels	32	5	4	8	9	3	4	1	1	1	-	-	1	1	-	-	-	-	38 (5)	
(6) Beans (Fresh)	Bushels	11	6	7	18	13	9	5	6	5	5	2	2	2	39	65	11	46	67	308 (6)	
(7) Blackberries (Canned)	Cases	-	-	-	-	-	-	-	-	-	-	-	80	80	-	-	-	-	-	80 (7)	
(8) Butcher	Pounds	15,035	-	-	-	-	-	-	-	-	-	130	338	2,143	3,377	5,109	3,783	3,804	1,719	20,603 (8)	
(9) Cabbage	Bushels	590	26	40	31	45	62	36	30	66	81	56	134	163	357	370	234	216	194	2,141 (9)	
(10) Cassia syrup	Gallons	237	107	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	107 (10)	
(11) Carrots	Bushels	-	1	2	11	7	7	6	7	10	12	8	15	8	7	6	1	16	17	141 (11)	
(12) Cauliflower	Dresses	-	-	-	-	-	-	-	-	-	-	-	12	2	-	-	-	-	-	21 (12)	
(13) Celery	Bunches	1,174	-	-	-	-	17	65	39	15	13	4	8	8	9	5	-	-	-	183 (13)	
(14) Cereal (Whole wheat)	Banks	408	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	14 (14)	
(15) Cheese	Pounds	3,446	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	- (15)	
(16) Corn	Bucks	-	-	-	-	-	-	1	4	3	-	-	-	-	-	-	-	-	-	8 (16)	
(17) Cotton	Bales	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	10 (17)	
(18) Cotton fabric	Yards	1,173	-	-	-	-	-	-	10	49	1	29	44	14	5	3	22	1	-	173 (18)	
(19) Cottonseed oil	Pounds	9,780	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	- (19)	
(20) Eggs (Shell)	Cases	270	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	- (20)	
(21) Fish	Pounds	3,677	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	- (21)	
(22) Flour	Barrels	2,699	-	-	-	-	-	279	-	-	-	-	-	-	-	-	-	-	-	279 (22)	
(23) Grapefruit	Bunches	401	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	- (23)	
(24) Grapefruit juice	Cases	552	-	-	-	-	-	-	-	-	-	464	-	-	-	-	-	-	-	464 (24)	
(25) Grapes	Tons	8	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	8 (25)	
(26) Labels	Labels	-	-	-	-	-	-	-	-	-	-	-	15,560	-	-	-	-	-	-	15,560 (26)	
(27) Mattress ticking	Yards	-	-	-	-	-	-	-	-	-	-	-	-	-	2,592	-	-	-	-	2,592 (27)	
(28) Milk (Dry skim)	Pounds	21,580	-	-	-	-	-	-	-	2,661	5,960	-	-	380	-	-	-	-	-	8,641 (28)	
(29) Milk (Fluid)	Quarts	12,497	497	515	583	588	925	536	530	511	522	509	515	524	415	544	551	580	631	8,968 (29)	
(30) Olives	Pounds	3,000	-	-	300	25	8	11	22	16	12	7	39	53	181	74	153	74	-	979 (30)	
(31) Oranges	Bunches	1,932	2	48	59	57	36	46	49	55	50	66	55	64	54	47	44	35	-	819 (31)	
(32) Paper bags	Bags	21,826	-	-	-	-	-	-	-	-	9,075	-	-	-	-	-	-	-	-	9,075 (32)	
(33) Peaches (Dried)	Pounds	8,534	-	-	-	-	-	-	-	-	-	-	1,223	-	2,300	-	-	-	-	3,523 (33)	
(34) Peaches (Fresh)	Bushels	8	2	4	-	-	-	-	-	-	-	31	96	73	17	12	-	-	-	229 (34)	
(35) Peas (Fresh)	Bunches	316	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	- (35)	
(36) Peas (Canned)	Cases	842	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	842 (36)	
(37) Peas (Dried)	Pounds	6,000	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	6,000 (37)	
(38) Peas (Fresh)	Bushels	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	- (38)	
(39) Potatoes (Sweet)	Bushels	440	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	440 (39)	
(40) Potatoes (White)	Bushels	4,315	-	466	183	120	44	167	266	142	219	108	12	-	42	232	45	19	-	2,307 (40)	
(41) Potatoes (White)	Bushels	4,315	-	466	183	120	44	167	266	142	219	108	12	-	42	232	45	19	-	2,307 (41)	
(42) Potatoes (White)	Bushels	4,315	-	466	183	120	44	167	266	142	219	108	12	-	42	232	45	19	-	2,307 (42)	
(43) Potatoes (White)	Bushels	4,315	-	466	183	120	44	167	266	142	219	108	12	-	42	232	45	19	-	2,307 (43)	
(44) Potatoes (White)	Bushels	4,315	-	466	183	120	44	167	266	142	219	108	12	-	42	232	45	19	-	2,307 (44)	
(45) Potatoes (White)	Bushels	4,315	-	466	183	120	44	167	266	142	219	108	12	-	42	232	45	19	-	2,307 (45)	
(46) Potatoes (White)	Bushels	4,315	-	466	183	120	44	167	266	142	219	108	12	-	42	232	45	19	-	2,307 (46)	
(47) Potatoes (White)	Bushels	4,315	-	466	183	120	44	167	266	142	219	108	12	-	42	232	45	19	-	2,307 (47)	
(48) Potatoes (White)	Bushels	4,315	-	466	183	120	44	167	266	142	219	108	12	-	42	232	45	19	-	2,307 (48)	
(49) Potatoes (White)	Bushels	4,315	-	466	183	120	44	167	266	142	219	108	12	-	42	232	45	19	-	2,307 (49)	
(50) Potatoes (White)	Bushels	4,315	-	466	183	120	44	167	266	142	219	108	12	-	42	232	45	19	-	2,307 (50)	
(51) Potatoes (White)	Bushels	4,315	-	466	183	120	44	167	266	142	219	108	12	-	42	232	45	19	-	2,307 (51)	
(52) Potatoes (White)	Bushels	4,315	-	466	183	120	44	167	266	142	219	108	12	-	42	232	45	19	-	2,307 (52)	
(53) Potatoes (White)	Bushels	4,315	-	466	183	120	44	167	266	142	219	108	12	-	42	232	45	19	-	2,307 (53)	
(54) Potatoes (White)	Bushels	4,315	-	466	183	120	44	167	266	142	219	108	12	-	42	232	45	19	-	2,307 (54)	
(55) Potatoes (White)	Bushels	4,315	-	466	183	120	44	167	266	142	219	108	12	-	42	232	45	19	-	2,307 (55)	
(56) Potatoes (White)	Bushels	4,315	-	466	183	120	44	167	266	142	219	108	12	-	42	232	45	19	-	2,307 (56)	
(57) Potatoes (White)	Bushels	4,315	-	466	183	120	44	167	266	142	219	108	12	-	42	232	45	19	-	2,307 (57)	
(58) Potatoes (White)	Bushels	4,315	-	466	183	120	44	167	266	142	219	108	12	-	42	232	45	19	-	2,307 (58)	
(59) Potatoes (White)	Bushels	4,315	-	466	183	120	44	167	266	142	219	108	12	-	42	232	45	19	-	2,307 (59)	
(60) Potatoes (White)	Bushels	4,315	-	466	183	120	44	167	266	142	219	108	12	-	42	232	45	19	-	2,307 (60)	
(61) Potatoes (White)	Bushels	4,315	-	466	183	120	44	167	266	142	219	108	12	-	42	232	45	19	-	2,307 (61)	
(62) Potatoes (White)	Bushels	4,315	-	466	183	120	44	167	266	142	219	108	12	-	42	232	45	19	-	2,307 (62)	
(63) Potatoes (White)	Bushels	4,315	-	466	183	120	44	167	266	142	219	108	12	-	42	232	45	19	-	2,307 (63)	
(64) Potatoes (White)	Bushels	4,315	-	466	183	120	44	167	266	142	219	108	12	-	42	232	45	19	-	2,307 (64)	
(65) Potatoes (White)	Bushels	4,315	-	466	183	120	44	167	266	142	219	108	12	-	42	232	45	19	-	2,307 (65)	
(66) Potatoes (White)	Bushels	4,315	-	466	183	120	44	167	266	142	219	108	12	-	42	232	45	19	-	2,307 (66)	
(67) Potatoes (White)	Bushels	4,315	-	466	183	120	44	167	266	142	219	108	12	-	42	232	45	19	-	2,307 (67)	
(68) Potatoes (White)	Bushels	4,315	-	466	183	120	44	167	266	142	219	108	12	-	42	232	45	19	-	2,307 (68)	
(69) Potatoes (White)	Bushels	4,315	-	466	183	120	44	167	266	142	219	108	12	-	42	232	45	19	-	2,307 (69)	
(70) Potatoes (White)	Bushels	4,315	-	466	183	120	44	167	266	142	219	108	12	-	42	232	45	19	-	2,307 (70)	
(71) Potatoes (White)	Bushels	4,315	-	466	183	120	44	167	266	142	219	108	12	-	42	232	45	19	-	2,307 (71)	
(72) Potatoes (White)	Bushels	4,315	-	466	183	120	44	167	266	142	219	108	12	-	42	232	45	19	-	2,307 (72)	
(73) Potatoes (White)	Bushels	4,315	-	466	183	120	44	167	266	142	219	108	12	-	42	232	45	19	-	2,307 (73)	
(74) Potatoes (White)	Bushels	4,315	-	466	183	120	44	167	266	142	219	108	12	-	42	232	45	19	-	2,307 (74)	
(75) Potatoes (White)	Bushels	4,315	-	466	183	120	44	167	266	142	219	108	12	-	42	232	45	19	-	2,307 (75)	
(76) Potatoes (White)	Bushels	4,315	-	466	183	120	44	167	266	142	219	108	12	-	42	232	45	19	-	2,307 (76)	
(77) Potatoes (White)	Bushels	4,315	-	466	183	120	44	167	266	142	219	108	12	-	42	232	45	19	-	2,307 (77)	
(7																					

The National City Bank
of New York
ESTABLISHED 1812

New York October 29, 1938.

CARD BUSINESS CITIBANK

IN REPLYING PLEASE QUOTE INITIALS

Dear Henry:

Here is the speech which I am to deliver at the National Foreign Trade Council next Tuesday night. It will be a large audience, and I am preceding Secretary Hull.

The people are groups interested in foreign trade. What I want to get them to do is think in larger terms than their competitive advantage in export and import business.

It seems to me it might be very useful to send out a little trial balloon on the question of an early stabilization, and as you will see, I am doing this in a tentative sort of way.

As I have been talking with people who come in from different parts of the country, Texas, Minneapolis, the Mid-west, California, etc., it seems to me that a gradual change is taking place in people's thinking about these subjects, and for that reason I think it might be useful to see what, if any, reaction comes from some of the queries I am throwing out.

I want this paper to be constructive and helpful, and shall be most appreciative for any comments and suggestions you care to make.

You will see, I think, that in preparing this speech I have had in the back of my mind our discussions about extension of credit in South America. Any program of financing there clearly needs to be accompanied by conscious provision for taking more imports from South America, so that they can service any credits extended as well as making provision for servicing

- 2 -

their old debts. We have been working on this whole question, and will have some ideas about it.

Sincerely yours,

W. Randolph Breyer

Honorable Henry Morgenthau, Jr.,
2211 - 30th Street,
Washington, D. C.

WRB.H
encl.

TRADE CHANGES AND MONETARY POLICY

On this twenty-fifth anniversary of the National Foreign Trade Council it seems appropriate to look back briefly over the record of the past twenty-five years. The broad trends of world trade are difficult to disentangle from the masses of statistics, particularly since the reports are mostly in dollars, pounds sterling, francs and other currencies greatly affected by the extraordinary price movements of the period and by devaluations of the currencies themselves.

Fortunately, however, a number of competent students have undertaken to digest this mass of figures and by various sorts of beneficent legerdemain produce figures not in currency values but for the total volume of world trade, as it would be if measured in bushels or pounds. These estimates show results quite different from the commonly reported figures. While the findings by different students differ somewhat, the general picture shows that with the outbreak of the world war in 1914 the volume of goods moving between countries fell off rapidly despite war activities. After the war and depression of 1921, there was a vigorous recovery, especially as different countries of the world returned to monetary stability, so that by 1929 trade had risen to a volume between 20 and 30 per cent higher than in 1913. But then the depression of the early '30s checked the rise and carried the volume slightly below 1913. Recovery began in 1933 and has brought world trade back to a level still 3 or 4 per cent under the 1929 figures.

Thus the net result of the past quarter century is a trade increase of between 20 and 25 per cent, far less than the increase in the previous quarter century, and far less than the increase in world production.

How has the United States fared in this period? The essential facts are that in 1913 our trade was about 10 per cent of the world total, during

- 2 -

the war we lost less than other countries, and in the 20's made a larger gain, so that by 1929 our proportion of world trade had risen to about 14 per cent. The succeeding depression has been more severe in this country than elsewhere, and has lasted longer, so that our proportion of trade has shrunk again to a little under 12 per cent. Thus during the whole period from 1913 the net result is that our trade has increased a little more than for the world as a whole. The countries which have lost most relatively are the five countries most intimately involved in the world war, England, France, Germany, Italy, and Russia.

The first conclusion which these figures suggest is clearly, "don't have wars." From whatever point of view one studies this period of history it fairly screams that lesson. So far, unhappily, we have not been able to do much about it. A second lesson from the period will perhaps be more obvious from data for prices at which trade has been carried on. This has, of course, been a period of extraordinary price disturbances. In the war and post-war boom, commodity prices in this country and England rose to figures more than twice as high as in 1913. In France, Italy, and a number of other countries the price rise was far greater, and currencies were devalued. More recently, there have been violent price disturbances, and the currencies of many countries have been depreciated, some for the first, some for the second or third times. Now, the striking fact which the data show is that in spite of all these disturbances, and in spite of the presumed inflationary affects of depreciation of currencies, prices in dollars or pounds of the principal commodities moving in world trade show as many decreases as increases from twenty-five years ago. For example, wheat sold for 86 cents in 1913, and 68 cents to-day, cotton was 14 cents, and now is 8 3/4 cents, wool was 23 1/2 cents, and now is 26 1/2 cents, copper was 17 cents, and now is 11 1/4 cents, petroleum was \$2.50, and now is \$1.04,

- 3 -

rubber was 73 cents, and now is 17 cents, sugar was 3 1/2 cents, and now is 3 cents, coffee was 10 3/4 cents, and now is 5 3/4 cents.

If one computes a price average for those commodities which dominate world trade, the index figure for 1938 is at about the same level as in 1913, measured either in dollars or in pounds sterling.

To guard against possible misunderstandings let me emphasize that these figures represent not the general price level, but the prices of principal commodities moving in export and import trade. The general wholesale price index of the United States Department of Labor is some 15 per cent higher than it was in 1913, but this broad index, which now includes over 800 articles, has a considerable weight of finished goods which reflect changes in wage rates, whereas the bulk of import and export commodities are raw or semi-finished materials. Wage rates in the United States are now more than double the 1913 average, and the real wage, after making allowance for changes in the cost of living is 50 per cent higher. But, as stated before, prices of commodities moving in foreign trade are in general at about the level of 1913.

With this amplification of the trade figures surely some conclusions are warranted as to the monetary policies of the period through which we have been passing, for in this period the principal countries of the world have devalued their currencies by an average of 40 to 50 per cent. The world's gold reserves have been enormously increased in currency value, not only because of the change in the measure of value, but also because of greatly stimulated gold production. World monetary gold reserves have been nearly quadrupled since 1913, and those of the United States have been increased over six times. Our proportion of the world's monetary gold has been increased from about 23 per cent to about 54 per cent, and yet prices of commodities in trade are at the 1913 level, and only slightly above the level of 1931 before Germany and England went off gold.

- 4 -

Clearly, currency depreciation has not yet resulted in the increases in prices which its advocates prophesied. Since the doctrine of price inflation through currency depreciation was so ardently taught and widely accepted, it is worth pausing a moment to examine the mechanism. It was supposed to operate in two ways. First, through the relationships between the devaluing country and other countries. When a currency depreciates the exporters of goods from that country receive a larger number of units of their own currency for what they sell abroad, and so prices of exports go up. Correspondingly, those who wish to buy goods abroad must pay a larger number of units of their own currency, and import prices are therefore higher. Since export and import commodities are a large factor in the life of most countries this is a considerable influence on the price level. But here is the rub - that more than one country can play at this game, and may indeed be forced to play by circumstances, and if several countries have all devalued by an equivalent amount, these influences on rising prices cancel or more than cancel each other. This is exactly what has happened in recent years, and in addition the whole procedure has produced an atmosphere of uncertainty and fear in which only the minimum essentials of trade could be conducted. In this atmosphere the loose funds of the world have flowed from market to market like a loose cannon on the deck of a boat. Only the speculator benefits. The sorts of trade competition so created, plus the erratic movements of capital, have been a principal cause of the erection of trade barriers, or barter arrangements, of quotas, prohibitive tariffs and exchange controls.

When theorists discuss proposals for flexible currencies as mechanisms for international adjustments, I think of Gelett Burgess's little verse which accompanied his delightful perspective drawing of a cart with elliptical wheels.

- 5 -

"Remarkable truly is art!
See - elliptical wheels on a cart!
It looks very fair
In the picture up there,
But imagine the ride when you start!

We have all been taken on just such a ride.

Aside from the relationships between countries, the other way in which a currency depreciation might be expected to raise prices is through an increase in the money value of gold reserves which may be effective on the economy through easy money and credit expansion. The depreciations of recent years have certainly succeeded, as has already been pointed out, in increasing gold reserves and in some measure credit expansion has been built on these gold reserves. But clearly something has been lacking. The credit has not been put to active use. Prices have not increased proportionately and the increase in volume of production and trade has been disappointing.

Here then is the picture of the quarter century, a war shocked period, a disappointing growth in trade, currency depreciations apparently acting as depressant not as stimulant when viewed from a world point of view. What's to be done about it?

Clearly the broad answer is that a revival of enterprise is necessary and the time is ripe for such a revival. If we may rely upon past experience the huge gold reserves of this and other countries are a vast reservoir of unused power. Our huge bank deposits which the millions of depositors prefer to leave relatively idle, represent potential expansion of business and prices. In the power of this money a giant lies asleep. He can only be aroused and put to work by human enterprise, by the willingness of millions of bank depositors to use their deposits to build buildings, to manufacture goods, to take risks, and by the willingness of enterprisers to borrow additional funds for such purposes. When this reservoir of power is put to work we shall have real recovery, both in this country and abroad. When that time comes the power is so vast that it

- 6 -

may be hard to hold in check. We shall indeed have a problem of making sure that these vast funds are used in wholesome ways and do not again create the sorts of excesses to which the depth of this depression may be partly ascribed. But in the meantime our problem here and everywhere is to put money to work.

This is not the time to discuss at length the many barriers which to-day stand in the way of enterprise and are holding back the use of money. But in the specific field we are discussing, that is, foreign trade, there are at least two obvious handicaps to enterprise which are impressed upon anyone who has contacts in the field. One of these is the instability of currencies. Visitor after visitor comes in and asks the question, "What about the dollar, will it be devalued further?" "What about sterling and the franc?" Cables come from the Far East, from South America, from Europe, asking the same question.

In this atmosphere of uncertainty, enterprise cannot go forward freely. An exchange risk added to other risks discourages undertakings and holds back trade.

Without raising the much debated and debatable question whether a policy of devaluation by the United States was necessary, I think we all recognize that the Treasury of the United States by maintaining a fixed gold value of the dollar steadfastly for now nearly five years, has exercised a most helpful leadership toward a return to that world currency stability which is greatly to be desired. Not only so, but through the Tri-partite agreement at least some check is now being placed upon arbitrary and erratic exchange movements, and there is fuller mutual understanding.

Looking ahead it seems a reasonable deduction from the experience of the 20s and the more recent period, that a further revival of enterprise, and a further expansion of world trade, will be greatly aided when fears about the

- 7 -

future value of the dollar can be definitely set at rest, and when other major currencies can be stabilized in a suitable relation to the dollar. Stabilization in the 20s was followed by increased trade activity. The main question about that action was whether the relationship between the currencies then established was sound in view of the basic economic trends. We want to be sure this time that the principal currencies are stabilized in a relationship which may have the best possible prospect of permanence. The difficulty is that we do not know and cannot compute with any certainty what that relationship should be. We do know that the position of the United States ever since the war has been very strong; that the balance of payments has tended to be strongly in our favor. The bookkeeping measure of this position is found in the gold movement.

Discussions of this subject are greatly confused by the use of words. We use the term "favorable balance of trade," to mean an excess of exports, and historically that has some justification. But under present circumstances the most favorable development for the United States would be one in which, with an expanding total trade, our imports of foreign goods would gain relative to our exports.

That would help to solve many problems of foreign trade finance. It would place many foreign countries which owe us money in a position to service their debts. It would help to open up again the extension of credits in less fully developed countries. It would, for example, facilitate the development of trade relations with South America. It seems a bit paradoxical, but on any careful analysis it seems clear that one of the best ways to increase exports from the United States is to stimulate our imports. The farmer in particular will benefit from such a program, for larger imports at reasonable prices improve his standard of life as well as widen the market for his exports. Certainly a situation in which we continue to draw funds so heavily from all over

- 8 -

the world is not a healthy one either for us or for others. The application to monetary policy is, of course, that we should think of the problem of stabilization not as a competitive struggle with other countries for markets, but as an effort to find a position livable for all, under which total trade may be largely increased.

The next step towards this objective is far from clear and I have no formula to offer. Consideration should be given, however, to the possibility that a solution might be reached most promptly by our stabilizing definitely, as the country in the strongest position, and letting other countries adjust to us. Such an action might exert the strongest possible pressure for stabilization by others, for I suspect the peoples of many countries are getting a little fed up with rubber money. It is worth remembering that in the experience of this country rapid recovery in business followed immediately the resumption of specie payment in 1879, and the defeat at the polls of the Bryan "funny money" plan in 1896.

Besides currency instability a second major obstacle to the expansion of world trade is trade barriers. Currency devaluation is a wholesale erection of trade barriers. Import and export duties, quotas, and barter arrangements are kindred weapons of a retail sort. World trade is now divided between those countries that trade with some measure of freedom and those in which trade is in the slavery of barter. Trade cannot prosper half slave and half free. In this confusion one reasonable and persuasive voice has been heard; the voice of our Secretary of State. Patiently and persistently he has pled for a reduction of trade barriers and he has implemented his pleas with the practical mechanism of the trade agreement. That sacred fetish, the tariff, has been taken out of the realm of log rolling and the control of selfish pressure groups into a clearer atmosphere, and progress is being made

- 9 -

not in spectacular ways but following biblical injunction, "line upon line, precept upon precept, here a little and there a little."

In these two ways, in a movement toward monetary stability and in a gradual lowering of other barriers to trade, we have been making progress toward a freer world trade in which enterprise may find ways to exchange between countries a larger volume of goods for the satisfaction of the desires of the people. But the goal is not yet achieved, and the responsibility for action rests not on governments alone, for they can move only with the support of their people. At that point arises the opportunity for this and like organizations to inform the people and to press for those distant objectives which are in the public interest even though at times immediate selfish interests may suffer.

Oct 29 1938

41

INTERNATIONAL STUDENT SERVICE,

13, rue Calvin,

Geneva, Switzerland.

Information Circular,
1938-39, No. 1.

October, 1938.

RELIEF FOR AUSTRIAN REFUGEE STUDENTS.The General Situation.

One of the most baffling things about the Austrian refugee situation is the impossibility of getting precise information about it. Even if one can find one's way among the mass of legislative decrees by which the laws of the old Reich have been extended or modified to apply to Austria, one may still miss some of the most important elements in the situation, which depend on human interpretation of the laws and other imponderable factors. Nevertheless, it is becoming possible, as the result of first-hand information from visits and from innumerable letters, to give our readers some idea of the disabilities and difficulties which face large numbers of students who were studying in Austrian universities before the Anschluss.

First of all, who is allowed to continue studying? Following the practice introduced in Germany in 1933, a strict numerus clausus limits the number of Jewish students to 2% of the total number of students. The incidence of this is aggravated by the fact that many non-Jewish students are being called up for military service, with the result that the total number on which the percentage is calculated is seriously reduced. Students who have one or two Jewish grandparents were permitted to finish the summer term, and will, as far as is known, be able to continue in the coming term too; but they can no longer benefit by any scholarships or similar facilities. Moreover, in several cases which have come to our notice the permission to finish the summer term was only accorded when the term was within two weeks of its end, the students having been forbidden to set foot in the university in the intervening period.

Again, even the few Jewish and partly Jewish students who will be able to complete their studies, will have no chance of entering the professions, government service, the army, and will have little or no chance of earning a living in commerce.

The number of students who are thus deprived of the right to finish their studies is difficult to estimate accurately; but the very fact that the Austrian Universities were overweighted with Jewish students, especially in the medical and legal faculties, means that those affected amount to hundreds and even thousands. The number is swelled by those who for reasons of politics and conscience have no place under the new regime, many of them people who have been imprisoned and are released only on condition that they quit the country within a certain period.

- 2 -

Flight of the Refugee Student.

Let us next look for a moment at the position of a student who is forced to the conclusion that he must emigrate. His Austrian passport is valid only until the 31st December 1938; he may exchange it for a German one which is probably valid for one year. If he emigrates, he must sign a declaration that he will not return to Germany without the permission of the German Government. With these credentials he cannot possibly obtain a visa of the type of the United States student visa, an essential condition of which is that the owner has some country to which he can return on completing the stay abroad. He can only take out with him 10 Marks, and once he is out can only receive from home 10 Marks a month. Whereas German students wishing to emigrate could sometimes benefit by special clearing arrangements permitting them to receive larger sums abroad, (e.g. in the case of Switzerland or Italy) no such arrangements exist for the territory formerly known as Austria.

But, it may be asked, why does he need visas? Why can he not simply cross the border like any ordinary tourist? The answer is that since the Anschluss, one after another of Germany's neighbour-countries has felt bound to impose rigid restrictions on the immigration of Austrians in order to prevent themselves from being overwhelmed by the flood of immigrants, so that now there is not a single country into which the refugee can enter without a special visa; if his papers are not thus in order, he is simply turned back on the frontier. The consulates in Vienna are flooded with applicants, and it often takes days of waiting in queues before the student can even get his request for a visa attended to. In the case of the United States, so numerous have been the applicants since March that the consulate has been forced to announce that - at the most liberal estimate - anyone applying at the present time cannot expect to receive the visa for two years.

Clearly these are difficulties which can only be dealt with by governmental action, and it is at least satisfactory to note that the Intergovernmental Conference, which met at Evian in July, has set up a permanent committee in London, with an American, Mr George Rublon, as its director, and with the avowed purpose of trying to overcome some of the restrictions both at the German end and in the matter of immigration facilities. Unfortunately the committee's work - which was in any case bound to take time - has been held up unduly by the whole international crisis. Meanwhile no government wants to be the first to open the flood-gates of immigration, and the individual refugees are crushed between the upper and the nether millstone.

Czechoslovakia - a new factor.

The incorporation of the Sudeten areas of Czechoslovakia in the German Reich has brought a new element into the situation described above. It is too early yet to estimate the numbers and needs of the former Czechoslovak citizens who will be driven into exile because neither the Reich nor the new Czechoslovak government will have them, though it is already clear that such refugees will form a considerable international problem. What is certain is that many of the unfortunate students who emigrated from Austria to Czechoslovakia will now be forced to become refugees a second time (in some cases

- 3 -

actually a third time, since many of those who had to leave Austria were already refugees from Germany).

What we can do.

So much for the factual background. What can I.S.S. do to help in this heartbreaking situation? The Assembly, acting on the recommendation of the Relief Commission at Les Avants, was unanimous in deciding that there was a real need which I.S.S. alone could meet. The work of helping the most brilliant to complete their studies abroad and helping others to find re-training for more practical work will be carried out mainly by the National Committees of those countries where the problem presents itself most acutely, particularly Great Britain and the United States. How much these committees can do depends partly on the general problems referred to above, in particular, it is clear that an I.S.S. committee's action is rigidly restricted to the lines laid down by the government of its country: I.S.S. cannot initiate migration policies; it can only help to adapt individual students to the policies established by the governments. But apart from such general considerations, the amount which these committees can achieve depends on the amount of help, whether in money or in the form of free tuition, hospitality etc., which they can secure.

Retraining.

The experience of all national committees who have been doing active work for refugee students during the past four years goes to prove that very much greater emphasis must be laid on retraining than in the past, as the demand for professional people all over the world has almost dried up. At the Evian Conference, many governments expressed their willingness to take young and adaptable people who knew how to work with their hands and who were not quite destitute on their arrival in their country of refuge. I.S.S. can make it possible for at least a small proportion to learn a trade or agricultural work, provided the necessary funds can be secured.

Finance.

The following budget was adopted by the Assembly at Les Avants on the basis of the pledges made on behalf of national committees by their representatives at the conference:

<u>NEEDS:</u>	<u>Sw.Frs.</u>	<u>TO BE RAISED:</u>	<u>Sw.Frs.</u>
Great Britain	141,750.-	England	126,000.-
U.S.A.	57,750.-	U.S.A.	57,750.-
France	2,100.-	France	2,100.-
Geneva (Coordinating Office)	4,200.-	Holland	5,250.-
		Scotland, Switzerland, India, etc.	14,700.-
	<u>205,800.-</u>		<u>205,800.-</u>

(For rough equivalents, divide Swiss Francs: by 21 for £ sterling,
by 4 for \$ U.S.)

- 4 -

It is up to all national committees to see that these figures are realized, and if possible surpassed. Some countries can help to receive students, others to raise the money to help in their training and establishment elsewhere. All can help if they only will.

Human Beings.

Here are brief notes on a few out of the hundreds of young men and women who are eagerly awaiting our help:-

A.B. 22 years old, Non-Aryan, Protestant, student of mechanics and electrical engineering. After 5 semesters at the University, left Vienna and went to Italy. Because of the new regulations there, cannot remain in Italy, also cannot return to Vienna. His mother can only send him 10 Marks a month, and he has no other means. As he is a Christian he cannot get any help from Jewish organisations in Italy. Has the necessary affidavit and offer of hospitality from the U.S.A., but as the quota is already full, will not be able to obtain a visa for some months, i.e. at best only for the academic year 1939-40. Asks I.S.S. to help him to live in some country until it is possible for him to go to the U.S.A. Is willing to undertake any form of work.

A.D. 23 years old, Jew, has studied medicine for 10 semesters, needs only one more semester to finish. After the Anschluss, came to Switzerland. Relations living in the Sudeten German regions of Czechoslovakia promised him the necessary means to complete his studies at Zürich University. Owing, however, to the present situation in the Sudeten German district, they were themselves ruined, and cannot help him further. He, therefore, asks I.S.S. for a scholarship to cover his University and examination fees for this one semester (another organisation has promised living expenses), after which he has a possibility of emigrating to South America.

...and here are two examples of students whom I.S.S. has already been able to help (over 70 have been helped financially since March, hundreds more by advice and information, negotiations, etc.):-

A.C. A student in Vienna, aged 25, had managed her father's estate and done eight years in the University in the faculty of Law, but was unable to obtain her doctorate as she was of Non-Aryan descent, and forced to leave Austria. Her sister, a journalist in England, appealed to I.S.S. to find her some place where she could train for market gardening. I.S.S. has obtained reduced fees for her to attend a horticultural college. She has now arrived and already shown her competence in this work, and has good prospects of finding a suitable job in England or in one of the British Dominions when she has completed her training in two years' time.

A.E. A student of architecture in his fourth year at Vienna University, was forbidden to finish his studies. The British Committee

- 5 -

helped him to come to England where he arrived in August and has been accepted as a pupil in an architect's office free of charge. It was essential that he should also obtain a degree, and as a result of a grant of £10 from I.S.S. he will be able to go to a Polytechnical School, and obtain a degree in two years. He can then find work in Turkey where he has relations.

Geneva,
17.X.38.

Edward Bradby
General Secretary

*
* *
*

October 29, 1938.

H. M. Jr. called the President at 11:40 this morning.

H.M.Jr: I would like to have your approval, if you think well of it, to send the following cable to Cochran which Monnet and I have prepared together.

President: Why didn't Monnet leave to-day?

H.M.Jr: Because he wanted two more days in the Treasury. He had not finished his work here and decided, therefore, to leave on the Bremen tomorrow.

FOLLOWING INSTRUCTIONS FOR YOU ONLY PERIOD
PLEASE ASK MR DELADIER TO SEE YOU ALONE AT HIS HOME WITHOUT LETTING ANY FRENCH OR AMERICAN OFFICIAL KNOW ABOUT IT AND THEN INFORM HIM IN STRICTEST CONFIDENCE THAT YOU HAVE THE FOLLOWING MESSAGE FOR HIM QUOTE MR JEAN MONNET WHO IS SAILING ON THE BREMEN TODAY HAS SEEN THE PRESIDENT AND MYSELF AND IS CARRYING A VERY IMPORTANT AND SECRET MESSAGE FOR MR DELADIER RELATING TO THE FRENCH FINANCIAL SITUATION END QUOTE PLEASE IMPRESS ON MR DELADIER THAT THIS MESSAGE IS FOR HIM EXCLUSIVELY PERIOD PLEASE ADVISE ME THROUGH SAME CHANNELS OF COMMUNICATION WHETHER OR NOT YOU HAVE BEEN ABLE TO CARRY OUT THIS MISSION SUCCESSFULLY PERIOD

President: Very good.

H.M.Jr: I thought I would send it through your Naval Aide. Is that all right?

President: Yes, that is all right.

H.M.Jr: Thank you sir. Goodbye.

Then H. M. Jr. called Admiral Leahy.

H.M.Jr:

I have a request to make which is a little out of the ordinary. I have just talked to the President - I have a message which is very very confidential that I want to send to Cochran, our First Secretary of the Embassy in Paris, who is detailed to me, and I want to send it via your code to your Naval Attache and have him deliver it personally to Cochran.

Leahy told the Secretary that their Attaches do not have there very good codes; that he would be delighted to send a message for Secretary Morgenthau but that it was not a very tight code.

The Secretary said, "It is the only way I have of sending this message and I will have to do it this way. I will send Lieutenant McKay, a Coast Guard officer, right over with the message. To whom should he give it?"

Admiral

Leahy: Have him bring it directly to me.

H.M.Jr:

Please surround this with all the secrecy possible.
Thank you, sir

October 29, 1938.

To: Merle H. Cochran
American Embassy,
Paris, France.

STRICTLY CONFIDENTIAL

From: Secretary Morgenthau

FOLLOWING INSTRUCTIONS FOR YOU ONLY PERIOD
PLEASE ASK MR DELADIER TO SEE YOU ALONE AT HIS HOME
WITHOUT LETTING ANY FRENCH OR AMERICAN OFFICIAL KNOW
ABOUT IT AND THEN INFORM HIM IN STRICTEST CONFIDENCE
THAT YOU HAVE THE FOLLOWING MESSAGE FOR HIM QUOTE
MR JEAN MONNET WHO IS SAILING ON THE BREMEN TODAY HAS
SEEN THE PRESIDENT AND MYSELF AND IS CARRYING A VERY
IMPORTANT AND SECRET MESSAGE FOR MR DELADIER RELATING
TO THE FRENCH FINANCIAL SITUATION END QUOTE PLEASE
IMPRESS ON MR DELADIER THAT THIS MESSAGE IS FOR HIM
EXCLUSIVELY PERIOD PLEASE ADVISE ME THROUGH SAME
CHANNELS OF COMMUNICATION WHETHER OR NOT YOU HAVE
BEEN ABLE TO CARRY OUT THIS MISSION SUCCESSFULLY PERIOD

Monday
October 31, 1938
4:59 p.m.

HMJr: Hello.

Operator: Mr. Cochran is trying to reach you.

HMJr: Oh. Well, is he on the phone now?

O: She says she can get him on right away.

HMJr: If she can get him on right away all right.

O: All right.

H. Merle
Cochran: Can you hear me?

HMJr: Yes.

C: I received a message from you at eleven o'clock today.

HMJr: At when?

C: I received a message from you at eleven o'clock today.

HMJr: Yeah. Now be terribly careful what you say now.

C: Yes. I understand.

HMJr: Yes.

C: Have you received my reply?

HMJr: No.

C: I saw the man at three o'clock and I sent you a reply.

HMJr: Yes.

C: And he was very anxious to receive some details.

HMJr: Yes.

C: And in that - in the wire which I sent you this afternoon -

HMJr: Yes.

- 2 -

C: I indicated his interest in receiving some information as to the general basis or so on as soon as possible.

HMJr: Well, I'm afraid he'll have to wait - ah - until - ah - well, you know.

C: I don't understand.

HMJr: He'll have to wait.

C: He called me just a half an hour ago by telephone.

HMJr: He did what?

C: He telephoned me -

HMJr: Yes.

C: - half an hour ago.

HMJr: Yes.

C: Saying that he had postponed the meeting which he had planned for this evening, -

HMJr: Yes.

C: - until tomorrow, hoping that he would have some word from you.

HMJr: Well, I - it - it's too complicated and too important - it's impossible - I just don't even - I don't even dare talk about it.

C: I see.

HMJr: He - he'll - he'll have to - ah - he'll have - as far as I'm concerned he'll just have to wait.

C: I only got part of your words.

HMJr: I mean I can't do anything more than that. I - I can't give you anything.

C: I see. You can't cable it either?

HMJr: No. I'm afraid to.

- 3 -

C: I see.

HMJr: I'm afraid to.

C: Because he was disposed to holding his friends, awaiting some word, you see.

HMJr: Well, of course that was the idea of the cable.

C: I know, but his time's a little short.

HMJr: Well.

C: Anyway he called me back and I thought I ought to phone you - I didn't like to let it go without calling you to let you know about it.

HMJr: Well, I'm awfully sorry but I just can't - I - I don't trust the phone or the cables.

C: I see.

HMJr: I'm sorry.

C: All right. I'll tell him that.

HMJr: And ah - but I - I couldn't do it - it would take me hours. Ah -

C: Because he received me very nice and all that.

HMJr: Uh huh. Well, you send me an answer.

C: I'll send you an answer this afternoon.

HMJr: Well, I'll wait until I get the answer.

C: I see.

HMJr: I'm sorry.

C: Ah - shall I hold out any hope for him at all?

HMJr: No. No. Just -

C: All right. Well, I'll call him back then.

HMJr: Ah - I'm sorry, but - you'll know all about it in time. Hello?

- 4 -

C: Hello.

HMJr: I'm - well, I'm sorry - I can't say anything more.

C: All right. Well, I just wanted to call you and tell you his reaction and if you wanted to give it through why -

HMJr: Well -

C: - all right. If not, why -

HMJr: No, I can't do it.

C: All right, sir. Fine.

HMJr: Thank you.

NAVAL MESSAGE
(Navy Department)

190

From ALUSNA PARIS

To CHIEF OF NAVAL OPERATIONS

Released by X-K Y-K

Date 31 October, 1938

Priority to XXX

0031 AFTER RECEIVING YOUR MESSAGE AT SEVEN AM TODAY IT WAS DELIVERED FULLY BUT ORALLY BY ME TO DALADIER AT 3 PM IN PRIVATE. HE SAID THAT ANY MESSAGE FROM SECRETARY MORGENTHAU WOULD BE HAPPILY RECEIVED AND THAT HE WAS ANXIOUS TO COOPERATE WITH THE U.S. HE ALSO SAID THAT HE DOES NOT WANT, THROUGH THE DECREE LAWS UPON WHICH HE IS WORKING, TO DO ANYTHING DISPLEASING TO THE U. S. THEREFORE HE SAID HE DESIRES TO HAVE YOUR MESSAGE AT THE EARLIEST MINUTE OR ITS BASIC ESSENTIALS. HE REQUESTED ME TO OBTAIN THIS INFORMATION AT ONCE BY THE PHONE OR CABLE. HE REMINDED ME THAT THE CABINET WOULD MEET AT 5 PM TODAY WITH OTHER MEETINGS IN RAPID SUCCESSION UNTIL HIS PROGRAM IS CARRIED THROUGH TO COMPLETION. A DELAY OR EVEN A REVERSAL OF POLICY WHICH WOULD BE EMBARRASSING MAY BE INVOLVED IF HE IS FORCED TO AWAIT THE SPECIAL MESSENGER LATE FRIDAY OR SATURDAY.

MERLE COCHRAN 1800

TOR CODE ROOM 1500 31 OCTOBER

DISTRIBUTION

LT. MCKAY.....

November 1, 1938.

Dear Cochran:

Would you please send me by mail a timetable of what happened, beginning with the receipt of my cable to you of October 29th.

With kindest regards.

Sincerely,

Mr. H. Merle Cochran,
American Embassy,
Paris, France.

*Thirty Broad Street
New York*

HANOVER 2-9393

October 31, 1938.

Mrs. Henrietta Klotz, Secretary to
Hon. Henry Morgenthau, Jr.,
Secretary of the Treasury,
Washington, D. C.

Dear Mrs. Klotz:

Just a line to confirm that my office telephone
number is HANOVER 2-9393, and that my secretary, Mr. Frank McFeely,
will be waiting your call.

Yours sincerely,

Jean Monnet

I called MdFeely November 1st and gave him the
following message to send to Monnet, "Automatic
order received".

H. S. K.

O October 29, 1938. This was drafted by Monnet, Bernstein and White and was a suggested statement to be issued by "club" members in event agreement is reached.

The Governments of the United States, Great Britain and France, adherents of the Tripartite Declaration of September, 1936, after joint consultation have come to the conclusion that the very purposes of this agreement, namely,

To restore order in international economic relations; to maintain equilibrium in the system of international exchange, are threatened by the unrestricted movement of "flight capital".

These movements by their magnitude and their sensitivity to political and economic changes serve to weaken the monetary system of the country losing the capital without strengthening the country receiving it, and therefore hampers not only the monetary stability of all countries, but in this endangers the very security that the owner of the flight capital is seeking.

If these movements are unchecked, they will gradually undermine the basis of the Tripartite accord. More serious than that, they threaten the continuance of free enterprises and of freedom of action in commercial and financial endeavor, to which the three countries are so deeply attached and are determined to maintain. This flight capital hangs at present as a Damoclean sword, threatening by its inordinate movements to destroy the fruits of the efforts of governments to restore stable domestic and international economic and financial relationships consistent with the maintenance of free enterprises.

The three powers have now considered that, consistent with the belief that the Tripartite declaration is a vital and growing instrument, an instrument adaptable to deal with various monetary problems pertinent to

- 2 -

the objectives stated in the declaration, the time is opportune for a further extension of the cooperative action undertaken through the instrumentality of the Tripartite Accord, and that such action will be directed toward dealing more adequately with undesirable flights of capital.

Accordingly, each of the adherents to the declaration have issued appropriate orders requiring the filing of reports relative to the holding of property in each of the countries by nationals of the other two countries. The information thus obtained will become reciprocally available to the three countries. Any action which each country will take will be decided upon after consultation with the other two countries, and further consultation will take place from time to time to consider what additional or different action may be necessary or appropriate for any of the signatory countries to take.

It is intended that whatever action of repatriation is taken by any country will be entirely consistent with the continuance of free enterprise and freedom of action in commercial and financial endeavors; also any flight money or speculative capital will be repatriated in an orderly manner consistent with the legitimate and proper interests of the countries and persons involved.

Given to Monnet October 29, 1938.

1. One of the most serious sources of danger to the continuance of free enterprise and freedom of action in commercial and financial endeavors is the unrestricted movements of "flight capital". These movements by their magnitude and their sensitivity to political and economic changes serve to weaken the monetary systems of the country losing the capital, without strengthening the countries receiving it and, therefore, imperil the monetary stability of all countries.

2. If these movements are unchecked they may gradually undermine the basis of the Tripartite Accord. More serious than that, they increase the danger of a movement toward autarchy and political dictatorship, as well as economic, on the part of the particular country which happens to be at the moment most vulnerable to these movements.

2. Even though England and the United States are not suffering from flight of capital there is no certainty what the future may bring. With the machinery in operation which will enable each country to know the foreign holdings of its nationals in the other country it would be much easier to take steps in the event conditions should warrant it.

3. The French funds in England are probably one billion or more dollars. These consist of gold kept in vaults as well as securities and bank deposits. The return to France of gold kept in vaults would not diminish the gold holdings of the Bank of England nor the Equalization Account and would, by strengthening the French position, serve indirectly to strengthen sterling.

The British authorities should, therefore, not be averse to facilitating the repatriation of hoarded gold. The bulk of gold so held probably is held by the four large bullion brokers for the account of their French clients. It would be a relatively simple matter for the British Treasury to ascertain informally the extent of such holdings. Equipped with that information, the French Government could easily take steps to assure the repatriation of much of the hoarded gold.

With respect to the security holdings and sterling balances, the British Treasury would doubtless wish to be assured that the rate of withdrawal would not be such as would substantially increase the pressure on sterling at this time. "Orderly" repatriation might call for a more gradual liquidation and withdrawal of funds from London than from the United States.

4. The prestige of the Tripartite Accord would be substantially strengthened. Such a step would indicate that the Tripartite Accord is a vital instrument which is capable of growth, extension and adaptation to new conditions. It would set a precedent for cooperation in cognate fields.

- 2 -

5. In implementing the proposal it is desirable to insure an orderly return of the funds now held in securities or on deposit. To accomplish this, it may be desirable to call for the return of a given percentage of the outstanding holdings each month, accompanied by the right to maintain the holdings abroad for longer periods, provided the repatriated funds are then made subject to a "tax" of a moderate amount increasing with the time they remain outstanding.

So far as hoarded gold is concerned, however, immediate repatriation can be insisted upon inasmuch as the country in which the gold is so hoarded suffers in no way from its sudden repatriation. To induce the owner of hoarded gold to repatriate it, it would be necessary to provide a sufficiently convenient period in which he may return his funds and obtain the full current value for the gold. Any fund remaining beyond that length of time would be heavily penalized. (The American practice has been confiscation of the total with a possible penalty of an additional amount equal to the value of the gold held.)

It may be possible to arrange subsequently the exchange of additional information as to the foreign holders of property. The knowledge that more and more information is being exchanged among the respective governments will make owners of gold hoarded abroad very uneasy about the ultimate safety of those hoards. Confronted with the choice of repatriating it at full value at once, or leaving them at the risk of ultimate confiscation and additional fine, it is quite likely that a large portion of the gold hoarded abroad will be repatriated.

6. The British Government may be not unfavorable to the proposal in view of the fact that failure to adopt some such procedure may sooner or later be followed by depreciation of the franc and by measures which give the impression to people in England and in France that France is about to follow the path of Germany and Italy. The prospect now is not as remote as it seemed at that time that England herself may be in a position where she would wish to take advantage of the information that would be exchanged under this proposal.

Another advantage of using the Tripartite Accord as a vehicle for this purpose is that it will then not appear as a move dictated by weakness of France, but rather as a measure called for by the general trend in international cooperation among the democracies and a further strengthening of the ties and mutual interests of those democracies.

Memorandum prepared by H.D.W. for Monnet., Oct. 29/38.
Original given to Monnet.

Based on available data, the French net export of capital for the past five-year period is estimated at about $2\frac{1}{2}$ billion dollars. Of that sum, almost 300 million dollars appears to have come to the United States directly from France.

The total French investment in the United States in September 1938 (coming directly from France to the United States) is estimated to be in the neighborhood of $\frac{1}{2}$ billion dollars, about two-fifths consisting of bank deposits.

The accuracy of the above estimates of French investments are, however, subject to important qualifications: A portion of the common stocks, preferred stocks and bonds recorded as being held by the United Kingdom, Netherlands and Switzerland are nominee holdings. A portion of these are doubtless held for French clients. A portion of the bank deposits recorded as being owned by British, Swiss and Dutch banks may likewise be in fact held in trust for Switzerland or France. Complete information in regard to the direct investments of foreign countries in the United States, as well as foreign ownership of securities, is not available. In many cases the estimates of the investments held, particularly those made before January 1, 1935, are rough.

Some idea of the amount of French funds coming to the United States via countries other than France and therefore included in the estimates of investments from residents other than residents of France may be obtained from the sums of foreign investments of residents of

- 2 -

European countries other than France estimated to have taken place since the fall of 1934. During the past four years the imports into the United States of capital from European countries other than France is estimated at approximately 2 billion dollars. Some portion of that sum unquestionably represents French capital.

In view of the above, it is not unlikely that the French total foreign investments in the United States are close to 1 billion dollars. Of this 1 billion dollars it would appear that at least half may be regarded as "hot money", i.e., funds that have left France during the last five years.

MJD

GRAY

London

Dated October 29, 1938.

Rec'd. 9 a. m.

Secretary of State,
Washington.

1263, October 29, 1 p. m.

FOR TREASURY FROM BUTTERWORTH.

The exchange market has been very quiet today with sterling steady, without support around $4.76\frac{1}{2}$ to $5/8$. Only 56 bars were sold at gold fixing all but nine of which were supplied by the British fund. The price was unchanged at 145 shillings $10\frac{1}{2}$ pence which was quoted as a $\frac{1}{2}$ penny premium at $4.76\frac{11}{16}$. With the Paris market closed the British authorities have steadily held the franc at 178.84 in a fairly restricted market.

KENNEDY

RR
✓

*Mr. Lambert brought this to my house
Sunday night. He has transferred it to the house
and I discussed it. Wm J*

OUTLINE OF A PLAN TO INTEREST PRIVATE CAPITAL IN

THE CONSTRUCTION OF LOW-COST HOUSING

The Problem

In his message to Congress on November 27, 1937, the President said:

"The long-continued lag in building is a drag on all industry and trade. This presents an urgent problem which is the common concern of industry, labor, and government. All business needs the infusion of orders and the diffusion of purchasing power that come when building is thriving. Great numbers of people look directly or indirectly to the construction industry for employment. This industry, to a greater extent than any other, can put idle funds to work and thus speed up the circulation of the Nation's money supply. This, in turn, would increase national income, reduce unemployment, and as a result contribute toward a balancing of the Budget."

This quotation may be supplemented by the statement that if private capital does not provide sufficient housing in the lower income groups, expenditures of State and Federal funds to meet an insistent demand will increase the burden on the taxpayers of the country.

Object of the Plan

The object of the plan outlined in this memorandum is to induce a form of capital, not now actively employed in housing, to invest large sums in low-cost housing. The capital

-2-

referred to is that which is ordinarily invested at a low rate of interest, and which could not be induced to engage in purely speculative building. A further object is to employ this capital in the form of large corporations, so that the obvious advantages of quantity building and operation may be utilized.

The Market Available

Generally speaking, private capital has never erected new dwelling units for rental or for sale which are planned for immediate occupancy by those in the lower income groups; hence a large untouched market exists in this field. Of the 12,000,000 urban rental families in the country--

- 4 million pay rent of less than \$5 per room per month
- 5 million pay rent from \$5 to \$10 per room per month
- 3 million pay rent of more than \$10 per room per month

For the first group some provision is being made by the activities of the United States Housing Authority, although the recent appropriation for that purpose will eventually take care of only about 200,000 families. Of the last group only about 60,000 families are in prospect of being provided for by the erection of rental units. The very large undeveloped market is for those families in the middle group paying rent from \$5 to \$10 per room per month--a monthly rental of \$20 to \$40 per family unit.

The Plan

If private capital, not now engaged directly in building, could be directed to the huge market not now being touched, the result on our national income would be equivalent to the discovery of a new industry. The plan proposed herewith should accomplish that result.

It is suggested that a new type of corporation shall be recognized in the Revenue Act. For the purpose of this memorandum these corporations will be called investment housing corporations.

Securities of the investment housing corporations would be limited to a maximum return of 4 per cent on the capital invested, and no profit could accrue to the corporation or investor beyond this income either during the period of operation or at liquidation. To accomplish this, it is proposed that funds invested by the corporation in housing properties shall be repaid to the corporation in equal periodic payments over a period of years predetermined with respect to each housing property.

That is to say, the corporation will receive annually from each property an even amount sufficient to return the capital over a period of years and yield 4 per cent on the amount of money still invested in the property in any one year. When the revenues from any given housing unit have resulted in

-4-

the repayment of the capital and a maximum of 4 per cent thereon, the unit must be turned over to the community if the houses were built for rental purposes, or to the occupants if built for sale.

In the case of a rental project that is to be turned over to the community after the retirement of the capital, it is reasonable to expect that, before the project is undertaken, arrangements could be made with the municipality, because of the assured acquisition of such a valuable asset, to accept local taxes only in the amount required for essential services to the property. This saving in current taxes would reduce one of the substantial charges which make for higher rentals, and yet the arrangement would eventually afford the municipality a property producing for it a revenue exceeding that ever expected from taxes.

In other words, the community acquires a capital asset and a source of revenue, which together may justify a marked reduction in local taxes. The community can, of course, use its discretion in the case of each housing unit, as it would have no forced obligation under the Federal law. The eventual ownership by the communities of properties of this sort would constitute a distinct advance in social control. In fact, it would be advisable to provide that the community may, in its discretion, obtain a property at any time after 15 years from the date of

its construction by payment of the outstanding amount of the invested capital.

The required release of the title to the property eliminates all desire or possibility of speculation, and in doing so permits lower rents or lower monthly payments. A study of rental projects now being built by private capital discloses that the desire for speculative profit is a very large factor in the prevention of low rentals.

It is proposed that corporations under this plan shall have no mortgages, thus eliminating the various charges, other than interest and amortization, which are incidental to mortgage financing.

After providing for current dividends, the corporations would be permitted to set aside at the end of any year, as a reserve for deficiencies of amortization and dividends, an amount equal to not more than one-half that year's requirements for amortization and dividends. The reserve so accumulated, however, would not be permitted to exceed at any time an amount equal to twice such requirements for any current year. Any earnings remaining after provision has been made for this reserve would be paid as a tax each year to the Federal Government.

It is further proposed that, as the amortization with respect to any housing property is completed, the accumulated reserve shall be proportionately reduced and the amount of such

reduction paid as a tax to the Federal Government. In the event of dissolution or liquidation of an investment housing corporation, all funds remaining after repayment of the invested capital and annual dividends of 4 per cent to the date of such dissolution or liquidation would be paid as a tax to the Federal Government.

With such a plan as outlined, no speculative profit would be possible for the investor. The security for the investment would be sought by reaching the mass market of the low income group. Such an objective offers an incentive for capital in large blocks to use its facilities to lower building costs by quantity buying of materials, improved methods of building, and steady employment of labor.

Control of Earnings

It is proposed that, although the rate of return for these securities may not exceed 4 per cent, the rate for any new issue may, if circumstances warrant, be made less than 4 per cent by joint action of the Secretary of the Treasury and the Federal Housing Administrator. This provision would prevent any possible conflict with Federal financing, and also would afford effective control by the Government if further expansion of these corporations is considered inadvisable.

Inducement to Capital

Having set up the mechanism which in operation would certainly provide new housing for the income group not now being reached, it is essential to include in the plan a factor that is a strong inducement to capital to make the investment. This is true because, as outlined, the plan requires capital to limit its return—to give up all chance of profit—to forego any guarantee of its investment or earnings—and to offer control of its rate of return and future expansion to a governmental body.

The inducement should be consistent with the policies of the Administration and of the Treasury Department. It should also be of a character which will actually attract capital in large amounts and for continuing periods. The inducement suggested herewith complies with these requirements.

It is proposed that all revenue accruing directly to individuals from these corporations shall be subject to all Federal income taxes, but that on account of the public good resulting from the investment a reward or subsidy be permitted in the form of a deduction from the total income subject to surtax, the deduction to be the amount of income from these corporations, but in no case to exceed 10 per cent of the aggregate income from all sources, including tax exempt securities.

For example, if an individual has an income from all sources of \$100,000, and it is derived as follows: \$40,000 from

-8-

tax exempt bonds, \$10,000 from common stock, and \$50,000 from securities of these investment housing corporations, a deduction of \$10,000 is permitted from the income subject to surtax before calculating the surtax. If only \$5,000 of his income is from these corporations, a deduction of \$5,000 from the income subject to surtax is permitted.

In the case of a corporate investor, it is proposed that, before calculating the Federal corporation tax, a deduction shall be allowed of 85 per cent of the amount received as dividends from the investment housing corporations, but in no case shall the amount upon which the 85 per cent deduction is calculated exceed 10 per cent of the aggregate income from all sources, including tax exempt securities.

It is clear that these provisions make it impossible for corporations or individuals of high income to retire behind these securities in an effort to avoid their proportionate share of Government expenses. Corporations holding such securities do not present any surtax problem. In the case of the investment housing corporations themselves, the very nature of their operations would suggest that the Federal Government require them to pay only the tax resulting from their earnings in excess of the authorized dividends and reserves.

Consistency

It has been stated above that the proposed inducement to capital would be consistent with Government policy. This statement is true for two reasons:

1. The Government has found it wise and necessary to offer some aid to promote various housing activities. In the case of the United States Housing Authority very substantial subsidies are offered. In the case of the Federal Housing Administration a contingent liability is undertaken. The assistance or subsidy suggested here applies to the income groups lying between those benefited by the activities of these two agencies. In this case, however, the operation of the plan results in no disbursements by the Government, no contingent liabilities of the Government, and in fact an increase in the net revenue of the Treasury. This increase in revenue comes from Federal taxes on the stimulated industrial activity resulting directly from the investment, and that increase can be shown to be greater than the tax deduction allowed.

2. Granting of tax deductions, as proposed for an inducement, is not inconsistent with the President's message of April 14, 1938, because the usual objections to tax exemption do not apply. The usual objections to exemption are as follows:

a. Tax exemption has a tendency to withdraw funds from active industry.

-10-

Under this plan, on the contrary, capital would be withdrawn from an inactive state to stimulate an industry readily susceptible of expansion.

b. Tax exemption results in a decrease in the revenues of the Treasury.

Under this plan there would be a net increase in the revenue of the Treasury, not otherwise obtainable from the building industry.

c. Tax exemption on municipal issues has a tendency to bring about unnecessary increases in the debt of communities because of ease of borrowing.

Under this plan no new debt to the municipalities is involved. On the contrary, they will receive a permanent asset and a new source of revenue. Moreover, any unearned increment in the properties will run to the municipalities rather than to private owners.

d. It is socially wrong that wealthy persons may completely avoid their share of Government and State expenses by investing in tax exempt bonds.

Complete or even a material avoidance of income taxes is impossible under the plan proposed. The tax deductions proposed are in return for a direct social and economic benefit. The deductions are earned only as funds are employed in the construction and operation of new housing for low-income groups.

-11-

In Conclusion

The most important single step necessary to achieve low-cost housing with private capital is the creation of large investing corporations, employing their financial resources and technical skill to lower building costs. The proposed plan should bring about this desired result. It is essential, however, that all component parts be permitted to function in combination, otherwise the present untouched market will not be reached.

GROUP MEETING

October 31, 1938.
9:30 A. M.

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

H.M.Jr: Oliphant, are or aren't you ready?

Oliphant: I am ready. I have those three things that were scheduled for today.

H.M.Jr: Yes.

Oliphant: And I've got them here.

H.M.Jr: Well, we'll do that after.

Oliphant: That Germany thing,

H.M.Jr: We'll take that off.

Oliphant: and something else.

H.M.Jr: Swell; I think we'll go right at this as soon as this meeting is over.

Herbert?

Gaston: On that document you asked us to hold a meeting on, on Friday; we did hold a meeting, and the general opinion is that it will be worthwhile to send it, and Mr. Hanes suggested some changes in wording, and we're all going to try to work out something a little different.

H.M.Jr: All right. Can you be a little definite with Mr. Hanes' suggestion.

- 2 -

Gaston: A little different, in the form, from which you saw it last.

Klotz: What?

H.M.Jr: Oh, he said Mr. Hanes made some suggestions; we are going to try to work it out a little different.

Gaston: Well, I think that may be true, too.

Oliphant: I did want to report

H.M.Jr: I've got to give you a funny story. At lunch yesterday, at the White House, wanted to know if I thought it would be all right for me to take Dano on the train with me. I said, "Surely, but I didn't know we were taking Dano back to the farm." "Oh no, but Dano must have his week-end in the country."

(Laughter)

So we'll have to have an extra Secret Service man on the train to look after Dano, because Dano is - she was perfectly serious.

Klotz: You mean she wants to give the girls a vacation here at the house.

H.M.Jr: Go ahead.

Oliphant: I did want to report one thing. There is in the shop an application to purchase five hundred thousand preferred stock in the Patchogue Citizens Bank and Trust Company.

H.M.Jr: Who did?

Oliphant: Patchogue - P-a-t-c-

Gaston: Patchone (phonetic), Long Island.

Oliphant: Patchogue, Long Island, and for the first time, on Thursday

H.M.Jr: I can't hear a word you're saying.

- 3 -

Oliphant: For the first time, on Thursday, came to my attention a practice called "cut-back" and I am holding that case until I work it out.

H.M.Jr: Well, I told Mr. Preston Delano - well, we did when - when was he in here - Friday - about this cut-back business - that I just learned about it this week. I told him I wasn't going to do any more of it.

Oliphant: Well, they

H.M.Jr: If you've got a five hundred thousand dollars case, that would be swell; it would be much better to do it on five hundred thousand and establish a precedent than it would be to do it on a hundred - seventeen. I am glad you brought it up. We just got it this week.

(Telephone conversation with Mr. Randolph Burgess, at 9:35 A. M., attached.)

October 31, 1938.
9:35 a.m.

HMJr: Hello.

Operator: Dr. Burgess.

HMJr: Hello.

Randolph
Burgess: Oh, hello, Henry.

HMJr: Hello, Randolph?

B: Yes, sir.

HMJr: I read your talk.

B: Yes, sir.

HMJr: And I don't know how frank you want me to be.

B: Go to it.

HMJr: Well, I don't like it.

B: Don't you?

HMJr: No, I don't like it at all.

B: Yes.

HMJr: And I'll tell you why.

B: Yes.

HMJr: If I'm correct - I mean the principal thought is that United States Government should stabilize the dollar at the present gold content.

B: No, not necessarily. I was simply throwing that out as one possibility.

HMJr: Well, that's what I get out of it.

B: Yes.

HMJr: And for the first time in four years I see the words "rubber dollar" used.

B: If you don't like "rubber dollar" I'll take it out.

HMJr: Well, I haven't heard it used in a long time.

- 2 -

Q: Yes.

Q: And -

Q: No, I didn't say that, I said "rubber money".

Q: Well, "rubber money".

Q: And I was talking about other countries too.

Q: Well the point is this. This is why I object to it. I mean - as long as you asked me, see -

Q: Sure, that's what I wanted to get. I'd rather get it beforehand than after, you know.

Q: Well, I wouldn't say.

Q: You and I have always played ball.

Q: Well, you say on page 3 - "the next step toward this objective is far from clear and I have no formula to offer".

Q: Yes.

Q: And then you proceed to offer formula.

Q: No, I said that's one of the possibilities that ought to be considered.

Q: Well, the point is this. This is my reaction.

Q: Yes.

Q: United States - well you say - "If we stabilize that maybe the other countries will gather around us and gradually we'll get a stabilization of currencies".

Q: Yes.

Q: Well, we've done it for five years, and it hasn't happened.

Q: Well, I think it's been an influence toward it.

Q: Well -

Q: And - of course we've done it - we've done it de facto, but the other boys constantly feel

- 3 -

that it is likely to change, that is we get -

HJR: Sure.

B: every - every day.

HJR: Sure.

B: There is a difference there, Henry.

HJR: Yes, but you don't - don't at all mention the fact that the right to devalue further is one of the greatest assets we have in the monetary field with the world as it is now.

B: Because I don't believe it Henry.

HJR: Well - well, then - well then I - just come out - This whole speech, as far as I'm concerned, is an argument that we should have stabilization de jure as well as de facto.

B: Yes.

HJR: And - and if we do that, then all the countries will follow us.

B: Well, I think that's one possible point of view that ought to be -

HJR: Well -

B: constantly considered, Henry.

HJR: Well, of course, that's where you and I differ, and that's -

B: Yes.

HJR: And - I mean - I just want to let you know if it's a trial balloon for United States Treasury -

B: No, I don't think that - it's a trial balloon for peoples' thinking, that's all.

HJR: Well -

B: And I think that most of the people here, probably, agree with your point of view.

- 4 -

HMJr: Agree with me.

B: Yes.

HMJr: Well the point - I mean - that I feel is - that - they're all the time saying we should do this thing, see? Well, why the hell shouldn't England do it. They've got the floating pound.

B: Well, because they - they're now just in the position they were when they stabilized in '25, and the result was that stabilizing in that position, that they got - they couldn't hold it.

HMJr: Well. The thing that I - I mean - get out - that this is the thing that's uncertain, you see?

B: Yes.

HMJr: Well, quite the contrary for five years we've been better than the rock of Gibraltar.

B: Now, let me - I - I'll - I'll -

HMJr: I mean -

B: I'll spell that out a little more.

HMJr: Well - and I - I don't feel that you've given enough credit to the tripartite.

B: All right, I'll spell that out more.

HMJr: And - and the fact that we're the only anchor to the windward in the whole monetary field.

B: Yes.

HMJr: Ever - we - we have been stable for five years.

B: Yes. Yes.

HMJr: And I have said that the right to stabilize further, I consider it a club and not a needle.

B: Yes.

HMJr: And I feel that very strongly.

- 5 -

- Q: Yes. Well there, I think - on that particular point - there's room for two points of view.
- ANS: Oh, yes. Oh, yes. But I just feel that in your thing, you belittle what we've done for five years.
- Q: Oh, well, I don't mean to do that. I - I'll go over that very carefully, Henry.
- Q: That you belittle - you belittle what we've held it steady - steadily -
- Q: Yes.
- ANS: And that - that just because we should fix the price and give up this right, and then suddenly all the other countries will rally around us.
- Q: Well, I say that's a possible thing, I'm not advocating it now, I think -
- ANS: Well, I got - well, out of the whole speech that's the thing - I said, "Well that's what Burgess wants."
- Q: Well, no, I'll put in some qualifications on that, because I want - what I want to do is get people thinking about that, though, that's all.
- ANS: Well - well, nobody could object to that.
- Q: No.
- ANS: I'm just telling you how I - and I read it twice - and I read it very carefully.
- Q: Then I've missed it somewhere, because -
- ANS: Take another look at it.
- Q: I don't want to be dogmatic, you know.
- ANS: Yes.
- Q: I think it is a good thing. People - these fellows are traders you know.
- ANS: Yes.
- Q: These foreign - foreign trade fellows, and they're awful apt to look at it from the high tariff point of view and from the point of view of exploiters

- 8 -

WMr: Yes.

B: Who want to export all the time and not import anything.

WMr: Yes.

B: And - they're the fellows that I want to give a - stick a needle under the ribs, you know.

WMr: Well, we won't have any argument on that either.

B: No, I don't think so.

WMr: But I - I - I keep coming back to the thing that I don't think it should give - enough credit to this Administration that we have been fixed for five years.

B: Oh, well I want - I'll spell that out more.

WMr: See?

B: Because that's one thing I want very much to do.

WMr: And that the tripartite was an - instrument which served notice on the world that we wouldn't stand for any more competitive devaluation.

B: Yes.

WMr: See?

B: Yes.

WMr: I - I don't think you've stressed that.

B: Yes.

WMr: That's all - I couldn't be any more frank with you, that if -

B: Well, that's just the reason I wanted to show it to you.

WMr: Right.

B: And I didn't want you to feel afterwards, well this fellow has done a lousey job, and if we have any

- 7 -

difference of view I want it now, not afterwards.

HJr: Well, I appreciate the opportunity that you give me, and that I can talk as frankly as this.

B: Well, I'll go over it very carefully Henry. I'm delighted to get your point of view on it. Very helpful.

HJr: Well, thanks so much.

B: I want to stir fellows up and make them think. That's - that's why I've made this thing hammer blow at times, I want to get people thinking, you know.

HJr: I understand.

B: Yes.

HJr: Thank you so much.

B: Thanks very much, Henry.

HJr: Goodbye.

B: Goodbye.

- 4 -

H.M.Jr: Would you say I covered it, Harry, without
(word misunderstood) myself.

White: I agree with you.

H.M.Jr: What?

White: I agree with you.

H.M.Jr: I couldn't go any more, could I?

White: I think you were gentle with his speech, on the whole.

(Mrs. Klotz and Mr. McReynolds laugh.)

McReynolds: We get an idea of how Harry feels.

H.M.Jr: Well, he's got the idea. They come at us -
"Why not get out the twenty-dollar gold pieces;
why not do this, and why not do that?"

Oliphant: Why doesn't he let sleeping dogs lie?

H.M.Jr: He says people keep coming in

(White House telephone rings; Mrs. Klotz answers.)

Lockhead: Might get like the rest of them; we should say
it is five dollars, and retain the right to change
it any moment, instead of on a twenty-four hour
basis.

Oliphant: People can't look at it in that light. They know
he's had years and years on the inside, and for
him to give a speech like that Why can't
he let a sleeping dog lie?

White: I'd like to see just a single foreign trade
use (or lose) his business - foreign excise fees,
because of that possibility in a trade....
in the export of capital to Latin America.

Oliphant: I was thinking about what's in his speech. Why
does he stir the thing up?

- 5 -

- H.M.Jr: Well, he gave me the honor of letting me read it; I told him what I thought; he can do what he wants with it. I mean, it's the first time I've heard him talk about the rubber dollar. A man - as for Burgess to do that
- White: It's a good thing to talk about, that instability of currency. I've been interested to know in what way it does.
- H.M.Jr: Me too. All right, Herman.
- Olliphant: I just mentioned that those first few cases hadn't been passing through the Legal Division. They began passing through the Division about ten days ago.
- H.M.Jr: Well, now, Herman, you said that once before, and we went through that. I don't understand that; didn't you look into that, Wayne? What was the story on that?
- Taylor: Well, what we had been doing in the past, we had a mechanism which was set up, when Jeff Coolidge was here, and to which I added Cy Upham, so you had the initials of whoever it was - Murphy, down from that standpoint. After all the other agencies had a great on it. I have talked to Ed Foley and various other people as to what additional they wished from the standpoint of legal documents and so on. There is - I don't see any difficulty in working out that mechanism.
- H.M.Jr: Have you worked it out now?
- Taylor: It hasn't come back yet. I think we can get anything we want from any of these agencies.
- H.M.Jr: Well, Mac, will you, in the next forty-eight hours, work out, as Administrative Assistant to me, a mechanism on this thing, please?
- Taylor: There is no mystery about this question of preferred stock, and cut-back.
- H.M.Jr: But I want Mac to work out an administrative thing which is - I mean, which will be satisfactory to everybody concerned.

- 6 -

- Taylor: I say there is no mystery about this cut-back business; I think everybody who's looked at the preferred stock program, and so on, has brought out this point about the cut-back. I know that I have talked to various people here in the Treasury about it, talked to the S. E. C. on certain aspects about it, talked to the Comptroller's Office, and F. D. I. C., and so on.
- H.M.Jr: Could you, for those assembled, describe the cut-back? I only heard about it in the last week.
- Taylor: Well, it works out about like this: You either do it in an original case or a secondary case. Where there is
- H.M.Jr: Use figures just as an example.
- Taylor: For example, here is a bank with, let's say, no impairment of capital, but they do want to put in some new money. They will probably - we'll say five million dollars, of probably a hundred dollars par value stock, and they won't alter the common. If there is an impairment of capital, say, to the extent of twenty-five per cent, you would decide whether you would make that all in the form of preferred, hundred dollars par, or whether you'd leave the common undisturbed in amount and change the par of the preferred stock. Cut-back really amounts to changing the par value of the preferred stock, dividend and liquidation provisions remaining exactly as they were.
- H.M.Jr: Let me see if I understand it. This is the way Cy explained it to me. If a bank needed five million dollars - subscribed to a million dollars worth of preferred stock, redeemable at five million dollars, but on the books it only showed a million dollars.
- Taylor: Shows a par value of a million dollars, but is entitled to dividends at whatever that rate may be.
- H.M.Jr: But on the bank statement it shows as a million dollars.
- Taylor: Shows as a million dollars. It doesn't alter the asset position of that bank in any way.

- 7 -

- H.M.Jr: And the reason, as I understand it, is in that way it didn't, so to speak, "water" the common stock.
- Taylor: No, it is the other way; it really doesn't change the assets of that bank in any way. But it does change the way you state it. So that instead of writing down the common, they change the par value of the preferred.
- H.M.Jr: Well, that is just what I say. In other words, the common maintains - by putting in the five million dollars, you don't change - the common maintains its same ratio of interest because you only put in one million of preferred.
- Taylor: I don't think that is right.
- H.M.Jr: That is the way I understood it; you don't water down the common; the common keeps - you get the same dividend, and everything else?
- Taylor: No, the preferred is entitled to priority on dividends. In most of these case you will find there will be very little dividend being paid on the common, on account of the high dividend requirement on the preferred.
- H.M.Jr: But in the mind of the public it looks as though they are only getting a million dollars worth of preferred, and actually, they are getting five.
- Taylor: That may be.
- Gaston: What you do is conceal an impairment of common capital.
- Oligphant: (Speaking low) A man buys a share of common; he assumes it is as a matter of fact, it is five million dollars of preferred.
- H.M.Jr: Well, as I understood, furthermore, from history, Jeff Coolidge went to bat with Jones on this thing, and got licked.
- Taylor: I think various other people have.

- 8 -

- P.A.Jr: I am not going to get licked on this thing. I am just not going to do it. I am tickled to death because I think it is a phoney; I think it is misleading the public, and if a bank needs five million dollars worth of preferred, let's have it right out in the open, and I think the United States Government would be a party to the thing. I - to me I just can't understand it.
- Gibbons: If an individual did it, he'd be indicted.
- Taylor: That isn't so, not the way it is stated.
- P.A.Jr: Well, it is stated legally.
- Taylor: John Hanes will bear me out on this, I know. You will find listed on the securities traffic (words misunderstood) ... listed in countries where you have par value, at whatever rate it may be. Maybe it is ten dollars; that stock will be entitled to six dollars preferential dividends; a hundred dollars in liquidation, or what have you? As long as it is fully disclosed there is no misleading the public on it.
- Hanes: This sounds to me like you are not disclosing the fact that you have borrowed five million dollars, but in effect, you do, whereas you set up an item on your balance sheet of one million dollars; it seems to me you are distinctly misleading the public.
- Gibbons: What will the balance sheet show?
- Taylor: The balance sheet will show, depending upon each individual case.
- Hanes: Will
(Mr. Gibbons and Mr. Hanes speaking at same time.)
- Hanes: Will it show a liability of five million dollars or one million?
- Taylor: It will probably show a liability
- Hanes: Of the par value?

- 9 -

Taylor: Of the par value; it will also say that that is entitled to

(Mr. Hanes and Mr. Taylor talking at same time.)

H.E.Jr: Well, gentlemen, look. What I

Taylor: I am not attempting to defend the practice, but I don't think it is as unusual as apparently we think, here.

H.E.Jr: Well, here is the point

Hanes: The unusual point, I think, is your statement you are borrowing one million dollars, and you are really borrowing five. I don't understand that.

H.E.Jr: Let's get down to the Anglo-California Bank. The idea on the Anglo-California Bank is that it is seventeen million dollars, and on the statement they are going to show, I think, five, aren't they?

Taylor: Well, I

H.E.Jr: Well, I just ain't going to do it. I am not going to do it.

Hanes: They are only setting up a liability of five million.

H.E.Jr: Yeah.

Hanes: I think that is the crux of the whole thing. They are not telling the public a thing.

H.E.Jr: My God! The Secretary of the Treasury, with his eyes open, should do it? I just guess I am not going to do it. Cy says, "You'd better do this Anglo-California one; you can't get by with it." He said Jeff Coolidge got licked on this thing. I've got to think about this thing; I am no banker but on the statement, it would appear the Anglo-California got five million dollars when, actually, they got seventeen.

Gibbons: All you need is the balance sheet on that statement.

- 10 -

- H.M.Jr: If I can thrash this out on five million dollars, it is much easier for me.
- Listen, Wayne, am I cockeyed on this thing, or am I not?
- Taylor: The impression I get is that most of us here do not quite understand what the problem is.
- H.M.Jr: No, but Wayne, let's take big figures like the Anglo-California. If I am correct, it is five; maybe it's four - maybe it's six. On the statement and in the public press, it would appear that the R. F. C. subscribed to five million dollars worth of preferred stock. Well, what is it? It gives us two and a half to the Anglo-California. It would be five; that's what it would appear.
- Oliphant: In the newspapers and counterslips it would appear that way.
- Taylor: I don't know whether it would. The question being, who are you misleading?
- H.M.Jr: Let's take a look at this thing. Who?
- Taylor: Who are you misleading?
- H.M.Jr: The public.
- Taylor: Well, which section of the public? When you've got those assets - the sound assets in the bank - haven't you - let's say that is fifty million dollars, for want of a better figure. Now on the capitalization side, as long as those assets are there, the only individual you are possibly misleading is a stockholder of the bank, or a potential stockholder of the bank,.....
- H.M.Jr: Isn't that enough?
- Taylor: if you are misleading him.
- H.M.Jr: Look! I want to buy some stock.
- Taylor: You are not misleading, certainly the depositors in the bank.

- 11 -

E. J. Jr: I may be slightly demented.

Gibbons: Why?

Taylor: The assets side is the important thing there. You've got, for instance, how you divide the thing; capital surplus, and undivided profits, etc., and

E. J. Jr: Wayne, I've got a hundred dollars, and I want to buy some stock in the Anglo-California after this thing goes through. I get a statement from them; I want to see their liability side. I've got a hundred dollars. The liability side says five million dollars, R. F. C. preferred - that is all.

Oliphant: May I put another case?

Taylor: It is something done in that way. If you - in the first place, if you bought stock in the Anglo-California simply on a counterslip which showed the condition of the bank as of a certain date, you ought to have a nurse.

E. J. Jr: Well, how can I, as a potential buyer, find out that they owe seventeen million dollars instead of five?

Taylor: Go to the Comptroller's report - the published statements, which they are required to submit. If it is listed anywhere, you can go to the S. E. C. and get complete details.

Gibbons: Mr. Secretary, I think this whole argument about who is mislead is beside the point, because it is perfectly obvious that unless someone is misled, there'd be no purpose in setting up this phoney device; there'd be no purpose to it unless you are intending to mislead somebody.

E. J. Jr: I don't see - to me, the easiest way to cross the street is to cross the street and not go around the block. I want to know why we go around the block.

Taylor: I think the obvious answer is, you don't want to wipe out the common stockholders.

- 12 -

- H.M.Jr: That's what I said in the first place; I said you don't want to water the common stock, dilute it. Dilute it.
- Taylor: Well,
- H.M.Jr: Huh?
- Taylor: Never mind. They don't want to wipe out the rights of the common stockholders, and that's the reason for the cut-back.
- Oliphant: Let's don't get the idea the depositor isn't hurt. I am in California, and thinking about opening a depository. I take a look at it, and say, "Oh, these people are in bad shape; they had to get seventeen million dollars from Jesse." I wouldn't touch it.
- Glenns: They owed the seventeen million to Jesse some time; that is a liability, isn't it?
- Taylor: He's got a stock investment in that bank.
- H.M.Jr: Well, anyway, you think besides the ethics of the think, you think there is legal doubt?
- Oliphant: Quite. I'm having a legal memorandum prepared now. I think it is - I think you violate the law.
- H.M.Jr: Well.....
- Taylor: Don't misunderstand me about this; I am not attempting to defend it in any way, but I think it is necessary that we understand what it is and what it means.
- H.M.Jr: Well, when we get down to this five hundred thousand..
- Oliphant: That is in my office now; I was going to hold it until I finished that study.
- H.M.Jr: That's all right; finish your study, and I'll ask Wayne to write me a memorandum, in view of everything whether he thinks we should or shouldn't continue this method, and give me your reasons.

- 13 -

- Hanes: Has this device been used before, or is it something new?
- Taylor: No, it's been done ever since we first started making investments in these banks.
- Hanes: I'd like to see a balance sheet of one bank that's done this. Then you could tell whether or not you are being deceived.
- Taylor: The only time you really deceive anybody, as far as I have been able to determine, is when they publish the counter statements and these things in the paper, which do not show the actual condition - where they will bulk all their capital in surplus capital; they will say, "Capital surplus and undivided profits," all in one item.
- Oliphant: Practically - that is the only source of the great mass of the public's information is what appears in the bank statements published in the papers, isn't it?
- Taylor: As I say, it depends upon who you are worrying about. The depositor is perfectly protected.
- Oliphant: I don't think so; he is - I think he is misled.
- H. A. Jr: I want two things out of this discussion. First, I want a regular calendar of procedure. After it is prepared, before it comes to me, I'd like Mr. Taylor to go over it and be satisfied; and then bring it to me - see if I am satisfied, and I want it done regular - and that's got nothing to do with the thing we are talking about. But I am tickled to death to do a five hundred thousand and establish a precedent on that basis instead of the seventeen million. Let's go forward, but I'd like all of these things. I've not - only rarely I've paid attention to the Comptroller's Office since Labor Day. The more I go into it, the less I like it, and the fact that we've done it for five years doesn't I'd like to put up a hypothetical case to S. E. C. - just on the question of the statement.
- Taylor: I have already done that.
- H. A. Jr: And they have approved it?

- 14 -

Taylor: Uh huh.

H.M.Jr: Bill Douglas approved it?

Taylor: I didn't put it up to Bill Douglas; I put it up to the people who were in the unlisted section there who were trying to find out if they could do something about this practice.

H.M.Jr: They wanted to stop this?

Taylor: I tried to get them to do it.

H.M.Jr: To stop it?

Taylor: Yeah.

H.M.Jr: Well, the place to stop it is right at my desk; your desk. Your desk - before it comes to me.

Taylor: The thing you are trying to stop is misleading statements.

H.M.Jr: Yeah.

Taylor: Information which is made for the purpose of selling stock. Is that right, Hanes?

Hanes: It is, yes.

H.M.Jr: It can be stopped at your desk or it can be stopped at my desk, either place. We don't need S. E. C. on this thing. That's the way I see it. It can either be stopped in your recommendation to me, or in the action I take; either place. But I again repeat, I am tickled to death it is five hundred thousand dollars; it's much easier than the argument is if you do seventeen million, and suppose that you are going to ruin the bank. O. K.

Taylor: The thing I am not sure about is that even if you don't go in for cut-backs

H.M.Jr: Yeah.

Taylor: on these counter-statements, and so on; suppose they showed in the case of the Anglo-California that they showed at the full seventeen. Then you

- 15 -

have these little counter-statements they get out, in which they bulk all their capital account in one figure. In other words, it will show fifty million dollars capital surplus and undivided profits.

- H.M.Jr: Well, aside from everything else, - well, I think we've spent enough on it now; but I will wait. To me the thing is very, very simple. I have to sign a request for seventeen million dollars, and I want to call it what it is - seventeen million dollars, and I want seventeen million dollars worth of preferred stock issued, and not five. And I don't need an awful lot of advice on that. I mean, it is just - to me that seems to be the straight-forward thing, and to be a party to hide the fact that seventeen - in any way, through any piece of paper - I just won't do it.
- Gibbons: How about if they just change it - put up seventeen million dollars on the liability and twelve million dollars good will on that as an asset? There is no asset there.
- Taylor: There is good money that goes in this, see, and that all shows in the asset side.
- Gibbons: They off-set it with a liability of preferred stock.
- H.M.Jr: All right, we'll go into this. Most likely Taylor will be just as vehement as I am to stop it.
- Taylor: I just told you a little of the past experience there.
- H.M.Jr: Well, we have covered an awful lot of ground since Labor Day - the whole set-up of this thing.
- Georgie?
- Was: (Low to H.M.Jr. at desk, with chart.) gain jobs; from here on it leaves it. It may be useful.
- H.M.Jr: I see. I'll talk to you afterward. You'd better hold it; I can't do this. It's too important.
- Was: The other thing is that Ruml asked me to come over to his hotel last night; he wanted to know what progress we're making on those three assignments of

- 16 -

the Treasury; and I did. He had Delano there, and Gardner Means. Means is making a similar report for the National Resources.

H.M.Jr: Whenever you people are ready, I'm ready.

Haas: He is expecting a meeting this morning at ten fifteen.

H.M.Jr: He is?

Haas: You announced it last time.

McKeynolds: You made a date for this morning at ten fifteen; it's on my calendar - another Fiscal Committee.

Klotz: (Speaks low to H.M.Jr:) ...

Haas: He is all set, and came down here.

H.M.Jr: Is it down?

Klotz: Oh, you switched it from ten fifteen to twelve.

H.M.Jr: Have we got anything for him this morning?

Haas: He's got something.

H.M.Jr: Well, you people better go on.

Klotz: I would have reminded you had I written it.

H.M.Jr: Well, they are coming in at ten fifteen. All right.

(Points to Mr. Taylor.)

Taylor: I've got that other. Will that ten fifteen thing be over by eleven?

H.M.Jr: I hope so.

Taylor: Because we've got this refugee thing over in State at eleven.

H.M.Jr: Well now, the only thing is this: I did want to do this thing - a couple things Herman Oliphant has got. I'd like to do them right after.

- 17 -

Taylor: I have been over their preliminary report - recommendation to Rublee, which has been readjusted as a result of this meeting we had the other day. There is only one suggestion I have in that, which is that they eliminate even the suggestion of the type of transaction that we are - that you are working on about a barter thing. Otherwise, I think it is perfectly O. K. Archie has been - I think Archie followed that.

H.M.Jr: Can Archie go over? Because I'd like to have you stay, because I want to do this German barter thing right after that.

Taylor: That is the one.

Lochhead: There will be somebody familiar with it besides Johnson over there, on that? I know the general idea, but if there is any discussion on it, I'd like someone else there too.

H.M.Jr: You know about it?

Lochhead: Oh, yes, I know about it.

H.M.Jr: You agree?

Lochhead: Oh yes.

H.M.Jr: As soon as I can I'd like to have Herman come in with his memorandum. I'd like you to stay, Wayne.

Taylor: Archie can cover that other thing perfectly.

H.M.Jr: John?

Hanes: Nothing this morning.

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

White: Captain Cullens came to see me at your request, or McReynolds, I can't tell. That can wait until later in the day. Apparently he is being pushed by virtue of the fact (words misunderstood).... to dump wheat is narrowing down before the Argentine. Sometime in the next day or two I think you ought to make a decision.

- 18 -

McReynolds: If the time expires wouldn't that dispose of it anyway?

W.J.Jr: I don't know.

White: I'll have a memorandum for you today.

W.M.Jr: Some time after lunch.

(Nods to Mr. Gibbons.)

Gibbons: (Nods "Nothing.")

W.J.Jr: Anything new on your friend, Judge Lauer?

Gibbons: I want to talk to Herbert about the publicity. Harry Durning was a little bit upset.

W.M.Jr: What was in those trunks?

Gibbons: The fellow that brought the things in has served time down south, somewhere. I think she was born in France and I think he married her over there. I have asked Customs to look up her record over there.

W.J.Jr: They took those trunks down; what was in them? Could you let me know?

Gibbons: Yes, I will.

W.M.Jr: Herbert?

Casten: No, I haven't anything else.

W.M.Jr: (Nods to Mr. McReynolds.)

McReynolds: No.

W.J.Jr: Now who sits in on this thing? George, Taylor, Hanes, Mac, and Bell. Well, Bell can't - I wonder if he knows there is a meeting today.

(Over telephone:) Tell Bell there is a meeting of the Fiscal Committee at ten fifteen - whether he's coming. Please.

THE FISCAL ASPECTS OF NATIONAL RESOURCES October 31, 1938.
POLICY 10:15 a.m.

Present: Mr. Hanes
Mr. Taylor
Mr. Haas
Mr. Eccles
Mr. Ruml
Mr. Delano

H.C.Jr: All right, Mr. Delano.

Delano: Well, Dr. Ruml and I and one or two others were in session for three or four hours last evening, and I think that while we haven't got the answers to all these questions that were propounded - I think we have made a start and I'll let Dr. Ruml tell you about it.

Ruml: Mr. Secretary, I might just report what we did after our meeting a week ago Thursday. Mr. Haas and I spent Friday morning together trying to, in a sense, get the sense of the meeting and list some of the problems that came up for discussion, as a point of general orientation. Do you think it would be a good thing, Mr. Haas, to put the list before the group here that we worked up on Friday morning?

Haas: Yes.

Ruml: Now, this is - this by no means attempts to be complete, and it is nothing more than, in a sense, a memorandum of our discussion organized in the terms of a possible investigation; and the names of the agencies we simply put down to be definitive for only the week until we got together, in order to indicate now we might get started. We listed in the beginning what we understood to be the objective of policy for this - that is, the objective of fiscal policy: to increase national income, production and employment. Very loose phraseology, but it gave us our orientation.

And I might explain the general architecture, if you want to call it that, of these investigations. There

-2-

are seven of them here. Let me read them off.

First, the amount of the national income necessary to balance the budget, at different price levels.

Two, the amount of national income with full employment, at different price levels.

Three, principal bottle necks under one and two above.

Fourth, effect on national income of principal budget classifications.

Five, effect on national income of Federal fiscal operations outside the budget: (a) Actual, and (b) Proposed.

Six, possibilities of increased flexibility in expenditures and receipts.

And seventh, transition or timing problem.

Now, in a sense, the first three hang together; four, five, and six hang together; and seven hangs all of them together, if you put it that way.

The general conclusion, or the general demonstration, that you would want out of one and two, I suppose, is to find out whether with reasonably full employment the budget can be balanced, at whatever price level seems reasonable within the next two or three years.

If number two is larger than number one at any reasonable price level, the nation is solvent in a realistic sense; that's making assumptions with respect to our existing levels of expenditure and our existing character of taxation and revenue.

Number three. The principal bottle necks or restraints would indicate the points at which some attack would be desirable or perhaps even necessary in order to realize two, which would make one practical. So in a sense the three investigations hang together logically, in that sense.

Four, five, and six hang together in this sense: that

-3-

these investigations are necessary in order to find out what action on the part of fiscal policy can be taken in the job of increasing national income, production and employment. First is the effects of the budgetary operations themselves; second, the effect on national income of fiscal operations outside the budget, and then - six - the possibilities of flexibility, applying both to four and five, really indicate what manipulative possibilities there may be with respect to fiscal policy.

The timing problem, the seventh problem, really involves all six and is the study of the indicators and methods for the type of action that may be shown possible under six to produce the effects you want under four and five.

Now, there may be a good many other things that should be done, but this in a sense summarizes what we understood to be the discussion of a week ago. We immediately communicated with the various agencies, asked them if they would, at least until this meeting this morning, assume leadership with respect to making a report of progress for today on each of the seven, and I think we are prepared to make at least some sort of report on all the various items.

H.H.Jr: Well, how do we proceed? What's the first report?

W.H.Jr: Well, the first is the report of progress. If this seems to be a satisfactory general agenda, why, then

H.H.Jr: Well, let's

W.H.Jr: Perhaps that would be - emerge as we went along.

H.H.Jr: Well, who doesn't think this is the way to proceed? Are you satisfied, Harriner?

W.H.Jr: Yes. I've been over this....

H.H.Jr: Fine.

W.H.Jr: ...during the week.

H.H.Jr: Well, is everybody satisfied to go along these lines?

All right.

-4-

Wahl: Well then, if Mr. Haas would want to discuss the first item.

Haas: I have a memorandum here, Mr. Secretary, which goes into a good deal of detail and technicalities. I think I can briefly summarize it. The statement of the project is the "Amount of national income to balance the budget at different price levels."

One thing that we are immediately confronted with is, what level of expenditures is contemplated? Once that is determined, whether it's eight billion or nine, or whatever it is, we can work out with a rather large amount of work a chart which will show, say, on one side national income and along the bottom the price level. And then if the figure which is accepted, say, is eight billions or so, you can read off the chart any combination of national income and price level which would produce the eight billion. But that's a tremendous amount of work. But that can be done, and I think that's what was in mind.

In doing this, there's various technical assumptions and so on, but I think those - probably those could be more profitably studied later than at this stage, because even the staffs aren't together on them. So I think it would be just wasting time to take a good many of them up.

But there's two things I'd like to impress. One is that it's rather a large job; it's almost equivalent, unless we find some real short cut methods - it's almost equivalent to the calculation of twenty budget revenue estimates. The other thing is that I would not like to have the impression conveyed that the expenditures are any simple function - rather, the receipts, Federal revenue receipts, are any simple function of national income, because we don't tax national income.

But we can work out an approximation which I think will serve the purpose for which it is intended. The only question involved there is that assumption as to what level of expenditures is contemplated. We can make some assumption about that and go ahead, or this group could give us a figure, either way. But we must have that even before we start.

-5-

- H.M.Jr: what do you think - I mean should we - I mean should we - what instructions should we give Haas?
- Ruml: well, Mr. Secretary, if I might suggest that we take the preliminary report straight down the list and then see what - then what should be done after we have the whole thing before us?
- H.M.Jr: All right. See, I'm getting my - I mean I haven't talked to anybody in advance of this meeting, so I'm getting it cold.
- Belano: I think it would be better to get a picture of the whole thing.
- H.M.Jr: I'm getting it for the first time. I mean I haven't had a chance to discuss it in advance of this morning.
- Ruml: Well, I might take the preliminary report on number two; that's the level of national income with full employment at different price levels.
- We have worked out a chart here that I will leave with you for study. I'll show you just what it is. Now, may I have a pencil, Mr. Secretary.
- H.M.Jr: Easy.
- Ruml: What we have tried to do here is to take different price levels - percent of 1938 from 90 to 130 - different levels of national income and different assumptions as to the number of unemployed. For example, if the price level were 105 and there were still three million unemployed, it would produce a national income of about 94 billion dollars. Well now, it is possible on this thing to read any combination that you want to and find out what the probable income is, with an error, I should say, of three or four billion dollars.
- The general facts that are shown are these. Assuming a three million residual unemployed, at the present price level you get a national income of around 88 billion dollars. Now the broad facts that come out of this investigation that should be tied up with Mr. Haas's investigation - there is a considerable margin, I suspect, in terms of any contemplated expenditure, as between what is potentially possible in terms of

-6-

production, and a balance as far as the budget itself is concerned. The budget will balance long before there is full employment, as far as anyone can see on present assumptions. Would you agree, Haas?

Haas: At the present level of expenditures.

Dean: Exactly. I'm talking about the current situation.

Haas: I think so, yes.

Dean: And then you can modify from that and see what the possible consequences are.

There are some refinements that are necessary here in one and two, and the first two investigations need to be brought together; but we set them up in this form because it seemed to us that the essential problem, as I stated before, is to find out whether the thing can be done.

H.M.Jr: You mean from the standpoint of setting it on paper, or whether we can accomplish our goal?

Dean: Whether we can accomplish our goal. That is, whether this country has the productive capacity and resources to take care of the present level of Federal expenditures, or whatever level, on whatever assumption with respect to the tax structure; because if you can't do that, then you really are in trouble; if you can do that, that's a problem of organization and administration.

H.M.Jr: But you think it can be done.

Dean: Everything we have so far, Mr. Secretary, would indicate that; and the further studies that Mr. Haas will make on various assumptions as to what the expenditure level will be would indicate at what point the balance would take place under this tax structure or some altered tax structure. In other words, it is possible to tie those two things together.

H.M.Jr: Now, what's the next thing?

Dean: The next investigation is the bottle necks, and there I shall simply put a memorandum in your hands after

-7-

having indicated that this is a very preliminary analysis and requires a tremendous amount of work by many agencies. The bottle necks or barriers have been classified in three kinds. First, physical barriers, such as deficiency of plant and equipment; second, deficiencies of particular skills in the labor force. Those are the physical.

Then there are the barriers to full employment in the industrial field, such as arbitrary price increases, labor conflict, too great increases in hourly labor rates, and the development of unwieldy agricultural surpluses.

This is, as I say, a very tentative and preliminary report on some of the problems that require investigation. I'll have to send the others over, I think.

H.M.Jr: Well, the electric one is being taken care of, isn't it?

Ruml: Yes, the

H.M.Jr: Or isn't it?

Ruml: Well, what I was going to say is that there are really two classes of problems. That is, are there any bottle necks that are likely to arise in terms of a national income that we are likely to reach within a year? Then, are there any that we have to take further steps on in terms

H.M.Jr: Ten years.

Ruml: Well, even three years, if you anticipate some increase in national income after the following year, which I think should be necessary.

H.M.Jr: Mac, come here. (Whispers few words to McReynolds)

Excuse me.

Ruml: Now, on number four

H.M.Jr: Everybody got a copy of this?

Ruml: Well, I unfortunately didn't have many copies. Perhaps I'd better - it's so sort of preliminary.

-8-

"Principal barriers to practical full employment and high national income.

"Nine principal barriers to practical full employment fall into three main groups, physical barriers, industrial barriers and fiscal barriers.

"Physical barriers can arise such as: 1. Deficiency of plant and equipment in particular industries. Have the railroads sufficient equipment to carry the tonnage that would develop with full employment? Is there sufficient electric power generating capacity? Has the steel industry sufficient plant?" And so forth.

I might say parenthetically that any barriers that are important enough to really be significant one can locate almost by thinking about them; that it isn't a matter of currying the country to find the barriers some place or other.

"2. Deficiency of particular skills in the labor force. In what fields has the unemployment of recent years resulted in a lack of trained workers? What are the industries in which rapid expansion is likely to call for more trained workers?"

Then the barriers to practical full employment that can arise in the industrial field, broadly defined to include agriculture, such as:

"1. Arbitrary price increases like the rise in steel prices in 1937.

"2. The breakdown of collective bargaining and resulting strikes and lockouts. The possibility is increased by the C.I.O.-A.F.L. conflict.

"3. The development of too great increases in hourly labor rates which put current labor costs too high in relation to current prices.

"4. The development of unwieldy agricultural surpluses.

"Barriers to practical full employment can also arise in the fiscal field, such as:

"1. A tendency to oversave in relation to investment opportunities, thereby providing insufficient current

-9-

expenditure on consumption.

"2. Unbalance in the composition of investment funds in relation to the risk character of investment opportunities. Funds seeking senior investment cannot be absorbed as equity capital and in excess could be as much of an impediment to full employment as oversaving.

"The above list makes no attempt at completeness but does indicate the types of barrier to full employment which exist or can arise. It suggests the need for a technical study of each possible barrier, (1) to establish its existence, character, and if possible, the magnitude of its influence, and (2) to bring to a focus all of the possible ways of dealing with the particular barrier so that the makers of policy can survey the alternatives and develop a coordinated yet flexible system of policies covering all of the major barriers. This is necessary because the methods of dealing with one barrier are so often dependent on the methods adopted to deal with other barriers."

H.M.Jr: Can I have that please?

Ruml: Yes.

H.M.Jr: You say a lot in one page.

Ruml: Well, it's terribly preliminary, Mr. Secretary.

H.M.Jr: Now, what else have you got?

Ruml: Well, we come to number four.

H.M.Jr: Excuse me. Anybody want to ask anything about this page?

Taylor: No, not a thing.

H.M.Jr: Marriner?

McCles: No, I don't have anything to say now. I agree with you that he's covered an awful lot of very important ...

Ruml: Well, all I'm trying to do is build a terrifically broad picture here, and it's terribly hard to do it without some

-10-

Madison: There's a lot of self-evident things said in there, though. We've been through this.

H.S.Jr: What I'd do is this, Nester: this stuff - see that these gentlemen afterwards are given copies, see? The people here should be supplied with copies of this.

Madison: Now, on number four, if I might, I should like to show you a little chart that I drew up. And the purpose of this chart is not to give you anything factual, but just to show what happens in different types of budgetary set-ups, depending on the relative weight of the various items as they affect purchasing power - the various items in the budget.

We know that - if I may use the term velocity with respect to expenditures - some kinds of expenditures circulate more rapidly than others. We know that some kinds of taxes are drawn out of purchasing power that would be spent faster than other types. And this, I think, you'll find rather interesting as showing what - now important that type of consideration is.

H.S.Jr: I can see it. Can everybody see it?

Madison: Now, I've taken here - this being the Federal budget on a very simplified basis, and not taking into account a lot of complexities - I've taken three classes of income, X, Y, and Z, and two classes of expenditure, A and B; and I've assumed that in dollars per year the income from X will be four, from Y two, and from Z one. And then I've made the assumption of the velocity of this tax, and by velocity I mean what it would have been if it hadn't been collected. You see, it's a negative velocity in a sense. There's two and three and four. So the effect on a national income of tax X is to reduce the income by eight billion dollars; the effect of tax Y is to reduce the income by six, and the effect of tax Z is to reduce it by four.

On expenditure, let's say that the expenditure in classification A is five, with a velocity of three, and therefore expenditure A adds 15 billion dollars to the national income; and expenditure B adds four billion: two, with a velocity of two.

-11-

Now the interesting thing in principle is this: that the budget here (at some point designated on the chart) is balanced and at the same time one billion dollars is added to the national income. The thing that I think the chart

E. J. Jr.: Well, it's very pretty, if you could really work it out in terms of - well, concrete facts.

Q. J. Jr.: I'm just going to show this (another similar chart) now, Mr. Secretary, to show how a change of those velocities will take the same balanced income but there will be a deficiency of six billion dollars. In other words, the operation of this balanced budget will take six billion dollars out of national income, whereas this balanced budget (indicated on previous chart) will add one billion dollars to it.

Now, I just wanted to make one major point here: that the study of these velocities is absolutely essential in considering the two-fold aspect of a budget: (1) the relation to its balance, and (2) what it does to purchasing power. You see, it would be possible in this budget, Mr. Secretary, to actually increase this by a billion dollars. But having a deficiency of one billion dollars here, do you see, you'd have a deficiency and at the same time you'd be reducing purchasing power, in spite of your deficit.

Now, I think that in the public mind there is a general feeling that a deficiency adds to purchasing power, that a balanced budget doesn't do anything to purchasing power, and that a surplus takes away from it. But although there is a relationship between those things, it is a relationship that's effective only in terms of the relative velocities of the various major classifications.

Q. J. Jr.: Give an example or two.

Q. J. Jr.: I'll give you an example. I suspect, if you won't hold me to it, that this is about the situation of 1937; that it was less a balancing of the budget than the introduction of a tax of rather low volume but of high velocity, namely the tax on wages - the Social Security tax; that produced a much more important deficiency in national income than would be indicated by the cash

-12-

figures themselves.

Another example might be to indicate - well, for example, there are some expenditures that have practically a zero velocity, and those, for example, are the expenditures that are made to bolster up the capital of banks who are not lending any more because their capital is bolstered up than they would have with no bolstering. I mean it's simply a liquidating situation rather than a situation that produces purchasing power. So you would have an expenditure here with practically zero velocity.

Now, to give you just a little confidence that this isn't too far drawn - as we said last time, economists in general, a good many of them, take a figure of some place between two and a half and three and a half as indicating average velocity; and it isn't too great an assumption, I think, to feel that the difference between, let's say, the gasoline tax and the income tax in higher brackets is a ratio of one to two. Nor is it too great a stretch of the imagination, I think, to feel that there is a substantial difference between PWA expenditures, or the purchase of agricultural lands, and WPA and things of that sort. That is, we know that there must be. But scientifically, of course, the problem is still very great to determine the actual quantities.

And just this other one thing. There is one assumption that we know is not true, and that is that they are all equal, and that's the one that we ordinarily work on.

S.S.Dr: I see.

Wylee: Well, a Government expenditure that would tend to stop private expenditure, such as - you take utilities; say the Government spends a billion dollars, and that would in effect displace private expenditure by a billion, and you've got a negative velocity. It's the same with your Social Security; if you pull a billion dollars in in taxes that otherwise would have been spent anyway, you haven't accomplished anything. You've decreased in the one source the billion merely to transfer it to some other source. On the other hand, if you take a billion out of that expenditure - those funds that otherwise would lie idle, uninvested, because

-13-

of an unprofitable field for investment, you have then put into velocity funds that otherwise would not be. That is, of course, where we got the idea of taxing - instead of putting money in at the top, like it was being done in the Hoover regime, the idea was to put it in at the bottom, on the bottom in consumer buying power, and create the greatest velocity. I mean that's the general

small:

That's the general thing. And the only addition to the general thing is that I believe that the matter is important enough so that the budget should be analyzed from that point of view, qualitatively as well as from the point of view simply on the dollars themselves. That's the general situation, I believe.

Well, Mr. Bess has made some explorations of point number four. Of course, this applies not only to expenditures within the budget but also those outside - PHA and all the rest - where figures can be analyzed from exactly the same point of view.

d.L.Jr:

Very, very interesting. George?

does:

Would you want me to read that statement?

R.C.Jr:

How long is it?

small:

Why don't you read the main headings?

does:

I can read the first page to give you some idea. I'm a long ways from those figures there, but as Mr. Ruml said, we know that from the point of view of the effect of expenditures and receipts on national income - we know the various items are not equal. I mean that's certainly a question of finding out exactly what the weights are, as to the problem that's still ahead of us.

"From the standpoint of the effects upon the national income of the various classes of governmental receipts and expenditures, the most useful immediate approach is to apply the touchstone: Does this class of receipts tend to reduce current consumption or does it tend to reduce pecuniary capital accumulation; and does this class of expenditure represent a true cost of government or does it represent merely a transfer of income from one class to another; and in

-14-

the latter case, does this transfer stimulate consumption or pecuniary capital accumulation?"

"By 'pecuniary capital accumulation,' as the term is used in this memorandum, is meant the amount by which the money expenditures of any individual or corporation fall short of his or its money income. The amount so saved from current consumption may be invested by the individual or corporation in physical capital goods, or it may be allowed to accumulate in money or bank deposits, or invested in securities. In the latter case, it may or may not find final investment in physical capital goods, depending upon the actions of the banks, of the parties from whom the securities are purchased, and of others more remote.

"In times of full employment, most or all pecuniary capital accumulation results in investment in real capital goods. In times of widespread unemployment, a large portion of it may 'run to waste' and so further aggravate the existing depression. The individual or corporation accumulating pecuniary capital can never know and is not directly concerned with the final social results of his or its accumulation. The Government, however, is vitally concerned with these results, and for this reason an analysis of the effects of different categories of receipts and expenditures in stimulating or repressing consumption and pecuniary capital accumulation, respectively, is of vital importance in the adoption of appropriate and flexible fiscal and general economic policies for the treatment of booms and depressions.

"The question of whether a dollar of deficit-financed Federal expenditure creates more than a dollar's worth of national income when expended in all or in certain channels -- i.e., the question of the 'multiplier' so-called -- has been reserved for further study and is not treated in this memorandum.

"In the following outline and discussion, convenience dictates the use of straight declarative sentences, when in many cases the statements should be regarded as contentions to be established, and preferably measured quantitatively, or disproved, rather than as pure affirmations.

-15-

"Tax Receipts

"From our present standpoint, the principal Federal taxes may be divided into two classes:

"(1) Taxes that tend primarily to curtail current consumption:

- (a) Excises.
- (b) Processing taxes.
- (c) Customs duties.
- (d) Payroll taxes.

"(2) Taxes that tend primarily to curtail pecuniary capital accumulation:

- (a) Death and gift transfer taxes.
- (b) Corporation income taxes.
- (c) Individual income taxes.
- (d) Undistributed profits tax."

I don't know just how much time you want to spend on this. Now I take the expenditure side and discuss some of it.

H.L.Jr: Go ahead.

Hess: O.K.

"Expenditures.

"From our present standpoint, the principal Federal expenditures may be divided into the following classes:

"(1) Regular operating expenditures, exclusive of public works and interest on and reductions in the public debt:

"The ordinary costs of government, consisting principally of salaries and supplies, do not significantly affect the published figures on national income during periods of fairly full employment. This is because, under such conditions, employment with or sales to the Government may be considered as substitutionary for rather than additive to corresponding employment in or sales to private industry and because the published figures always take the services of government into the national income at exactly what

-16-

they cost. In times of widespread unemployment, an expansion in the ordinary costs of government would increase the published figures for the national income.

"It should be clearly borne in mind, however, that, to the extent that the expenses of government are expanded or fail to be contracted because of inefficiency, the real national income, in terms of consumers' satisfactions, is not accurately expressed by the computed national income, in the calculation of which it is a necessary statistical convention to consider the value of the services of government to be equal to their cost.

"In general, the ordinary services of government present an unpromising field for the conscious introduction of fluctuations in current expenditures with a view to influencing the national income. It is best that the only considerations should be the necessity of the services, or their value to the public, and the costs of rendering them, and that they should be rendered in the most efficient -- i.e., low cost -- manner possible. An expansion in the cost of general government brought about during a period of depression for 'pump-priming' purposes would be likely to prove an incubus during a subsequent period of prosperity. Even in the field of ordinary governmental costs, however, a certain minor degree of flexibility is possible, as has been evidenced from time to time in the Treasury's policy of bunching orders for most of a year's supplies in periods of acute weakness in business.

"(2) Public works and purchases of capital goods:

"Variations in the expenditures on these items to act in such fashion as to compensate in some measure for opposite fluctuations in private industry are clearly desirable. In periods of fairly full employment, expenditures by the Federal Government in these fields may fail to add one cent to the national income; whereas, in other periods, a very large fraction of the entire gross expenditure may conceivably constitute a net addition to the national income.

"(3) Interest on the public debt:

-17-

"This type of expenditure largely represents a transfer of income from one class to another. That part of the interest on the public debt which is paid to commercial banks may for some purposes be regarded as a cost of maintaining the banking system, and so ultimately diverted in large part to consumption through the medium of disbursements for banking expenses. The rest tends to promote pecuniary capital accumulation, whether it be paid to insurance companies, savings banks, or to wealthy individual rentiers. In general, so long as a significant fraction of the public revenues is derived from taxes on consumption, the greater the amount of interest payable on the public debt, the greater is the stimulus to pecuniary capital accumulation; for the payment of such interest tends to constitute a transfer of income from the lower income groups to the upper income groups of society.

"(4) Debt retirement:

"Actual net expenditures for debt retirement out of current tax receipts tend to divert national income from current consumption to capital accumulation, when any significant fraction of the Federal revenues is obtained from the taxes on consumption. Debt retirement swells the volume of funds available for private capital investment. If such additional funds are made available during periods of strain in the capital markets, the effects upon the national income are probably favorable. If, on the other hand, debt retirement takes place at times when a large volume of additional investment funds already exists, the effect is likely to be a diminution in the national income. The timing and volume of debt retirement and their relation to the national income demand the most careful study.

"(5) Direct relief and work relief expenditures:

"Under a balanced budget, expenditures for these purposes tend to promote current consumption, and therefore under conditions of subnormal business activity, they tend to increase the national income. In important measure, under such conditions, they represent transfers of the national income from members of the upper income classes to members of the lower income classes, or the payment to the lower

-18-

income classes of national income which might otherwise not have existed. They should not be considered as true costs of government.

"When tax revenues are inadequate and such expenditures are financed by borrowing, their direct effects are strongly in the direction of increasing the national income. This is true even if the securities issued are sold to bona fide savers, for the latter in many cases would otherwise have merely hoarded their pecuniary savings. The effect is more pronounced when the obligations issued to finance these expenditures are purchased by commercial banks, for in this case there is a net expansion in the volume of effective currency and substantially no diminution in the volume of funds available for investment.

"The indirect effects of deficit expenditures for direct relief and work relief are more debatable. It is contended by some that a deficit so occasioned exerts no net stimulating effect upon the national income because it inhibits investment expenditures of the same or even greater amount by private business.

"The contrary is also contended. It is held by some that capital investments respond far more directly to immediate consumption demands than to remoter psychological influences; and that the increase in consumption which is engendered by deficit spending therefore stimulates capital investment.

"Varying measures of truth no doubt reside in both contentions as applied to different parts of our economic structure; and both merit careful study."

H.A.Jr: How much more you got, George? How many pages?

Hess: I've got just a half a page.

H.A.Jr: O.K.

Hess: "Borrowing."

"The national economy is affected not only by the sources of Federal tax receipts, the kinds and amounts of Federal expenditures, and the amounts of Federal

-19-

deficits and surpluses. It is also influenced by the character of the deficit financing, and, as suggested in the preceding, by the timing and volume of debt retirements.

"In the years 1933 to 1935, inclusive, the Nation's economy was suffering from a shortage of currency media because of the previous drastic reduction in the volume of bank deposits, a reduction occasioned by the great deflation of bank loans. Under such circumstances, it was highly desirable for the Federal Government, in issuing securities, whether for new money or for refunding purposes, to issue them in such form and with such maturities as would particularly attract bank investment. The purchase by commercial banks of Government securities would add to the volume of bank deposits. Under such circumstances, it was natural, therefore, that the Treasury met a large part of its needs through the offering of short-term securities -- in this case, Treasury notes and bills.

"A little later, when the volume of bank deposits was restored to 1929 levels, and it was desired to tap part of the large volume of idle and frightened investment funds of institutions and private individuals, longer-term securities were offered."

That just gives some ideas of the problem.

I just want to say for myself I think it is very refreshing to take a look at this budget from this angle, and I'll say that in the five years that I've been here we've never looked at it from that angle. I'm talking just now for myself. We get down to how much we whack off Wallace, or how much does the Army need, so forth and so on. And I think I can include the President in what I'm saying: that he's never thought of it from this standpoint.

I mean it gets down to gerrymandering - an expedition on the Hill. I mean I told the story last night, which is as good a story as I know of to illustrate this particular point - the story about the 40 million dollars we collected a year on the two-cent tax on checks. Now, it wasn't considered that - does that help national income or doesn't it, but it got down to a point that there was a creamery in Bob Doughton's district and this fellow had to hire a girl, paid her

-20-

a couple dollars a week to take care of these checks. It was very annoying to this fellow. He made Bob Doughton's life miserable. So Bob Doughton came back and said, "No more check tax." We lost 40 million dollars revenue. We lost it. Bob Doughton says, "I don't care what you have; I won't go along unless you promise to remove that 40 million dollar tax on checks." By God, we did. Able to get our program through. Suppose if I got somebody to pay that fellow to write those checks, I could have saved 40 million dollars. But that's the kind of - that's the way a revenue bill was made. And there isn't a squarer fellow on the Hill than Bob Doughton.

But I mean it's never considered, is 40 million dollars - will it produce four billion dollars worth of national income, or is it a good tax or is it a bad tax? But it just was a nuisance to one little creamery fellow in his district. It's a true story.

Wetmore:

It's a wonderful story.

H.A.Jr:

It's a true story. And that's the way these things work out. But if a fellow - I hope that you gentlemen will be able to proceed fast enough that the philosophy which we are talking about will be able to be introduced into the President's budget message, because I think this is great stuff. As a matter of fact, I showed the President Haas's memorandum on what you're working on today, and he wanted the statement for his Friday press conference on this.

(Hearty laughter)

and we all tried to do it and I wasn't satisfied. We haven't given him anything. But he wanted to announce this committee and wanted to talk about a hundred billion dollars and wanted to shoot the works right away. But I don't think we're ready. But he was just crazy about it and he wanted to pop it right off the bat.

But this - I just want to say this, just talking for myself, and I think I can say, because of the way he grabbed this thing the other day, it's - it's very, very worth while. Explore this to the very limit - I mean just to see how far we can go in this thing. And

-21-

this - well, I mean it gets down to - take the surplus tax and the fight we waged on that. Now, if we had figures to say, "Well, this will produce so much national income; now, gentlemen, this is why we want it, we've got to get it for this reason," we can build up public opinion, because by the time we try to explain this thing to the man on the street, it's impossible, but you can explain that.

Ambl: You see, it's so interesting - I mean suppose you transfer this one from here to here (indicating on chart).

H. S. Jr: This is the most exciting morning I've had in a long time.

Ambl: You add two billion dollars to the national income by transferring from Z to X. Simply another question of differential velocity.

H. S. Jr: This is the most refreshing morning I've had in a long time.

Ambl: I drew this thing up on Thursday. I've talked to one or two business men just about the principle of the thing, and the reaction is simply astonishing. What is needed is also a program of public education that will get some of these people convinced; because it is so reassuring to know in the first place it can be done, in the second place that it's a scientific problem to find out how to do it.

H. S. Jr: I mean I appreciate we've just turned over the first spadeful on a new building, but I just want to let you know how it affects me.

Ambl: That's very encouraging.

H. S. Jr: What?

Ambl: Terribly encouraging to me.

H. S. Jr: I want you to know how it affects me.

Ambl: Well now, this fifth point, Mr. Secretary, is simply - I'll simply hand it to you. It's a statement as to how we would go about the problem of finding out the effect

-22-

of fiscal operations outside the budget. I don't think I need to read it, because it's a statement of how you would proceed if you were going to begin.

H.M.Jr: Go on. Well, all right, you've got enough copies to go around.

Huml: We're persuaded that a very large area exists of possibilities outside the budget, and they're terribly important, considering any total picture.

H.M.Jr: Why don't you read this out loud?

Huml: Shall I?

H.M.Jr: Will you please?

Huml: All right.

"The effect on national income of federal fiscal operations outside the budget.

"This problem involves two separate sets of considerations, 1) how can you get the maximum effect on national income of a limited quantity of direct federal expenditures, 2) what procedures will be most useful for this end?

"The study of this problem will involve several stages:

"a) Listing of federal agencies now conducting fiscal operations outside the budget, and collecting information on the manner and extent of their operations.

"b) Analyzing the way these agencies operate, and possibly developing several different classes according to the effect of their operations.

"For example, F.H.A. largely is limited to facilitating (through pooling risks) the direct investment of private funds. F.C.A. sells debentures on the open market, and itself invests the funds. It receives some appropriations to maintain low rates. U.S.H.A. depends on annual appropriations to subsidize below-the-market interest rates. What are the effects of each of these alternative methods on national income? What are the effects on the credit of the United States? How far can each

-23-

such method be expanded without future drain on the federal treasury?

"c) Summarizing the extent of operations of each class, and their total effect on the economy, in comparison with direct federal spending.

"d) Studying federal fiscal agencies which now operate within the budget, selecting those which might be shifted, in whole or in part, to outside-the-budget position, and developing for each such agency the methods of operation outside the budget which seem most appropriate for its activities.

"Examples of agencies that might be shifted include the Post Office, irrigation and power districts, T.V.A., R.R.A., Rural Rehabilitation loans, Farm Tenant Loans, and acquisition and administration of national forests.

"e) Studying desirable new public fiscal activities that might be established on an outside the budget basis, and developing the methods of operation which would be most appropriate for each.

"Examples include the proposed Federal Railway Equipment Corporation and Toll Road Authority.

"f) Summarizing the extent of operations possible under d) and e), and the effect of such operations 1) on the national economy, 2) on the federal budget, and 3) on the future credit of the United States.

"As these several stages of analysis are completed, interim reports can be prepared on the significance of such operations, and as to possible or desirable extensions."

H.M.Jr: Just excuse me - I'll talk to Mrs. Morgenthau.

(H.M.Jr steps into wash room)

Reeles: That railroad equipment is another thing, of course, that ...

Beland: Isn't it true, Mr. Reeles, that the English Government, perhaps other governments, have protected their own federal budget a good deal by doing those very things? They've done things - for instance, I know, in some

-24-

cases, guaranteed interest on bonds, but not the principal; guaranteed interest for a certain number of years on these quasi-governmental activities in order to get them started. Well, we've tried that in this country but we've usually come to grief on it because the corporation comes to grief and Congress at once feels sorry for them and proceeds to guarantee the whole works.

Taylor: If - go ahead.

Eccles: Of course, we've got to avoid government competition unless they're going to usurp entirely the field that they're going to compete in. Government expenditures which compete with private expenditures, of course - I can't imagine any expenditure that does less to increase the national income than that type of expenditure. That's the one type

Wahl: Because nobody knows how far it's going to go.

Eccles: For every dollar the Government spends you may likely cause a loss of twice as much in private expenditure. That's certainly possible.

I think that we've overlooked what we might have gotten as a result of leverage here. I've been stressing leverage for a long while. I've been over here trying to get for each dollar of government expenditure - to try to get a multiple expansion of that.

Taylor: That's your top line over there.

Eccles: Yes, that's right. And I don't think we've commenced to explore that field at all.

Wahl: When you go outside the budget, your multiplier may be eight, ten, or twelve. In F.H.A., for example, your multiplier is very high. There, of course, you get into the bottle necks; you talk about your skilled labor. Of course, I don't think there is anything especially new in this, Mr. Eccles. It's set in terms of the whole picture. I was trying to show that it is relevant.

Eccles: Well, there is this much new about it, that it's coming in now in an organized way; that if the budget is

-25-

approached from this standpoint, as the Secretary says, it will be the first time that we've been able to even give any consideration to it from the standpoint of just in what way this expenditure or this tax is going to influence national income, which is after all the important thing, and it's the right approach; yet it's the first time I think it's been approached in that manner.

(Secretary returns)

S. J. Jr: Are you - am I interrupting you?

Secles: I'm all through.

S. J. Jr: What I wanted to say on this thing, inasmuch as you people are making such good headway - I'd like you to take on something that I haven't been able to crack for five years - be worth doing - for five years; before I came here with Mr. Roosevelt, in Albany, for four years, we talked about overlapping taxes, Federal, state and municipal, and we've never done anything about it.

Now, why is it a fiscal policy? I'll give you an illustration. Mr. Straus has been bedeviling me, rightfully from his standpoint, to get an answer for him that on the 90 percent tax community - can they go ahead and sell that locally, because if they sell it locally it's totally tax-exempt, if we sell it for them it's subject to the surtax. I had a chance to mention it to the President yesterday and he said, "Absolutely, no." But I'm giving him a formal memorandum, because Straus says even if I say, "No," he can't, under the local housing authority - they've got a right to sell them anyway. Which brings up the point that if it's done locally there would be 300 million dollars worth of bonds sold which would not appear in the budget. We'd give them the velocity test: is that something which is good or which isn't? And we might go to the President and say, "Notwithstanding your message on tax-exempts, this is such a wonderful thing, adds so much to the national income, and they're entitled to the tax-exempt feature."

But if it's a local thing it gets into this whole question of where we should look for additional revenue. Well, if you're going to tell us, "Well now, 30 or 40 percent of your revenue is deflationary," let's say - I mean I'm just using that for argument's

-26-

make - then you've got to look for new sources, and then if you look for new sources maybe we're going to go over more into the stuff that the states and municipalities are taking, or we should release this and we should release that. And if this group would be willing to take it, I'd like to dump it in their lap as a fiscal policy, because in looking for new sources - discarding present revenue, we've got to look for new revenue, good, bad, and indifferent. And nobody for Mr. Roosevelt has ever sat down and tackled this question of overlapping taxes, and it's one of the big things facing the country.

Now, this fellow Toll - is that his name - out in Chicago begged us to do it. I've talked to Ros Magill time and again. His answer is, "Well, Henry, any time you go into such a meeting, make up your mind you're going to lose your shirt, because they're going to take more away from you than you can give." So we go round and round and round and we haven't got anywhere.

Now, if Mr. Delano would be willing that this group and the rest of you take this on, it would certainly be doing the country, I think, a great service, and I don't see why it doesn't fit into this picture. I'd like to hear it discussed, because certainly I'd like in the next two years to see somebody take hold of this with two fists and do this kind of a job on it.

Delano: Well, I think it ought to be done by someone, but I also agree with you that it's loaded with dynamite. I mean if you just said - let it be known that you're making such a study, you'd have the entire thing in a state of friction. And the states won't give up anything, and as you say, they're going to try to grab more than they give up.

H.M.J.: Well, let me

Delano: Yet ...

H.M.J.: I'm sorry.

Delano: Yet that's not an argument against a study. There's no argument against making a thorough study. Thinking people in the states must see that there's got to be a study of this question.

-27-

H. J.: Well, I mean, take for example the collection of gasoline tax. If the Federal Government could collect the gasoline tax for the states and then rebate, so that the big companies doing a national business didn't have to make out 48 returns and do all the paper work, why, the savings to these companies would be something enormous. I'm just using that as an example.

Tarano: We were talking about that. It's very essential.

H. J.: Just enormous. And it's just perfectly silly that the companies - they've got to have lawyers, got to have accountants, got to have everything in each state; then they have to do it for the Federal Government besides. And the Federal Government could do it at the source and, depending on what each state wanted, it could just rebate it. We'd save millions of dollars.

McCles: I think that that is just as important an item as this. As a matter of fact, I think one is a corollary of the other. I don't think that it is possible to make an intelligent approach to this whole problem apart from the relationship of Federal taxes and state taxes.

H. J.: That's the point.

McCles: I just don't think it's possible. The national wealth is not equally divided according to states. We know that. And it's been my idea for a long while that the inheritance tax and the income tax should be solely the prerogative of the Federal Government, that it makes no sense to say that because Henry Ford lives in the state of Michigan that the state of Michigan can tax his inheritance up there, when his wealth is from all over the United States. There are some states that have a high inheritance tax and some states have no inheritance tax. The same thing is true with the income tax. People leave New York and go to Florida because Florida at the present time says, "We'll have no income tax." It's a hell of a note when a citizen can shift from one place to the other and avoid that type of tax.

And it seems to me we could control the states in this thing if you say, "Will you give up this tax? You'll

-28-

get so much back in the form of road construction or in this field - educational field, or in this other field" that the Federal Government can allocate back to them, if they will not withdraw.

H.M.Jr: I think, Marriner, it's a part of the thing, because I don't see - well, take your payroll tax; that's your best example - your state and Federal. If we're going to do this thing, and instead of having this damn fool Morris Tremaine all the time shooting at us - I mean we'd have an answer to him, and we simply say, "Now wait a minute, what you're talking about - this either does or doesn't fit into the whole national picture." And this way - of course, I campaigned with him six years ago, I don't want to hurt his feelings, I don't want to say anything, but I - I think ... What do you think, John - I mean don't you?

Hanes: Well, this is right along the lines we have been discussing with Ros Magill about getting - you remember we set down the names of individuals who are familiar with this, both Federal and state, and worked out a committee or group that would study the coordination of Federal and state taxes. I think that is highly desirable and I'm delighted with this approach to this budget situation.

H.M.Jr: But this approach in connection with what is deflationary and what is inflationary from the standpoint of taxes, I mean, and that we'd apply the same rule to states and municipalities?

Hanes: Well, I've used the expression several times that we're just in the process of chasing our tail around every time we need more revenue and we run up and tax something without any idea of its implications or impact on the economy as a whole, just as our capital stock tax was put on because we needed 150 million dollars of revenue. Never gave a thought to the ability to pay, because that thought doesn't come into it. Your corporation pays the tax whether you earn or not, so your deficit corporations are paying whether they earn or not.

H.M.Jr: What do you think, Wayne? Would you add it?

Taylor: I'd certainly add it, and I think it's - this is the first semi-intelligent discussion of this subject that I've attended since I've been here in Washington.

-29-

- H.M.Jr: George, are you equipped to contribute on this thing, or would you have to call in special people on this - if we took in this overlapping taxes?
- Haas: I think, Mr. Secretary, on this whole problem that we ought to have at another session - the problem was set up today; the next job is, what type of organization do you need to do it? You see, many of these problems are very easy to state but very difficult to work out. Now, my staff as presently constituted has some very good men in there, but it would mean - it would just bury them down with all this and cut them off from the regular Treasury activities. I don't think we want to do that completely.
- H.M.Jr: They're used to that.
- Haas: What?
- H.M.Jr: They're used to that.
- Haas: As long as you cut them off, we feel happy.
- H.M.Jr: Well, as far as I'm concerned - I mean you've got a deadline here for the middle of December if you want to introduce this philosophy in the President's budget message, so I'd say cut loose and put everybody to work on this thing. If there are people around town that can help
- Haas: We've got to draw some in.
- H.M.Jr: We can either get the President or Mr. Delano, or somebody - get a little chit: "Release this man" or whoever it is, so he can do this work. That can be done, can't it?
- Delano: Surely.
- H.M.Jr: I think I got this. I think I'd like to include this thing, because we're only taking care of - I mean
- Rumi: Well, you know, there's one thing, Mr. Secretary: you can't hard-boil an egg in two minutes by increasing the fire under the pan.
- H.M.Jr: Wait a minute. I don't know whether I like that or not. Where do I come in on this? Am I the egg? Wait a

-30-

minute. Am I the fire or the egg?

Ans: You're the fellow that can put the fire under the pan; and I'm afraid that you'll melt the pot and the egg will soon be soft. I think we have to study procedure a little bit on this thing in order not to try to make haste too fast. The essential logic of this thing is very simple, but you have to carry with it, it seems to me, not only the conviction of the administrative branch, but of a lot of other people as well, together with a certain countenancing of its purpose. And if you're going to go into this tax thing, you've got to set it up on such a basis that it doesn't seem to be arbitrary. I don't know how the rest feel, but it seems to me the most we can do this morning is to agree to make a proposal as to how we'd go about studying it. You hope that you'd get results by the middle of December of a definitive character. I'd be tickled to death if we'd get them a year from now.

W. J. Jr: I'm talking about the philosophy, introducing the philosophy.

Secles: It seems terribly important while the President now feels as he does about it and wants to approach this thing, that if he in his message - he can do more by that tax message to get the entire public discussing this approach than in any other way.

Ans: True.

Secles: And that would help us in our further pursuit of this thing. And as you say, if you can get it in a year, fine - or two years even. But you're not going to get it at all unless you first get a recognition of it on the part of the Administration and the public; and if the President starts out, he blazes the trail for us, then it's going to be a darn sight easier to follow up.

Ans: Well, I misunderstood the Secretary a little bit, because he moved from the tax matter to December 15, and I was tying the two together.

Secles: I misunderstood the Secretary too.

-31-

- H.M.Jr: No, all I was trying to say was that in his message should be introduced this new philosophy.
- Eccles: We ought to be far enough so that he can
- Ruml: On yes.
- H.M.Jr: That's all.
- Ruml: That certainly could be done.
- H.M.Jr: That's all, and I'm throwing into your lap for consideration today the question of whether this group couldn't include in its study the question of overlapping taxes, which also should be a part of the message.
- Taylor: Part of the message and the philosophy.
- Eccles: Because it all goes together.
- Taylor: And it should be more than saying just "Let's study this thing," which is what we've done before; because you've outlined a pattern here which gives you some place to go. You want to see where the impact comes and where it
- H.M.Jr: Well now, have we gone about as far as we can today?
- Ruml: Well, I think we can just refer in passing to number six, Mr. Secretary, because number six is the question of studying the budget to see at what point you can get flexibility, and that's an extremely intricate subject that I think we can only report on briefly today to the effect that we have found that it is intricate and that probably something can be done, how much we don't know.
- Is that about right, Haas?
- Haas: That's right, and on the expenditure side I think there is no doubt a great deal of work can be done in working up a whole portfolio or plan of expenditures in advance, which is available to be tapped, bearing in mind the relationship between the state and local governments and the Federal Government in participation, and so forth.
- Ruml: The engineering and legal plans should be drawn as well as the fiscal plans, with respect to a lot of stuff.

-32-

H.A.Jr: Now what else, Mr. Delano?

Delano: Do you want to touch on number seven? That's the transition and the timing.

Lucas: Well - yes, well that of course is - that's a somewhat over-all tying together of the thing, and it involves the question of not reducing expenditures too soon and not reducing the wrong kind of expenditures. And there is - we've done some study on this before, and this past week I got Currie and several others working with him and we've gotten out already quite a number of charts showing the effect of timing, showing the different types of expenditure going back to '25, and it's brought forth some very, very interesting results. I'll be glad, if at the next meeting you're interested in going into the thing farther, to bring some of these charts over and to show just what has happened and how we made mistakes, how they stand right out, and how the question of timing and the method of treating this thing in the past has been guess work, as we know, of course; that we just didn't approach it from this standpoint.

H.A.Jr: Well now, let's just see what - I think this was a good meeting. I know I got some encouragement, and I needed it. Let's see, this next week is election week. Would you people want to meet on Friday? Well, let's see, Friday the 11th is Armistice Day, but I work just the same. Or would you want to meet Monday the 14th?

Sam: It's immaterial. What do you think, Mr. Delano?

Delano: Monday suits me as well ...

H.A.Jr: Well, it's just a question of

Lucas: The - I ...

Sam: Monday would be better for me, Mr. Secretary.

H.A.Jr: Monday the 14th.

Lucas: It would be for me. I had a previous engagement Friday. I agreed to go down to Atlanta. But I'd like to get out of that; I'd just as soon.

-33-

Ruml: I have an estate* meeting on Thursday and Friday. I can come if that's the best day for everybody else, but

H.M.Jr: No. No, this is - we'll make it Monday the 14th at 10:15. Mac, see that everybody gets a formal notice, including myself.

McR: Yes, sir.

Eccles: Yes. What is this now - you say this is Monday?

McR: Monday the 14th, 10:15.

Eccles: Same time.

H.M.Jr: Is that a good time?

Ruml: That's fine.

H.M.Jr: Ought to have a lot of stuff. This is all very refreshing, because here I've got this picture of the present budget, and, looking at it through my old eye-glasses, it gives me a stomach ache; maybe through the new glasses furnished by this committee it may look a little rosier.

Ruml: I wonder what we ought to try to do, Mr. Secretary, by two weeks from now.

H.M.Jr: I'd say continue what you are doing, only get it more factual; take that thing (income, expenditure, and velocity chart) and get it down - get some examples.

Ruml: I wonder if it would be possible to analyze last year's budget from that point of view - just an approximation - where you've got a complete record.

Bass: Really don't know until you get into the job.

H.M.Jr: Well, would you mind, Mr. Ruml, sort of going into a huddle with George now? What? And then - you fellows have done so well that as far as I'm concerned .. you fellows get into a huddle and talk it over. You've got two weeks.

Ruml: What we've done is easy as compared to what we do from now on.

* Not clearly understood; might be "Standard" According to Who's Who Dr. Ruml is connected with two Rockefeller philanthropies.

CONFIDENTIAL

Objective of policy:

Increase of national income, production and employment

Investigations required:

1. Amount of national income to balance budget (Treasury)
 (a) At different price levels
2. Amount of national income with full employment (National Resources Committee)
 (a) At different price levels
3. Principal bottle necks under (National Resources Committee)
 1. Above
 2. Above
4. Effect on national income of principal budget classifications (Treasury)
5. Effect on national income of Federal fiscal operations outside the budget (National Resources Committee)
 (a) Actual
 (b) Proposed
6. Possibilities of increased flexibility in (Treasury)
 (a) Expenditures
 (b) Receipts
7. Transition problem (Federal Reserve Board)
 (a) Timing
 (b) Methods

October 31, 1938.
10:15 a.m.

WJr: Hello.

Operator: Secretary Wallace.

WJr: Thank you.

W: Go ahead.

WJr: Hello.

Secy
Wallace: Hello, Henry?

WJr: Hello. Hello.

W: Yes. Hello. Do you hear me?

WJr: Hello.

W: Do you hear me?

WJr: No, I can't. Are you at your office?

W: - White House

WJr: What?

W: Can you hear me?

WJr: Hardly.

W: I wonder if it would be better for you - let me -
let - do you hear any better now?

WJr: I can hear you.

W: Yes. I was talking with the President about this
barter thing.

WJr: Yes.

W: Wilcox, who has been working with Peoples on this,
is going over to England the day after tomorrow.

WJr: Yes.

W: And I'm wondering if you could see Peoples, Wilcox
and myself before he leaves.

WJr: Sure. Sure.

- 2 -

W: What time would you suggest?

HMJr: Just a minute. How's ten-thirty tomorrow morning?

W: Fine.

HMJr: Ten-thirty tomorrow morning.

W: That's all right.

HMJr: On this barter thing.

W: That's right.

HMJr: All right. Be glad to.

W: Fine.

HMJr: Thank you.

October 31, 1938.
10:22 a.m.

WMJr: Hello.

Operator: Mr. Macdonald. Go ahead.

WMJr: Hello.

Stewart
Macdonald: Good morning, Mr. Secretary.

WMJr: How are you Stewart?

M: I'm fine, thanks.

WMJr: None the worse?

M: Oh, my no. I was up at the Budget office at nine-fifteen this morning.

WMJr: Stewart, I'm sleeping over this thing of - of Lambert, but I'd like to tell you and Lambert.

M: Yes.

WMJr: I'd like you to put your whole organization, if it's agreeable to you to try to sell this to the thirty seven states where they have laws that they can organize housing authorities.

M: Yes.

WMJr: And then come back and see me after the first of January, but take the high pressure off me until you can see what you can do.

M: Well, maybe that's a good suggestion.

WMJr: I mean, you put your organization - all the publicity that you've got behind this thing and put people out in the field - let - let's see what we can do.

M: Let me make up a plan first and then I'll talk the plan over with you - in a day or so.

WMJr: Will you do that?

M: Yes.

WMJr: That's the best thing to do.

WMJr: Do that. I may go away Wednesday night.

- 2 -

(M: Well, anyway, I'll take care of it when you get back.

HQJr: But -

M: When are you coming back?

HQJr: Well, I'll be back the day after election.

M: Oh, that's right. Well, all right, it - it'll take some little time to work it out, you know, anyway.

HQJr: But that's my thought - then come back and talk it over. But, I'd like to see what you could do under the present law.

M: All right. O. K. I'll do that.

HQJr: Thanks.

M: Goodbye.

DISCRIMINATION AGAINST
AFRICAN COMMERCE

October 31, 1933.
12:05 p.m.

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

Oliphant: Now the German thing we went over and polished, as you suggested, and the idea would be for this letter to go over to the Secretary of State, and that I would call Mr. Mackworth and say this letter was coming over and send him a copy, and - or I would go over and take him a copy.

H.H.Jr: Just restate this whole thing again on this German thing. Just let's start - what are we trying to do?

Oliphant: What we're proposing to do is to impose duties on the ground that they're granting a - paying a bounty on their exports to this country, and their way they're doing it is for a man who wants to buy jewelry in Germany to call a broker in cotton downtown in New York and get from the broker a price at which that cotton can be sold; and then figures out the amount of the remittance and buys that much cotton, and the cotton is sold in Germany at a higher price in marks in view of the fact the proceeds are used for the payment of exports to the United States.

H.H.Jr: Well now, let me ask you this. Did you include in this thing the proportionate business being done this way, which Harry now has?

White: No, it's not included in this.

H.H.Jr: Have you told him how much of the business is being done ...

White: I have not.

H.H.Jr: Well, tell him now.

White: Preliminary reports of one month that they have already gone through indicate two-thirds of our imports are undertaken - arranged through this barter arrangement. That's only one month. We may have another month in a couple days.

-2-

- Oliphant: I'd rather not include that in this memorandum. Rather use it in discussing it with Hackworth. Rather not put it in this memorandum. If, on the re-examination of the whole matter, we find that the practice does violate the law, we ought to stop it whether it's a large amount or small amount.
- H.M.Jr: You (Taylor) have no question about sending this to Mr. Hull?
- Taylor: No. I think that we have to be pretty careful on it. In effect you say that a jeweler or anybody else who last week wasn't in the cotton business, can't go into the cotton business in Germany.
- Oliphant: No, we don't say that, because if a jeweler would go into the cotton business, he'd go into the cotton business for the purpose of making - this is important: if a jeweler was going into the cotton business, he'd go into the cotton business for the purpose of making a profit on cotton, or the purpose of getting cotton to manufacture something out of it. The jeweler gets this cotton and only gets it when he is sure he won't make a profit and won't suffer a loss on it. He gets the cotton, typically gets it, after he has a "put" for it in Germany. It is in no sense - he in no sense goes in the cotton business.
- Taylor: Well, that's what he's going to say he's doing, Herman; that he's found it's profitable for him to go into the cotton business as a side-line in Germany.
- Oliphant: No. If after he gets through with his cotton deal he has the same number of dollars - before as after - and always does and wants only to have the same number, then he's not in the cotton business.
- H.M.Jr: Well, the thing that you fellows are arguing about is the thing we want to get settled, isn't it? And we're sending this to Mr. Hull for his comments. Now, you (Taylor) have initialled this letter to Mr. Hull.
- Taylor: Right.
- H.M.Jr: I'm not asking you (Hanes) for your comment, but I want you to know what I'm doing in case it comes up.

-3-

Reuben: Yes.

James: We're sending this thing over. It says: "Recent information coming to the Treasury Department from responsible quarters, indicating that practices in connection with exports from Germany to the United States involve subsidies that require the application of countervailing duties under section 303 of the Tariff Act of 1930, has led the Treasury Department to inquire into current procedures and reexamine the whole matter."

"The present stage of this examination is set forth in the enclosed memorandum, which is submitted to you at this time for any comment you may care to make."

This is to Mr. Hull. You see, what happened was, we found they were dumping and we got out two orders two years ago - then they revised them - making it possible for them to do a certain special way, certain kind of procedure; and I do think the Germans have outsmarted us in the sense they have taken this device and now are doing two-thirds of their business on that basis. And the whole thing all gets down that they use a roundabout way to make use of a devaluing of their currency without devaluing in fact. Isn't that the simplest way of explaining it?

White: Might put it that way. I think myself this is probably a little bit less defensible, probably more accurate: that they're using this device to get around a prohibition which was announced prior to the initial document.

H.S.Jr: Well, all I'm going to do is send this over to Mr. Hull, and then I ask for his comments, and I think that's the way to proceed. You (White) are satisfied, aren't you?

White: Quite.

Oliphant: Do you want me to follow the idea we had when discussing the matter before: that it is a legal matter and I should get in touch with Hackworth and say this is being sent over - you asked me to call him - and I would send him a copy?

-4-

H.M.Jr: Yes, I do.

Oliphant: I think I'll send it to him. Won't take it over.
I'll call him on the phone and send it to him.
The original will go right to Hull, right?

H.M.Jr: That's right.

Replied to Oct. 31, 1938

281

OCT 31 1938

My dear Mr. Secretary:

Recent information coming to the Treasury Department from responsible quarters, indicating that practices in connection with exports from Germany to the United States involve subsidies that require the application of countervailing duties under section 303 of the Tariff Act of 1930 (U.S.C title 19, sec. 1303) has led the Treasury Department to inquire into current procedures and reexamine the whole matter.

The present stage of this examination is set forth in the enclosed memorandum, which is submitted to you at this time for any comment you may care to make.

Very truly yours,

(Signed) H. Morgenthau, Jr.

Secretary

The Honorable

The Secretary of State

Enclosure

Typed in final form 10/29/38 s

Initialed by Huntington Cairns, Wayne Chatfield Taylor, Harry D. White
Herman Oliphant

Under current regulations of German governmental authorities, the importation of substantial amounts of many German products into the United States has come to be financed through the medium of so-called "barter" arrangements. The essential features of all these arrangements as set forth in Special Circular No. 426, issued by the United States Department of Commerce on July 15, 1938, and other reliable information before the Treasury Department, are:

(1) The prospective American importer of German goods "buys" one of a limited number of kinds of merchandise (cotton or copper in most, if not all, cases) for dollars at the world price. The kind of merchandise to be admitted into Germany for the purpose of the "barter" must be approved by the German import control authorities, and such approval is strictly limited to a very few kinds of goods.

(2) The merchandise is shipped into Germany, having theretofore been sold to a German purchaser for free marks (which, as appears below, are immediately blocked) at a price substantially higher than the mark equivalent of the total cost to the vendor, if such cost is calculated at the current official rate of exchange. This spread or "überpreis" (over-price) is uniformly 33-1/3% in the case of cotton. It has been less uniform but usually greater in amount in the case of copper. In every case the price to be paid by the German vendee must receive

- 2 -

prior approval by the German import control authorities.

(3) The marks paid by the German vendee are required to be paid into special accounts in German banks, where, as mentioned above, they are held as "blocked" or controlled funds for the account of the prospective American importer mentioned above.

(4) Whatever the formal limitations upon the use of such controlled funds by their American owner may be, their only practical use is in payment for German goods to be shipped to the United States. The kinds of goods for which such payment may be made are restricted to those set forth in detail in a list published by the German exchange control authorities on July 19, 1938. Excluded from this list are, in general:

(a) Articles and commodities in which Germany has a virtual international monopoly to such extent that their export at the current high German prices requires no assistance.

(b) Goods of which there is a shortage in Germany so that their export is not favored by the German Government.

(c) Goods composed of foreign materials to such a large extent that their export is objectionable to the German Government because of the drain on

Germany's foreign balances which would result from the purchase of the materials used in their manufacture.

The net result of the above described system would seem to be that, to those who avail themselves of it, the grant of a valuable privilege is being bestowed by the German Government in connection with the exportation from Germany to the United States of the selected kinds of merchandise enumerated in the above mentioned list. It appears that, by restricting imports, fixing import prices, regulating the method of paying for imports, and controlling the disposition of the proceeds of payment, the regulatory system of the German Government has provided a means whereby commodities (cotton and copper) suitable for the purpose may be used as a special medium of exchange for converting dollars into marks on the basis of an assured premium of marks, on condition that the total marks received, including the premium, be used for the purchase of the listed goods to be exported from Germany to the United States.

The purposes and underlying causes of the regulatory system appear to be immaterial. If the result of the system is to benefit exporters in an amount which may be determined or estimated and in such manner that the goods may be sold to the United States for less than would otherwise be possible, it seems clear that there is a bounty or grant within the meaning of our countervailing duty law. The features of the system which give to the American importer certainty as to the premium rate at which his dollars will be converted into marks by the use of cotton or copper as an intermediate and special medium of

exchange, and those features which restrict the use of the enhanced mark proceeds of the exchange transaction, would seem to preclude a conclusion that the premium created in the form of marks to be used for promoting exports is a profit on the sale of the cotton or copper in Germany by the American importer, rather than a subsidy on the export of German goods.

Since the usual and ordinary result of the system in its current operation seems to be the payment or bestowal of a bounty or grant upon the export of German merchandise in the form of an assured sum in marks for the German exporter in addition to the equivalent of the investment made by the American importer in transactions directed solely to payment for the German goods, it would seem clear that such goods which are dutiable under the Tariff Act of 1930 are subject to countervailing duties under section 303 of that Act (U.S.C., title 19, sec. 1303) in the amount of the premium. Dunn v. United States, (1903) 187 U.S. 496; Nichols v. United States, (1919) 249 U.S. 341 (1936) 38 Op. Att'y. Gen. 489.

October 31, 1938

My dear Mr. Secretary:

Recent information coming to the Treasury Department from responsible quarters, indicating that practices in connection with exports from Germany to the United States involve subsidies that require the application of countervailing duties under section 303 of the Tariff Act of 1930 (U.S.C. title 19, sec. 1303) has led the Treasury Department to inquire into current procedures and reexamine the whole matter.

The present stage of this examination is set forth in the enclosed memorandum, which is submitted to you at this time for any comment you may care to make.

Very truly yours,

(signed) H. Morgenthau, Jr.

Secretary

The Honorable

The Secretary of State

Enclosure

Typed in final form 10/29/38 s

Initialed by MC WCT HDW HD

MEMORANDUM

Under current regulations of German governmental authorities, the importation of substantial amounts of many German products into the United States has come to be financed through the medium of so-called "barter" arrangements. The essential features of all these arrangements as set forth in Special Circular No. 426, issued by the United States Department of Commerce on July 15, 1938, and other reliable information before the Treasury Department, are:

(1) The prospective American importer of German goods "buys" one of a limited number of kinds of merchandise (cotton or copper in most, if not all, cases) for dollars at the world price. The kind of merchandise to be admitted into Germany for the purpose of the "barter" must be approved by the German import control authorities, and such approval is strictly limited to a very few kinds of goods.

(2) The merchandise is shipped into Germany, having theretofore been sold to a German purchaser for free marks (which, as appears below, are immediately blocked) at a price substantially higher than the mark equivalent of the total cost to the vendor, if such cost is calculated at the current official rate of exchange. This spread or "überpreis" (over-price) is uniformly 33-1/3% in the case of cotton. It has been less uniform but usually greater in amount in the case of copper. In every case the price to be paid by the German vendee must receive

prior approval by the German import control authorities.

(3) The marks paid by the German vendee are required to be paid into special accounts in German banks, where, as mentioned above, they are held as "blocked" or controlled funds for the account of the prospective American importer mentioned above.

(4) Whatever the formal limitations upon the use of such controlled funds by their American owner may be, their only practical use is in payment for German goods to be shipped to the United States. The kinds of goods for which such payment may be made are restricted to those set forth in detail in a list published by the German exchange control authorities on July 19, 1938. Excluded from this list are, in general:

(a) Articles and commodities in which Germany has a virtual international monopoly to such extent that their export at the current high German prices requires no assistance.

(b) Goods of which there is a shortage in Germany so that their export is not favored by the German Government.

(c) Goods composed of foreign materials to such a large extent that their export is objectionable to the German Government because of the drain on

- 3 -

Germany's foreign balances which would result from the purchase of the materials used in their manufacture.

The net result of the above described system would seem to be that, to those who avail themselves of it, the grant of a valuable privilege is being bestowed by the German Government in connection with the exportation from Germany to the United States of the selected kinds of merchandise enumerated in the above mentioned list. It appears that, by restricting imports, fixing import prices, regulating the method of paying for imports, and controlling the disposition of the proceeds of payment, the regulatory system of the German Government has provided a means whereby commodities (cotton and copper) suitable for the purpose may be used as a special medium of exchange for converting dollars into marks on the basis of an assured premium of marks, on condition that the total marks received, including the premium, be used for the purchase of the listed goods to be exported from Germany to the United States.

The purposes and underlying causes of the regulatory system appear to be immaterial. If the result of the system is to benefit exports in an amount which may be determined or estimated and in such manner that the goods may be sold to the United States for less than would otherwise be possible, it seems clear that there is a bounty or grant within the meaning of our countervailing duty law. The features of the system which give to the American importer certainty as to the premium rate at which his dollars will be converted into marks by the use of cotton or copper as an intermediate and special medium of

- 4 -

exchange, and those features which restrict the use of the enhanced mark proceeds of the exchange transaction, would seem to preclude a conclusion that the premium created in the form of marks to be used for promoting exports is a profit on the sale of the cotton or copper in Germany by the American importer, rather than a subsidy on the export of German goods.

Since the usual and ordinary result of the system in its current operation seems to be the payment or bestowal of a bounty or grant upon the export of German merchandise in the form of an assured sum in marks for the German exporter in addition to the equivalent of the investment made by the American importer in transactions directed solely to payment for the German goods, it would seem clear that such goods which are dutiable under the Tariff Act of 1930 are subject to countervailing duties under section 303 of that Act (U.S.C., title 19, sec. 1303) in the amount of the premium. Dowds v. United States, (1903) 187 U.S. 496; Nichols v. United States, (1919) 249 U.S. 34; (1936) 38 Op. Atty. Gen. 439.

Typed 10/29/38
cp

Summary Statement on Countervailing Duties

Section 303 of the Tariff Act of 1930 provides for the imposition of countervailing duties whenever there is paid or bestowed directly or indirectly any bounty or grant upon the manufacture or production or export of any dutiable article or merchandise manufactured or produced in a foreign country.

Order of June 4, 1936

On June 4, 1936, the Treasury issued an order announcing the application of countervailing duties to certain German products. This order was based upon information in possession of the Department disclosing that exports from Germany to the United States of particular commodities were being aided by the following three devices:

- (1) Payments of direct cash bounties by German industrial associations.
- (2) Scrip and bond procedures.
- (3) Currency manipulations.

The first device requires no comment.

The second procedures involved the use of certain foreign-owned German bond coupons and securities. The foreign creditor received substantially less than par in foreign exchange; the German debtor paid his full obligation in marks into a German bank; and the difference was used to aid exports. These procedures appeared to the Treasury to amount to the bestowal of a bounty or grant.

In the case of the third device, controlled marks were used in payment for goods exported from Germany. These marks were purchased

- 2 -

by American exporters at substantial discounts. It was the Treasury's view that a bounty or grant was bestowed in the amount of the discount.

The views of the Treasury were submitted to the State Department in the Spring of 1936, and on April 2, 1936, the Secretary of State advised the Treasury that, in his opinion, there was considerable doubt with respect to the soundness of the Treasury's legal position. On April 15, 1936, the General Counsel of the Treasury concluded in a formal opinion that a bounty or grant was bestowed within the meaning of the statute in all three cases mentioned above.

On April 16, 1936, the Secretary laid the matter before the President, together with the letter from Secretary Hull, dated April 2, 1936. The matter was referred by the President to the Attorney General, who advised the Secretary on June 2, 1936, that the Treasury Decision subsequently issued on June 4, 1936, was within the requirements of section 303.

Thereafter, during the summer of 1936, a German mission was in this country to protest the order of June 4. The German Government later acquiesced in the order by agreeing to discontinue the three procedures dealt with therein. The mission sought from the Bureau suggestions of methods of handling their exports which would be within the law. These were consistently refused.

Thereafter, the Bureau received numerous inquiries from American importing, exporting and banking interests asking whether various hypothetical procedures tying up German imports to this country with

the export of American products and involving old holdings of marks would be within the law.

Press Release of December 23, 1936

On December 23, 1936, the Treasury Department issued a press release holding that certain procedures in connection with imports from Germany did not involve the payment or bestowal of any bounty or grant within the purview of section 303. For present purposes, the principal import procedure approved involved the payment of the purchase price in whole or in part with the proceeds of the sale in Germany of merchandise exported from the United States, provided that the proceeds so used were continuously owned by the person for whose actual account the American merchandise was sold in Germany and the German goods were purchased in that country.

December 23, 1936, to Present Time

It now appears that the picture has radically changed since the issuance of the press release of December 23, 1936. The principal import procedure above described has become a standard device for financing imports from Germany at reduced costs. On July 15, 1938, the United States Department of Commerce published Special Circular No. 426, outlining the procedure for the information of American traders and giving an English translation of the controlling German regulations. This publication, recent indications of the surprising volume of trade carried on under the procedure, and new information from our Treasury Attache at Berlin have led us to reexamine the matter in the light of the current situation. This reexamination indicates that what seemed in December, 1936, to be only an opportunity, in a limited class of

- 4 -

cases, to utilize commercial profits to offset high German prices has been developed into a systematic device which is operated to subsidize exports to the United States.

A regulated over-price is paid on the two American articles now extensively used in the procedure. On cotton the over-price is uniformly 33-1/3%, and on copper it ranges from 50 to 70%. Thus the selected commodities perform the function of a special medium of exchange; in reality, they amount to a form of money and are utilized as such in addition to dollars and marks. This over-price furthers exports by permitting a reduction in the cost of the purchasing mark. In essence it is a substitution for a selective or discriminatory devaluation of the mark.

Possible Future Action

Before any action is taken, we should secure a more detailed description of present practices and additional evidence of their use. Special inquiry along these lines has been made of Erwin G. May, Treasury Attache at Berlin, who happens to be in this country at this time.

If and when it is proposed to make any of the present practices the basis of Treasury action imposing countervailing duties, the procedure followed before the issuance of the order of June 4, 1936 might well be used again. Thus a letter would go to the State Department indicating the Treasury's views, and, when its response was received, the Treasury would advise the President that, under all the circumstances, he might want to secure the opinion of the Attorney General before final action was taken.

HC/HO:s Retyped 10/29/38

American Exports to Germany

Calendar Years	1937	1936
Cotton, cotton linters and cotton waste.....	\$55,000,000.....	\$49,500,000
Petroleum, crude, and derivatives.....	20,000,000.....	18,500,000
Copper and copper scrap.....	12,500,000.....	7,000,000
Tobacco, unmanufactured.....	1,400,000.....	1,300,000
Dried and evaporated fruits.....	1,250,000.....	1,250,000
Lumber.....	1,000,000.....	1,400,000
Aircraft.....	<u>1,000,000.....</u>	<u>1,400,000</u>
Totals.....	\$92,150,000.....	\$80,350,000
Total Exports.....	\$125,800,000.....	\$100,600,000

Chart prepared by Div. of Statistics and Research, Customs
to take place of these figures photostated by
Cairns 10/29/38 - six copies were made

October 31, 1938

I spoke to the President last night at 6:30 and told him what had come over the UP ticker at 5:51 (Attached) I said that I had told Cochran that I could not comply with Mr. Deladier's request that I indicate to him what the message was that Mr. Monnet was carrying; that I felt that this was such an important decision that I wanted his approval. The President said, "How much time has Deladier got to get out his decrees?" I said, "Until November 15th". The President said, "That gives him time enough".

At the time I spoke to the President, I had not seen the UP story indicating that the French were waiting to hear from the United States.

At lunch the President told me how he told Baron de LaGrange, who used to be in aviation, all about the French airplane situation and that this Frenchman said it would be crazy to build planes in Canada and that the place to build them was Morocco. The President said, "He is right". I am very suspicious that the President told this Frenchman the whole story because he told me that he had gone so far as to tell him that the French had two alternatives - (1) To become a vassal of Germany or (2) To rearm and take the chance that while they were rearming Germany would jump the gun and try to destroy the French.

At my suggestion, the President is going to invite three of the leading manufacturers in America who are not interested in airplane activities to come down at a dollar a year and later take full charge of production after the Army has turned over to them the blueprints of the model that they want.

PARIS--THE GOVERNMENT DECIDED TONIGHT TO ASK WASHINGTON'S ADVICE AND APPROVAL OF THE MONETARY ASPECTS OF ITS RECOVERY PROGRAM BEFORE ITS FINAL ADOPTION.

AN AUTHORITATIVE SOURCE SAID THE CABINET DECIDED TO HOLD UP FURTHER DISCUSSIONS UNTIL 5 P.M., TOMORROW, PENDING WASHINGTON'S REPLY.

ONE GROUP OF CABINET MINISTERS WHO CONSIDER THE MONETARY QUESTION THE CRUX OF THE RECOVERY PROGRAM, PROPOSED TO DECREE REGULATIONS SIMILAR TO THE PROHIBITION BY THE UNITED STATES IN 1933 OF PRIVATE GOLD HOLDINGS, REGULATING FOREIGN EXCHANGE TRANSACTIONS, CREDIT TRANSFERS AND CURRENCY EXPORTS ABROAD.

THIS GROUP CONTENDED THAT SUCH REGULATIONS WILL NOT CONTRAVENE THE TRI-PARTITE MONETARY AGREEMENT AMONG FRANCE, BRITAIN AND THE UNITED STATES, INASMUCH AS IT WAS EMPLOYED BY THE UNITED STATES AND IS NOT INTENDED TO CONTROL EXCHANGES BUT TO PREVENT FURTHER CAPITAL FLIGHTS AND FORCE HOARDERS TO DISGORGE THEIR GOLD.

10/31 ON526P

ADD FINANCES, PARIS

THE GOVERNMENT DECIDED TO ASK WASHINGTON WHETHER THE UNITED STATES SHOULD CONSIDER SUCH REGULATIONS ON FRANCE'S PART AS INCOMPATIBLE WITH THE TRI-PARTITE AGREEMENT.

IF SUCH MEASURES ARE HELD BY WASHINGTON TO BE INCOMPATIBLE WITH THE THREE-POWER ACCORD, THE UNITED STATES WAS ASKED TO CONSIDER MODIFICATION OF THE AGREEMENT TO PERMIT THE REGULATIONS.

THE GOVERNMENT WAS UNDERSTOOD TO HAVE DECIDED TO MAKE CLEAR, IN ITS COMMUNICATION TO WASHINGTON, THAT FRANCE HAS NO INTENTION OF IMPOSING FOREIGN EXCHANGE CONTROL BUT URGENTLY REQUIRES SOME MEANS TO FORCE HOARDERS TO SURRENDER ABOUT 20,000,000,000-(B) OR 30,000,000,000-(B) FRANCS IN GOLD, PREVENT FURTHER EXPORTS OF CAPITAL AND GAIN FIRM CONTROL OF THE FRANC'S PARITY.

10/31 ON551P



HEADQUARTERS

TREASURY DEPARTMENT

UNITED STATES COAST GUARD

WASHINGTON 31 October, 1938.

From: Spagent, Hongkong, China.
To : Secretary of the Treasury.

Message from Mr. Campbell.

Buck left for Chengtu October 28. Expects
return Chungking in three weeks time. His Chengtu
address is Department Agricultural Economics number
sixteen Chien lien hang.

SECRET

October 31, 1938.

Dear Abe:

I am writing this very confidential letter which I suggest that you tear up after you have read it.

Of course, I have known of certain personal difficulties that you had several months ago and I had sincerely hoped that there would be no further recurrence.

I am terribly disturbed because the inevitable Washington grapevine has been telling stories of what happened at a dinner at which you were present last week.

It has occurred to me that it might be advisable to change your assignment. Have you any suggestions to make?

As ever your friend,

Admiral C. J. Peoples,
Director,
Procurement Division,
Washington, D. C.

Project Outline.

4. The effect on national income of federal fiscal operations outside the budget.

This problem involves two separate sets of considerations, 1) how can you get the maximum effect on national income of a limited quantity of direct federal expenditures, 2) what procedures will be most useful for this end?

The study of this problem will involve several stages:

- a) Listing of federal agencies now conducting fiscal operations outside the budget, and collecting information on the manner and extent of their operations.
- b) Analysing the way these agencies operate, and possibly developing several different classes according to the effect of their operations.

For example, F.H.A. largely is limited to facilitating (through pooling risks) the direct investment of private funds. F.C.A. sells debentures on the open market, and itself invests the funds. It receives some appropriations to maintain low rates. U.S.H.A. depends on annual appropriations to subsidize below-the-market interest rates. What are the effects of each of these alternative methods on national income? What are the effects on the credit of the United States? How far can each such method be expanded without future drain on the federal treasury?

- c) Summarizing the extent of operations of each class, and their total effect on the economy, in comparison with direct federal spending.
- d) Studying federal fiscal agencies which now operate within the budget, selecting those which might be shifted, in whole or in part, to outside-the-budget position, and developing for each such agency the methods of operation outside the budget which seem most appropriate for its activities.

Examples of agencies that might be shifted include the Post Office, irrigation and power districts, T.V.A., R.E.A., Rural Rehabilitation loans, Farm Tenant Loans, and acquisition and administration of national forests.

- e) Studying desirable new public fiscal activities that might be established on an outside the budget basis, and developing the methods of operation which would be most appropriate for each.

Examples include the proposed Federal Railway Equipment Corporation and Toll Road Authority.

- f) Summarizing the extent of operations possible under d) and e), and the effect of such operations 1) on the national economy, 2) on the federal budget, and 3) on the future credit of the United States.

As these several stages of analysis are completed, interim reports can be prepared on the significance of such operations, and as to possible or desirable extensions.

Investigation Required:

303

3. Principal Barriers to Practical Full Employment and High National Income.

The principal barriers to practical full employment fall into three main groups, physical barriers, industrial barriers and fiscal barriers.

Physical barriers can arise, such as

1. Deficiency of plant and equipment in particular industries.
Have the railroads sufficient equipment to carry the tonnage that would develop with full employment? Is there sufficient electric power generating capacity? Has the steel industry sufficient plant?
2. Deficiency of particular skills in the labor force.
In what fields has the unemployment of recent years resulted in a lack of trained workers? What are the industries in which rapid expansion is likely to call for more trained workers?

Barriers to practical full employment can arise in the industrial field (broadly defined to include agriculture), such as,

1. Arbitrary price increases like the rise in steel prices in 1937.
2. The breakdown of collective bargaining and resulting strikes and lockouts. The possibility is increased by C.I.O.-A.F.L. conflict.
3. The development of too great increases in hourly labor rates which put current labor costs too high in relation to current prices.
4. The development of unwieldy agricultural surpluses.

Barriers to practical full employment can also arise in the fiscal field, such as,

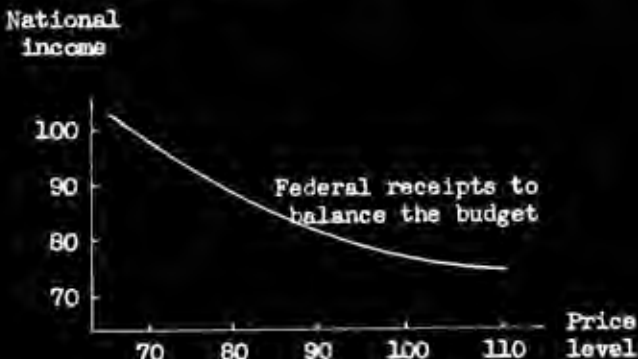
1. A tendency to oversave in relation to investment opportunities, thereby providing insufficient current expenditure on consumption.
2. Unbalance in the composition of investment funds in relation to the risk character of investment opportunities. Funds seeking senior investment cannot be absorbed as equity capital and in excess could be as much of an impediment to full employment as oversaving.

The above list makes no attempt at completeness but does indicate the types of barrier to full employment which exist or can arise. It suggests the need for a technical study of each possible barrier, 1) to establish its existence, character, and if possible, the magnitude of its influence, and 2) to bring to a focus all of the possible ways of dealing with the particular barrier so that the makers of policy can survey the alternatives and develop a coordinated yet flexible system of policies covering all of the major barriers. This is necessary because the methods of dealing with one barrier are so often dependent on the methods adopted to deal with other barriers.

Preliminary Report on the Problems Involved in Attempting
to Answer the Question of the

"Amount of national income to balance
the budget (a) at different
price levels."

If the Advisory Committee will specify the amount of money necessary to balance the budget, the treatment of Social Security expenditures and receipts, and also indicate the type of further assumptions which they approve and which are presented later in this memorandum, we feel that we may be able to present our answer in somewhat the following fashion:



Unless some shortcuts not now in sight can be devised, the work involved in getting the basic material necessary to present this over-simplified concept of the desired relationship involves work equivalent to the making of twenty budget estimates similar to those annually prepared for inclusion in the President's Budget Message. This estimate of volume of work assumes that some one year can be specified at which time the amount required to be raised is to be yielded by the tax system. We estimate that this work will take about one full month's uninterrupted work of all people now engaged in working on revenue estimates which means that with our other duties the work would have to be spread over several months. If more than one year is specified, the work will be correspondingly multiplied because of the complications presented by the time factor of advancing Social Security tax rates.

In order to prepare the required estimates it is necessary that we know the size of the budget which is to be balanced, whether it is to be balanced over some long period such as a 10-year interval, and whether the budget is to be maintained at a constant level for the purposes of this problem.

We need, further, to know whether the budget is to include all expenditures to be made under the Social Security laws or simply the grants in aid. If all of the Social Security type of expenditures are to be included, the level of national income necessary to balance the budget will vary in different years since the rates of tax under Title VIII of the Social Security Act and under the Railroad Retirement Act increase gradually until 1948.

We believe that any attempt to correlate revenue merely with the level of national income is foredoomed to failure. Moreover, planting in the official or public mind a belief that such a correlation exists and that revenue can be estimated from the amount of the national income is likely to result in disastrous misunderstandings. There is no one answer as to the amount of revenue at a given level of national income. The course of the national income upward, downward, sidewise or irregularly fluctuating may well have as much influence upon the revenue as the level of national income.

Some other assumptions as to the course of national income might be made but the following appears to be not only feasible to handle but likely to be especially informing for immediate policy-determining purposes.

Our suggestion for approaching this problem is to assume that for each level of national income for which we make revenue estimates the recent course of national income has been upward and at a gradual and sustained pace and that such course is persisting. This implies that any given high level of national income is reached after an advance from a lower level and not after a decline or a plateau of that same level. It implies that the given high level is not attained by any violent expansion such as would raise national income in 1939, for example, to \$85 billions, but rather that the \$100 billion level of national income paid out is reached after a gradual rise over a 10-year period. It implies that the recent course of national income has not been jumpy with frequent short-term oscillations but has been at a sustained, though of course, not absolutely rigid pace. It implies that the upward movement of national income is still in progress at any given level and that the particular high level is not just preceding a decline.

In determining the amount of national income which will balance the budget, we must know whether the concept of national income produced or national income paid out is intended. In recent years there has been as much as \$9 billions difference between the two types of national income. In estimating revenue each concept is helpful in connection with particular taxes.

If the foregoing assumptions as to the movement of national income are adopted, we suggest utilizing the Department of Commerce concept of national income paid out and making adjustments where necessary to arrive at a concept of national income produced.

Another assumption must be made as to the distribution of the national income at each of the suggested levels. Is the national income produced to be produced by the various segments of our economy, i.e., agriculture, manufacturing, etc., in the same proportions as at present? Is the national income paid out to be made up in the same proportion of wages and salaries, dividends, etc. as at present? If so, will these additional payments for wages go to increase the wages of individuals already employed or will they be spread over a larger number of workers? Is the present trend towards the breaking up of large fortunes by the high tax rates of the present law to be continued with cumulative effect? This is particularly important because of the steeply progressive rates of the individual income and estate tax laws.

Then assumptions must be made as to the future course of public policy along the lines of taxes, expenditures, labor, and prices. If the Advisory Committee can suggest bases for assumptions in regard to these problems they would be very helpful. Failing such suggestions, we propose the following assumptions:

1. We shall assume that all revenue estimates are to be made on the basis of the existing revenue laws, including an extension of the corporation income tax, the temporary excise taxes and such future changes in rates as are now contained in these laws if the Social Security, Railroad Retirement and Railroad Unemployment Insurance taxes are to be included in the estimates. This fixation is particularly helpful as it facilitates application of the taxes to our estimate of the tax base. It enables us to limit our study of economic effects of tax burdens to the existing structure of taxes.

2. On the expenditure side of the budget we shall assume that no important change in agricultural policy either in degree or in kind will be made. Any shifts in the share of the income going to agriculture, as contrasted to manufacture, make a difference in the amount of tax collections. We assume that as the money spent on relief and public works is reduced because of enlarged employment and salaries, those funds will be made available for debt reduction.

3. Official policy concerning labor has a vital bearing upon our estimates. Existing policies tend to reduce the lag between advancing wages and expanding activity, and hence narrow profits margins, and both of these tendencies affect the tax base not only as to its amount but also as to the rates applicable thereto. Existing policies possibly

-4-

account for a greater tendency toward industrial dispute and the consequent economic instability of a given national income level. Unless the Committee suggests otherwise we feel bound to assume that present policies will continue and have accumulating effects.

4. Official policy with respect to the price level is also capable of affecting our estimate. Unless otherwise advised we shall assume that existing domestic policies will not be altered either in degree or in kind whether as regards policies in the money and banking area or other policies intended or alleged to affect prices. We shall have to assume that there are no extraordinary policies adopted in other countries which affect world prices and hence price movements in the United States will be responsive almost entirely to narrow economic realities.

One further point regarding prices needs to be clarified. The question is "amount of national income to balance budget at different price levels". It is important from a revenue estimating point of view to know what kind of prices are meant. For our purposes the wholesale commodity price level has more significance than any other concept of prices. Unless otherwise advised, we shall assume, as in the case of national income, that a particular price level has been reached after a gradual rise in prices and that the prices of farm products have the same relative weight in the index as at present.

With the foregoing set of assumptions, it is possible to attempt an answer to the question posed although the answer will be subject to a substantial margin of error. It is not possible to approach directly the problem of determining a level of national income which at a designated price level will yield the specified sum necessary to balance the budget. This is so because the national income as such is not subject to tax. Various parts of the national income, or various aspects of it, do control the tax base for particular taxes. We shall, therefore, have to approach the problem by associating with several assumed levels of national income various associated price levels and by making assumptions with regard to the physical volume of production most probably associated with such national incomes and such price levels. The physical volume of production can be estimated independently but an alternative and easily defended approach is to associate a definite value of production with a given level of national income and then infer the physical output for each assumed price level.

The various price levels associated with a given national income will center around the price level which we feel would most probably be associated with that level of national income under our assumptions,

other price levels will deviate on each side of that most price level. We will have to make at least three or four for each level of national income.

This procedure will give us estimates similar to those previously for five assumed levels of national income over the next under conditions where the value of industrial production is of varying price and physical volume of production components. These data graphically presented we can prepare the chart indicated on the first page of this report.

Effect on National Income of Principal Budget Classifications

I. General Approach

From the standpoint of the effects upon the national income of the various classes of governmental receipts and expenditures, the most useful immediate approach is to apply the touchstone: Does this class of receipts tend to reduce current consumption or does it tend to reduce pecuniary capital accumulation; and does this class of expenditure represent a true cost of government or does it represent merely a transfer of income from one class to another; and, in the latter case, does this transfer stimulate consumption or pecuniary capital accumulation?

By "pecuniary capital accumulation", as the term is used in this memorandum, is meant the amount by which the money expenditures of any individual or corporation fall short of his or its money income. The amount so saved from current consumption may be invested by the individual or corporation in physical capital goods, or it may be allowed to accumulate in money or bank deposits, or invested in securities. In the latter case, it may or may not find final investment in physical capital goods, depending upon the actions of the banks, of the parties from whom the securities are purchased, and of others more remote.

In times of full employment, most or all pecuniary capital accumulation results in investment in real capital goods. In times of widespread unemployment, a large portion of it may "run to waste" and so further aggravate the existing depression. The individual or corporation accumulating pecuniary capital can never know and is not directly concerned with the final social results of his or its accumulation. The Government, however, is vitally concerned with these results, and for this reason an analysis of the effects of different categories of receipts and expenditures in stimulating or repressing consumption and pecuniary capital accumulation, respectively, is of vital importance in the adoption of appropriate and flexible fiscal and general economic policies for the treatment of booms and depressions.

The question of whether a dollar of deficit-financed Federal expenditure creates more than a dollar's worth of national income when expended in all or in certain channels -- i.e., the question of the "multiplier" so-called -- has been reserved for further study and is not treated in this memorandum.

In the following outline and discussion, convenience dictates the use of straight declarative sentences, when in many cases the statements should be regarded as contentions to be established, and preferably measured quantitatively, or disproved, rather than as pure affirmations.

II. Tax Receipts

From our present standpoint, the principal Federal taxes may be divided into two classes:

(1) Taxes that tend primarily to curtail current consumption:

- (a) Excises.
- (b) Processing taxes.
- (c) Customs duties.
- (d) Payroll taxes.

(2) Taxes that tend primarily to curtail pecuniary capital accumulation:

- (a) Death and gift transfer taxes.
- (b) Corporation income taxes.
- (c) Individual income taxes.
- (d) Undistributed profits tax.

III. Expenditures

From our present standpoint, the principal Federal expenditures may be divided into the following classes:

(1) Regular operating expenditures, exclusive of public works and interest on and reductions in the public debt:

The ordinary costs of government, consisting principally of salaries and supplies, do not significantly affect the published figures on national income during periods of fairly full employment. This is because, under such conditions, employment with or sales to the Government may be considered as substitutionary for rather than additive to corresponding employment in or sales to private

industry and because the published figures always take the services of government into the national income at exactly what they cost. In times of widespread unemployment, an expansion in the ordinary costs of government would increase the published figures for the national income.

It should be clearly borne in mind, however, that, to the extent that the expenses of government are expanded or fail to be contracted because of inefficiency, the real national income, in terms of consumers' satisfactions, is not accurately expressed by the computed national income, in the calculation of which it is a necessary statistical convention to consider the value of the services of government to be equal to their cost.

In general, the ordinary services of government present an unpromising field for the conscious introduction of fluctuations in current expenditures with a view to influencing the national income. It is best that the only considerations should be the necessity of the services, or their value to the public, and the costs of rendering them, and that they should be rendered in the most efficient -- i.e., low cost -- manner possible. An expansion in the cost of general government brought about during a period of depression for "pump-priming" purposes would be likely to prove an incubus during a subsequent period of prosperity. Even in the field of ordinary governmental costs, however, a certain minor degree of flexibility is possible, as has been evidenced from time to time in the Treasury's policy of bunching orders for most of a year's supplies in periods of acute weakness in business.

(2) Public works and purchases of capital goods:

Variations in the expenditures on these items to act in such fashion as to compensate in some measure for opposite fluctuations in private industry are clearly desirable. In periods of fairly full employment, expenditures by the Federal Government in these fields may fail to add one cent to the national income; whereas, in other periods, a very large fraction of the entire gross expenditure may conceivably constitute a net addition to the national income.

(3) Interest on the public debt:

This type of expenditure largely represents a transfer of income from one class to another. That part of the interest on the public debt which is paid to commercial banks may for some purposes be regarded as a cost of maintaining the banking system, and so ultimately diverted in large part to consumption through the medium of disbursements for banking expenses. The rest tends to promote pecuniary capital accumulation, whether it be paid to insurance companies, savings banks, or to wealthy individual rentiers. In general, so long as a significant fraction of the public revenues is derived from taxes on consumption, the greater the amount of interest payable on the public debt, the greater is the stimulus to pecuniary capital accumulation; for the payment of such interest tends to constitute a transfer of income from the lower income groups to the upper income groups of society.

(4) Debt retirement:

Actual net expenditures for debt retirement out of current tax receipts tend to divert national income from current consumption to capital accumulation, when any significant fraction of the Federal revenues is obtained from the taxes on consumption. Debt retirement swells the volume of funds available for private capital investment. If such additional funds are made available during periods of strain in the capital markets, the effects upon the national income are probably favorable. If, on the other hand, debt retirement takes place at times when a large volume of additional investment funds already exists, the effect is likely to be a diminution in the national income. The timing and volume of debt retirement and their relation to the national income demand the most careful study.

(5) Direct relief and work relief expenditures:

Under a balanced budget, expenditures for these purposes tend to promote current consumption, and therefore under conditions of subnormal business activity, they tend to increase the national income. In important measure, under such conditions, they represent transfers of the national income from

members of the upper income classes to members of the lower income classes, or the payment to the lower income classes of national income which might otherwise not have existed. They should not be considered as true costs of government.

When tax revenues are inadequate and such expenditures are financed by borrowing, their direct effects are strongly in the direction of increasing the national income. This is true even if the securities issued are sold to bona fide savers, for the latter in many cases would otherwise have merely hoarded their pecuniary savings. The effect is more pronounced when the obligations issued to finance these expenditures are purchased by commercial banks, for in this case there is a net expansion in the volume of effective currency and substantially no diminution in the volume of funds available for investment.

The indirect effects of deficit expenditures for direct relief and work relief are more debatable. It is contended by some that a deficit so occasioned exerts no net stimulating effect upon the national income because it inhibits investment expenditures of the same or even greater amount by private business.

The contrary is also contended. It is held by some that capital investments respond far more directly to immediate consumption demands than to remoter psychological influences; and that the increase in consumption which is engendered by deficit spending therefore stimulates capital investment.

Varying measures of truth no doubt reside in both contentions as applied to different parts of our economic structure; and both merit careful study.

(6) Social security expenditures:

Except for the administrative costs involved, the cash outlays for social security expenditures largely represent transfers of income from one class to another, rather than true costs of government. These cash outlays likewise tend to stimulate current consumption rather than capital accumulation.

The non-cash expenditures for social security -- notably appropriations to the Old-Age Reserve Account which are met by transfers to that Account of interest-bearing Government securities -- are in a different class, however. When the budget is formally unbalanced, these non-cash expenditures should be deducted from the net deficit in order to arrive at the true current cash deficit. The national economy obtains no stimulus from a non-cash deficit expenditure. In other words, so far as effects on the national income are concerned, the only social security expenditures that count are the cash expenditures.

IV. Borrowing

The national economy is affected not only by the sources of Federal tax receipts, the kinds and amounts of Federal expenditures, and the amounts of Federal deficits and surpluses. It is also influenced by the character of the deficit financing, and, as suggested in the preceding, by the timing and volume of debt retirements.

In the years 1933 to 1935, inclusive, the Nation's economy was suffering from a shortage of currency media because of the previous drastic reduction in the volume of bank deposits, a reduction occasioned by the great deflation of bank loans. Under such circumstances, it was highly desirable for the Federal Government, in issuing securities, whether for new money or for refunding purposes, to issue them in such form and with such maturities as would particularly attract bank investment. The purchase by commercial banks of Government securities would add to the volume of bank deposits. Under such circumstances, it was natural, therefore, that the Treasury met a large part of its needs through the offering of short-term securities -- in this case, Treasury notes and bills.

A little later, when the volume of bank deposits was restored to 1929 levels, and it was desired to tap part of the large volume of idle and frightened investment funds of institutions and private individuals, longer-term securities were offered.

Possibilities of Increased Flexibility in Expenditures and Receipts

Greatly increased flexibility in the timing of expenditures and possibly in receipts would be highly desirable in the light of the experience of recent years.

I

As respects expenditures:

(1) Our previous experience suggests the desirability of procuring substantially uniform enabling legislation on the part of State and local governments that would permit ready participation in national spending programs. However much or little subject to criticism on other grounds, it is generally conceded that statutory obstructions seriously impeded many public bodies in their efforts to utilize the P.W.A. program.

(2) A perpetual inventory of desirable projects, Federal, State and local, should be maintained by some Federal body and variously cross-classified as to type, cost, time necessary to complete, types of labor and materials required, distribution of total costs between direct labor and materials, etc.

(3) Analysis might well be made of the possibilities of articulating prospective State and local public works projects with prospective Federal projects into a comprehensive but flexible long-range program which would be capable of ready inauguration and susceptible to ready curtailment. This may well involve the division of nearly all projects into small units, one or more of which can be inaugurated at a time.

II

As respects receipts, the difficulty of accurately determining income during the period in which it is being earned -- delays in the receipt of various bills, inventory adjustments, depreciation, etc. -- and the great complexity of the laws and regulations, conspire to make it difficult

to achieve any great range of flexibility in income taxes. Flexibility in income tax receipts there is, but it is an unsought flexibility arising out of fluctuations in taxable income.

Greater flexibility is possible in the field of excise taxes and the like, but there are important economic objections to frequent changes in such taxes: Commodities differ considerably in the elasticity of their demand schedules. The competitive relationship existing between different products is commonly disturbed by new excise taxes because of this fact and numerous and often costly readjustments are required.

Perhaps the most practicable and desirable type of flexibility with respect to tax receipts would be achieved if the proper authorities were given the power to raise or lower either the normal income tax alone or all income tax rates uniformly within a range stipulated by Congress.

It may be noted that over-all flexibility in receipts is achieved in at least one sense and in one direction by the ability of the Government to borrow.

ALL TAX-EXEMPT FEATURE ON LOCAL HOUSING AUTHORITY BONDS

October 31, 1938.
11:45 a.m.

Present: Mr. Ames
Mr. Taylor
Mr. Dillman
and Klotz

Dillman: "My dear Mr. President:

"I wish to make some observations in connection with the plan submitted to you by Mr. Straus for financing low-rent housing projects by the sale of the obligations of local housing authorities to private investors instead of to the United States Housing Authority. You will recall that the bonds of the local housing authorities would be exempt from all taxation now or hereafter imposed by the United States, in contrast with the United States Housing Authority's obligations guaranteed by the United States which are subject to the Federal surtax.

"Consideration in connection with this proposal should be given to the question whether the added subsidy to low-rent housing which it involves in addition to that otherwise already provided should be granted. This subsidy, while difficult to appraise accurately, is estimated to be somewhere between one-half and three-quarters of one per cent on a fifty year three per cent bond. Expressed in terms of price, this would amount to between \$160 and \$250 on each \$1,000 bond."

H.M.Jr: How much?

Dillman: "... between \$160 and \$250 on each \$1,000 bond" - a three percent 50-year bond. The boys didn't have any tables going beyond 50 years.

"The cost to the Government, however, in lost revenues from full tax-exemption would be even greater than its value to the market. The extent and character of this revenue loss can be seen readily from an examination of the attached two tables where a comparison is made of the value of full tax-exemption to individuals in

-2-

various tax brackets. It is difficult to state accurately the amount of this revenue loss but it may be regarded as reasonably certain that the loss to the Federal Government will exceed the amount of the interest saving to the local housing authorities."

Paragraph. Now, that's point number one.

Point number two: "Regardless of the fact that the tax exemption proposed is now fully authorized by law, any such large increase in fact in the amount of outstanding tax-exempt securities should be considered in the light of the spirit of what you said to Congress in your message on this subject of April 25, 1938, copy of which is attached." That's point number two.

Point number three - and this is the most important one, the one I wanted to check carefully with you: "A further consideration in this connection is the effect of the local issue and sale of any such amounts of these bonds upon the credit and the good faith of the United States. They could be sold at the rates and in the amounts proposed only if prospective purchasers thought that the credit of the United States was pledged to the payment of the bonds of the local authorities, i.e., that Congress would every year, for the full term of the bonds, make the annual appropriation of the subsidy involved, and that it would be used to pay principal and interest on the local bonds. If a particular Congress failed to make such appropriation; or if the United States Housing Authority for good cause withheld payment of the subsidy; or if the local housing authorities failed to use the subsidy to pay principal and interest on their bonds, the resulting default would, in the minds of the purchasers of these bonds, be deemed a default by the Government of the United States."

And I've put that in because his plan is, when he gets your approval on this, to get the opinion of the Attorney General.

H.A.Jr: Whose plan?

Whipant: If he gets your approval - their plan was to get the Treasury's approval and then get the opinion of the Attorney General.

-3-

"No present administrative or legal determination can remove this uncertainty. Future Congressional and administrative action is, and will be, conditioned upon satisfactory performance of numerous future acts by the local authorities involved. It is the future withholding of the subsidy by the United States Housing Authority, not its position as a minority bondholder, that was intended as the sanction to compel the local authorities to act in the future as they should."

Now may I explain what I mean by that.

H.M.Jr: I understand.

Wipmunt: He intended to hold a few of the bonds and have a position as a minority bondholder.

"Thus, the obligation to make future appropriations and payments is subject to substantial conditions, and hence these bonds are not the equivalent of Government guaranteed bonds, although the public would not buy them at a low yield on any other basis.

"Sincerely yours,"

H.A.Jr: Well, you don't end up "Therefore, I recommend that he shouldn't."

Olliphant: I'll be glad to add that.

H.A.Jr: "Therefore, I recommend to you, in view of the above statement, that Mr. Straus be directed not to sell these go-and-so." You see?

And then I want down at the bottom the usual thing: "Approved by the President of the United States." A place for the President to write, "Approved: Franklin D. Roosevelt."

Do you think you could have that within an hour for me, just that last page?

Olliphant: Yes.

H.M.Jr: Are you (Taylor) with me?

-4-

Taylor: Absolutely.

H.M.Jr: We're together.

Taylor: Absolutely.

H.M.Jr: The last page should have "Therefore, Mr. President, in view of this foregoing - so forth - I recommend - hereby recommend that the thing"

Oliphant: "... that this plan be disapproved - that you disapprove this plan."

H.M.Jr: "... that the plan be disapproved." And down in the corner a place for the President to say "Approved." My letter - you see?

Oliphant: Yes.

H.M.Jr: What? In the corner, you know.

Oliphant: Sure. Now, Straus has ...

H.M.Jr: Now, just a second, Herman, because I'm fighting time, and I want to get there's a - in the preparation, you haven't been hurried, have you?

Oliphant: Oh no. See, these things were scheduled for Monday, all of these things.

H.M.Jr: So there is no doubt in your mind.

Any in yours (Taylor)?

Taylor: No. I talked to Ed Foley at great length about this, and it's - I'm entirely

H.M.Jr: We'll do what we said we'd do, let Straus see this before ...

Oliphant: Now, Straus is out of town, and what he did - he tried to get hold of it Saturday, but we weren't ready yet. And he sent a note to the President - he sent a letter to the President and sent a copy over to you with a pencilled note on it, somebody said.

H.M.Jr: I haven't seen it.

-5-

Oliphant: Do you want to see it?

H.M.Jr: Have you seen it?

Oliphant: I haven't seen it.

H.M.Jr: (On phone) Mrs. Klotz please. - Mr. Straus told Mr. Oliphant that he sent a letter over to us on Saturday. - Fifteen minutes

Just came in 15 minutes ago.

Oliphant: Ed got that from some subordinate of his. He's out of town until Thursday.

Actually the situation is this. This is Keyserling's idea. Keyserling is handling it. Keyserling is so upset about it, he left Wagner, came down here Saturday, hoping to get the letter.

H.M.Jr: Well, it's funny, I said to Mrs. Klotz, "The one person I don't want to have sit in on this thing is Keyserling; because I smell Keyserling."

Well now, in good faith to Straus, do we have to show it to him?

Oliphant: Show it to Keyserling.

Taylor: Have to show it to Straus.

H.M.Jr: Well, I can't show it to him.

Taylor: In terms of timing, I think either you ought to call him up on the telephone ...

Oliphant: This is pretty dishonest trickery.

(Mrs Klotz brings in letter
from Straus)

H.M.Jr: Well now, wait a minute. Straus writes the President. He didn't show it to me.

Taylor: But you did tell him

-6-

H.M.Jr: Well, let Keyserling come on over.

Oliphant: Keyserling went back.

H.M.Jr: "This is a copy of the letter I am sending the President on the subject of the sale of local housing authority bonds to private investors. The President indicated his approval of the plan when I discussed it with him briefly at Hyde Park. I hope he sees no objection to it now."

That's a dirty trick. He sits here and he writes the President first. And before I sent it to him I said I'd send a copy - I'd show it to him.

Oliphant: That's the reason I wanted you to know about it.

H.M.Jr: That's a dirty trick of Straus's.

Taylor: I'm not arguing about that, but I think that you - you certainly told him that you would let him see it.

H.M.Jr: I'll get him on the telephone.

(On phone) Nathan Straus, wherever he is.

Oliphant: Do you want to discuss it

Klotz: Should I get the envelope?

H.M.Jr: If you please, because it's dated October 29.

(Mrs Klotz goes out)

Oliphant: Do you want to discuss it at lunch with the President?

H.M.Jr: Yes, because I said I was going through with it. I think it's a dirty piece of business. The hell with Straus.

Have you (Oliphant) had a chance to study this, to see it?

Oliphant: I've never seen that. Tell you what he did. He sent a copy of that, I learned this morning - Ed learned this morning, from some subordinate over there - sent that to the President, sent you a copy.

-7-

H.M.Jr: That's a dirty piece of business.

Shipment: It's a dumb one.

H.M.Jr: I told him before I wrote my letter I'd show it to him - the dirty so-and-so.

(Mrs Klotz returns with envelope)

Klotz: Sent over by messenger. There's nothing on there, you see.

H.M.Jr: Well, it just came over.

Klotz: I mean I turned around and there it was. Maybe I can ask Chauncey.

H.M.Jr: I'll have her come in.

(On phone) Tell Chauncey to come in here please.

Klotz: I opened this myself.

(Hanes comes in)

H.M.Jr: He says: "But in order to determine whether this proposed plan would conflict with any general policies of Government financing, I have discussed it with the Secretary of the Treasury. The Secretary raised a question as to whether the new plan would be inconsistent with your message to Congress of April 25, 1938, dealing with the elimination of tax-exempt feature of securities, and I understand that he will cover that question in a letter to you."

"Let me point out in this letter what seem to me to be the compelling advantages of the proposed plan."

He's just a double-crosser. He's just a double-crosser. I told Nathan Straus that we'd write a letter to the President and before we'd do it we'd show it to him. He, without showing it to me, writes the President a letter.

(Chauncey comes in)

Do you (Chauncey) know when this came in from Nathan Straus?

-8-

Chuncey: Well, just before noon.

H.M.Jr: Today, you mean?

Chuncey: Yes, as far as I know it came in this morning.

H.M.Jr: Well, just go back and call up Straus's office and ask them what time. We want to know what time that letter left his office. I want to know.

(Miss Chuncey goes out)

He's just a double-crosser.

Alta: He may have some answer.

H.M.Jr: Oh, sure. No, he has no answer. I was to show him my letter

(On phone) Hello? What about Nathan Straus? - Where is he? - Can't get his office? - His office in Washington? - Who is this? - Where's Miss Spangler? - Put her on. - Why can't you get Nathan Straus? - You mean you can't get through to his office?

No, it's perfectly clear what he's done. I wasn't born yesterday. He knows I'm going to write the President, so he sits down and writes the President a letter first. But I told him I'd show him my letter before

Oliphant: And Keyserling was in town Saturday, when the letter was written.

H.M.Jr: What's that?

Oliphant: Keyserling was in town Saturday, when the letter was written. That's his bright idea.

Alta: 29th. It was dated the 29th. I mean the letter.

Oliphant: That's Saturday. Keyserling was here Saturday.

H.M.Jr: "The President indicated his approval of the plan when I discussed it with him briefly at Hyde Park. I hope he sees no objection to it now."

-9-

Slats: Maybe he misunderstood you.

H.M.Jr: No, no.

Oliphant: No, they were after the letter on Saturday; they understood they were to see the letter before it went over, and they wanted to get hold of the letter Saturday, because apparently Keyserling could come down Saturday. You see, he's working with Wagner on his campaign. And our figures just weren't ready.

H.M.Jr: Well, while we're waiting for Straus, let's take up Germany next.

(On phone) Hello. - Cambridge? - Yes. I don't know whether you can locate him there. - What? - Just a minute.

Do you know whether Keyserling is in town?

Oliphant: Keyserling went back, I think. Back in New York, out on the stump. He's in New York City with Wagner.

H.M.Jr: See whether Nathan Straus is up - see whether you can locate him, wherever he is. (On phone)

Oliphant: I think he's in Detroit.

H.M.Jr: He's up in Cambridge.

(Miss Mauncey returns)

Mauncey: It left his office at 9:30 this morning.

H.M.Jr: All right. (Miss Mauncey leaves)

(At this point other subject matter was brought up, discussion of which is transcribed separately. Discussion re housing again took place as follows:)

(On phone) Hello. - All right.

Now, Straus isn't there. I think Straus has double-crossed me. Now, I think to say - he had absolutely no business, after the meeting we had here, to sit

-10-

down and send the President a letter. And he says, "This is a copy of the letter I am sending the President on the subject of the sale of local housing authority bonds to private investors. The President indicated his approval of the plan when I discussed it with him briefly at Hyde Park. I hope he sees no objection to it now."

Now, we said we'd show him our letter and he could make any suggestions. But instead of that, he isn't satisfied - in other words, he doesn't trust me, so he writes his own letter to the President. Now, I can do one of two things. I can say I'm mad. I am, frankly, very much annoyed.

Olliphant: May I volunteer a suggestion?

H.M.Jr: Just a minute. Just let me ... You(Hanes) sat here. What

Hanes: He couldn't misunderstand that, no.

H.M.Jr: Could he?

Hanes: When he left here, you said, "We'll draft the letter. You'll be shown the letter. If you have any suggestions to make, we'll be glad to change it in accordance...." That was the

H.M.Jr: Were you (Taylor) here?

Taylor: Yes.

H.M.Jr: There couldn't be - could there be any misunderstanding?

Taylor: There couldn't be any misunderstanding about our showing him the letter on this one. His writing the President - I think he's probably got a technical out in which he'd say, "Well, I never told you I wouldn't write the President." I mean it's a technical one.

H.M.Jr: But that isn't the thing.

Taylor: It's a technical one. Oh, he's doing just what you say he is.

H.M.Jr: All right.

-11-

- Taylor: but I mean if he wants to get into a debate on it, I think he could say that "I didn't do it that way."
- H.M.Jr: Well, the question that I'm raising is, not having been able to show him my letter, should I go ahead with it at one o'clock the way I said I would, or should I wait?
- Oliphant: Well, does this have any bearing on it? He's a pretty nice fellow, we're going to have to work with him, and it's important, I think, to bear in mind that his writing the President is largely the work of Keyserling. Now, I'd be inclined to carry out my promise, whether he did his or not.
- H.M.Jr: Well, that's my inclination.
- Taylor: Three or four days aren't going to make any difference.
- H.M.Jr: That's my inclination. I said I'd show it to him before I'd send it. And particularly in view of the fact that he hasn't kept faith with me, and I said, "Well, I won't do it - now, I'm not going to do it until you've got a chance to see it."
- Oliphant: I'd show him my letter and I'd forget the other one.
- H.M.Jr: I won't forget it. He's going to get right straight between the eyes what I think.
- Taylor: You can tell him at the time you're playing it a little differently from what he does, but that's
- Oliphant: Ordinarily in going ahead I would forward a copy of this letter, proposed draft, to him wherever he is.
- H.M.Jr: I'd send it over by hand to his office and say, "Please get this to Mr. Straus as soon as possible, because he didn't tell us - we'd like to have his comments." See? What do you think, John?
- Hones: I'd agree with Herman. I think that's the way to handle it.
- H.M.Jr: As long as I'm going to give him hell, I might be a little extra noble about it, huh?
- Oliphant: All right.

-12-

H.M.Jr: If there's anybody in this town that this office has helped over the bumps, it's Straus.

Oliphant: That's right.

Klotz: That's why I don't - I mean that's why I still want to leave one little ...

H.M.Jr: No, I grew up with him, Mrs. Klotz.

Klotz: He's changed, maybe.

H.M.Jr: All right. Well, you (Oliphant) haven't seen this yet.

Oliphant: No, I haven't seen it.

H.M.Jr: Well, that clears the decks as of now. What do I take over to the President? Nothing - do I?

Oliphant: I've got that Japanese thing.

Taylor: You can talk to him if he wants to talk about it.

H.M.Jr: I talked to him. I asked him yesterday. I said, "How do you feel about this thing, Mr. President, with Straus?"

"What do you mean?"

I said, "Do you want full tax-exemption?"

He said, "I wouldn't hear of it. I wouldn't hear of it for a minute."

And Nathan Straus, when he sat here, didn't say that the President said he could go ahead, and in the letter he says he did say so. He never told us when he sat here that the President approved the thing. Does anybody remember that he said the President gave him the approval?

Hones: I got the impression that he said he only had a ten minute talk with the President, and the President gave him not a complete clearance, but the understanding of a clearance - he didn't have it quite clear; and yet he added one more statement, he said, "I don't

-13-

want you to get a wrong impression about the President approving this thing, but I do want to give you the impression that in my ten minute conference the President thought well of it."

H.M.Jr: You're not confusing him with Lambert?

Hanes: No, no, this was the fellow that sat right here.

Taylor: That's the way I recall it.

Gliphant: Liked the idea - the President liked the idea.

H.M.Jr: What

Hanes: We can get that out of the notes. He referred to it twice.

Taylor: He certainly didn't indicate complete approval. That was the impression I got.

H.M.Jr: Well, O.K., we'll send it over there and we'll be extra noble about this thing, because, believe me, Nathan Straus is going to get a lesson.

Remember when I told you (Klotz) I didn't want that so-and-so Keyserling to come over here, and I said, "Tell him not to bring Keyserling with him," when you were making the appointment?

Klotz: (Nods yes)

H.M.Jr: He's running Wagner's campaign. Maybe that's why Wagner's doing so badly.

All right, gents.

TREASURY DEPARTMENT

330

INTER OFFICE COMMUNICATION

CONFIDENTIAL

DATE October 31, 1938

TO Secretary Morgenthau
FROM Mr. Haas
Subject: The Business Situation.
Week ending October 29, 1938.

House

Conclusions

(1)

The foundation for further business recovery is being strengthened by a rising trend of national income resulting from increased factory employment and payrolls. This has already begun to reflect itself in increased buying by consumers, as shown by a composite index of consumer buying, seasonally adjusted, which we have recently constructed.

(2)

A prospective further improvement in durable goods production -- steel, automobiles, lumber and cement -- is suggested by the fact that production in these industries has not yet increased to the estimated level of demand. In textiles and leather, on the other hand, production reached the estimated demand level in August and has since shown some decline. A recent rise in the general level of basic demand provides additional evidence of improvement in the underlying business situation.

(3)

The continued depression in commodity prices, which remains the major unfavorable factor in the business outlook, has tended to moderate the recovery by restraining speculative buying. Recent greater stability in foreign currencies, and an improving industrial demand for commodities, have gone far toward removing the threat of a further price decline which clouded the industrial outlook earlier in the fall.

The general situation

The current business picture is one of continued gradual improvement, following the sharp gains of July and August, with a foundation for further improvement during the coming year indicated by rising trends of employment and consumer incomes, and by the prospect of additional gains in certain important industries, notably in building activity and automobile production.

The rate of business improvement slackened somewhat during September, a 2-point gain in the FRB index during that month comparing with a gain of 5 points in August and 6 points in July. An October index of about 94 appears likely, with greater than seasonal gains in steel activity and automobile production probably offset in part by reduced textile activity.

In Chart 1, the trend of the FRB index of industrial production through September is compared with the trend of the New York Times index of business activity through the week ended October 22. In the lower section of the chart the individual components of the latter index are shown according to their respective weights in the index. Owing to differences in construction, and in the statistical series included, the FRB index currently is at a somewhat higher level than the New York Times index.

For the week ended October 22, the New York Times index maintained its sharp gain of the previous week, holding unchanged at 87.7. Declines in the two carloadings figures and in steel and electric power production were offset by a marked rise in automobile production and by gains in the indexes of lumber production and cotton mill activity.

A rapid recovery in business such as that of the past five months would ordinarily tend to carry production above the prevailing level of demand, due to speculative influences and business momentum, and be followed by a temporary setback as in late 1933 and 1934. The September business data which have just become available show that, except in certain consumer goods industries, production so far has not increased to an excessive level in relation to demand. The continued depression in commodity prices has apparently acted to restrain speculative buying, and thereby contributed toward maintaining an orderly recovery trend.

Secretary Morgenthau - 3

The business outlook

In appraising the outlook for business over the next six months or longer, consideration must be given to two major factors: (1) The extent to which production deficits have been made up by the recent increase in industrial production; and (2) the underlying trend of consumer demand.

The improvement in business activity from an FRB level of 76 in May to 90 in September has been only partly in response to an increase in industrial buying. In part it has reflected a depletion of manufacturers' inventories to the point where orders could no longer be filled from stock, and mills had to be started up to meet the current demand for goods. According to our basic demand study, production during the first half of the year had been running materially below the level of consumer demand, due to the continued liquidation of distributors' stocks and manufacturers' stocks. After the former had been reduced to more nearly normal levels, new factory orders began to increase, but it was not until the excess stocks of manufacturers had in turn been largely liquidated that the increasing new orders could be reflected in increased factory production.

Production deficit not yet entirely made up

The level of industrial production, according to our analysis, is still somewhat below the general level of basic demand. (See Chart 2.) While the production of certain non-durable goods, notably textiles and leather, has reached a full adjustment to demand and in fact has tended downward during September, the durable goods industries have still somewhat further to go before they reach the current demand level. The greater than seasonal upturn in automobile production in recent weeks reflects the strong basic demand situation existing at the end of September, as shown on the chart. Steel, cement, and lumber production must also increase further to reach the estimated level of demand. This strongly points to a continued improvement in the general business trend, in the absence of developments that might unfavorably affect the trend of basic demand.

Secretary Morgenthau - 4

Demand has begun to improve

After industrial production has risen sufficiently to adjust itself to the level of demand, any further healthy improvement in production must come about through an increase in demand. An encouraging feature of the present business situation is the fact that basic demand, as shown in Chart 2, is already turning upward. The rise in the combined index during September resulted largely from a marked improvement in basic demand for steel.

Underlying the improving demand is a rising trend of factory payrolls and of national income. The BLS index of payrolls rose in September to 80.7, as compared with 76.8 in August and a low of 70.6 in July. The national income has been rising gradually since May, according to the seasonally-adjusted monthly index of income payments compiled by the Department of Commerce. The September index of 83.3 compares with 82.5 in August and a low of 80.4 in May.

Consumer buying increasing

We have recently compiled an index to measure the combined volume of consumer buying, based on data for various products or product groups for which retail sales figures are available. The data are expressed in terms of physical quantities and adjusted for normal seasonal variation. This provides in one index a composite picture of the rate of consumer buying as reflected in department store sales, rural retail sales, chain store sales, automobile registrations, farm implement sales, and various other data, each weighted according to its apparent importance in measuring the "offtake" of manufactured goods.

The index of consumer buying (See Chart 3) showed a marked upturn during August and September, tending to confirm other indications of an increase in underlying demand. In comparing the present trend with that of the FRB index (upper section of the chart) it will be noted that industrial production has not yet risen to the consumer buying level. In 1933, 1934, and most notably in 1936-37, a rise in industrial production to a higher level than the index was followed by a business setback roughly proportional to the extent of the excess of production.

Secretary Morgenthau - 5

In the lower section of the chart, the consumer buying index is compared with an index of total income payments, to which it should be closely related. The effect of the veterans' bonus payment in 1936 on consumer buying is shown clearly here, indicating the extent to which the actual payment was anticipated in earlier months. An increase in installment sales was doubtless a factor in bringing an increase in buying in 1936 out of proportion to the increase in income payments, and a corresponding contraction in buying in 1937 and 1938 when automobile finance companies tightened their credit terms, and buyers of various kinds of goods were committed for a considerable period to pay installments on earlier purchases.

Commodity prices remain depressed

The commodity price situation remains the weak point in the business outlook, though increasing industrial demand and recent greater stability in foreign currencies have gone far toward removing the threat of a further price decline which clouded the business outlook earlier in the fall. During the current week, sensitive commodity prices have held generally steady, though Reuter's index of prices in Great Britain has tended slightly downward.

Industrial sentiment remains cautious toward commodity prices, which has apparently tended to prevent a speculative business boom, and must be set down as a favorable factor in the longer term outlook. The business survey committee of the National Association of Purchasing Agents, in its current monthly review, states that most purchasing offices "are proceeding on a most cautious basis pending more definite evidence of further quickening in business volume", and that "there is entire absence of speculative buying at the moment, as the opinion persists that price changes during the months to come will be moderate in scope, and conditions do not at the moment warrant extensive commitments ahead." With business recovery to date showing little evidence of speculative buying, any definite upward movement in prices would be likely to provide a business stimulus sufficient to bring a further advance in industrial production.

Increase in new orders

Our index of new orders for the fourth week of October (See Chart 4) recovered much of its loss of the previous week, with textile orders showing a marked improvement. New orders

Secretary Morgenthau - 6

for steel, as reported by the U. S. Steel Corporation, increased slightly to the equivalent of 46 per cent of capacity, as compared with 45 per cent the previous week. This corporation has apparently not shared much in the increased volume of light steel reported to have been bought by automobile companies and others during the temporary period of price weakness.

Rumors of a probable increase in finished steel prices for delivery after January 1st, if confirmed by a sufficiently early official announcement, would doubtless be followed by a heavy increase in steel orders, which would maintain steel production at relatively high levels during the remainder of 1938.

Current business news

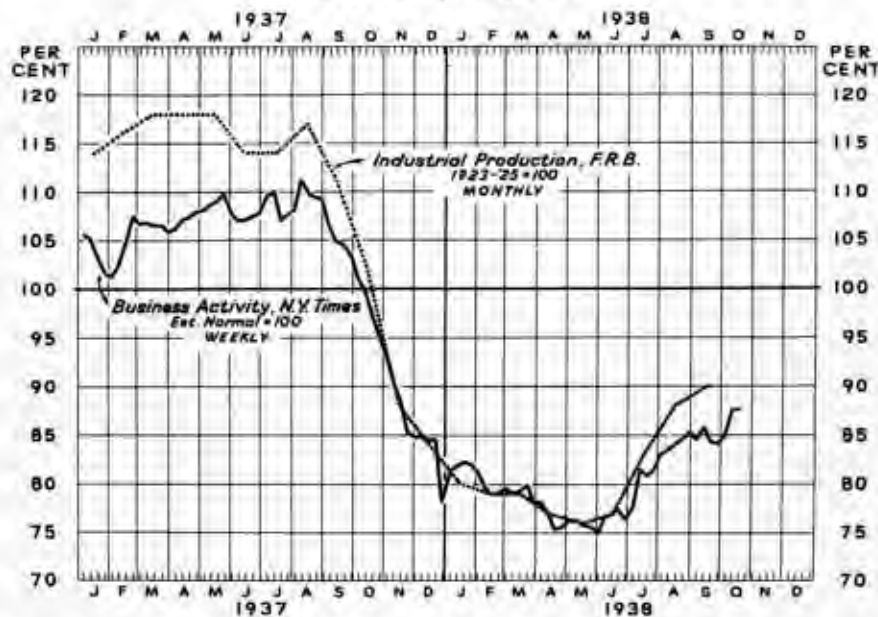
Steel operations this week rose to a new high at 53.7 per cent of capacity, more than recovering their 2-point drop to 49.4 per cent last week. A further increase is expected in the trade during the coming week, as steel companies work on the increased orders for light steel received during the recent period of price cutting.

Construction contract awards, after rising very sharply during the last period of September, held most of their gains during the first half of October. Awards totalling \$181,194,000 for the first half of October compare with \$113,604,000 during the same period of September, and are nearly double the figure of \$99,914,000 for the corresponding period of last year. Privately owned projects show a substantial gain, the total of \$82,435,000 for the first half of October comparing with \$60,142,000 in the same period of last month, and with \$63,169,000 during the corresponding period last year.

Department store sales improved with more favorable shopping weather during the week ended October 22, showing a reduction of 9 per cent from the sales of the corresponding week last year, which compares with a reduction of 18 per cent during the week ended October 15.

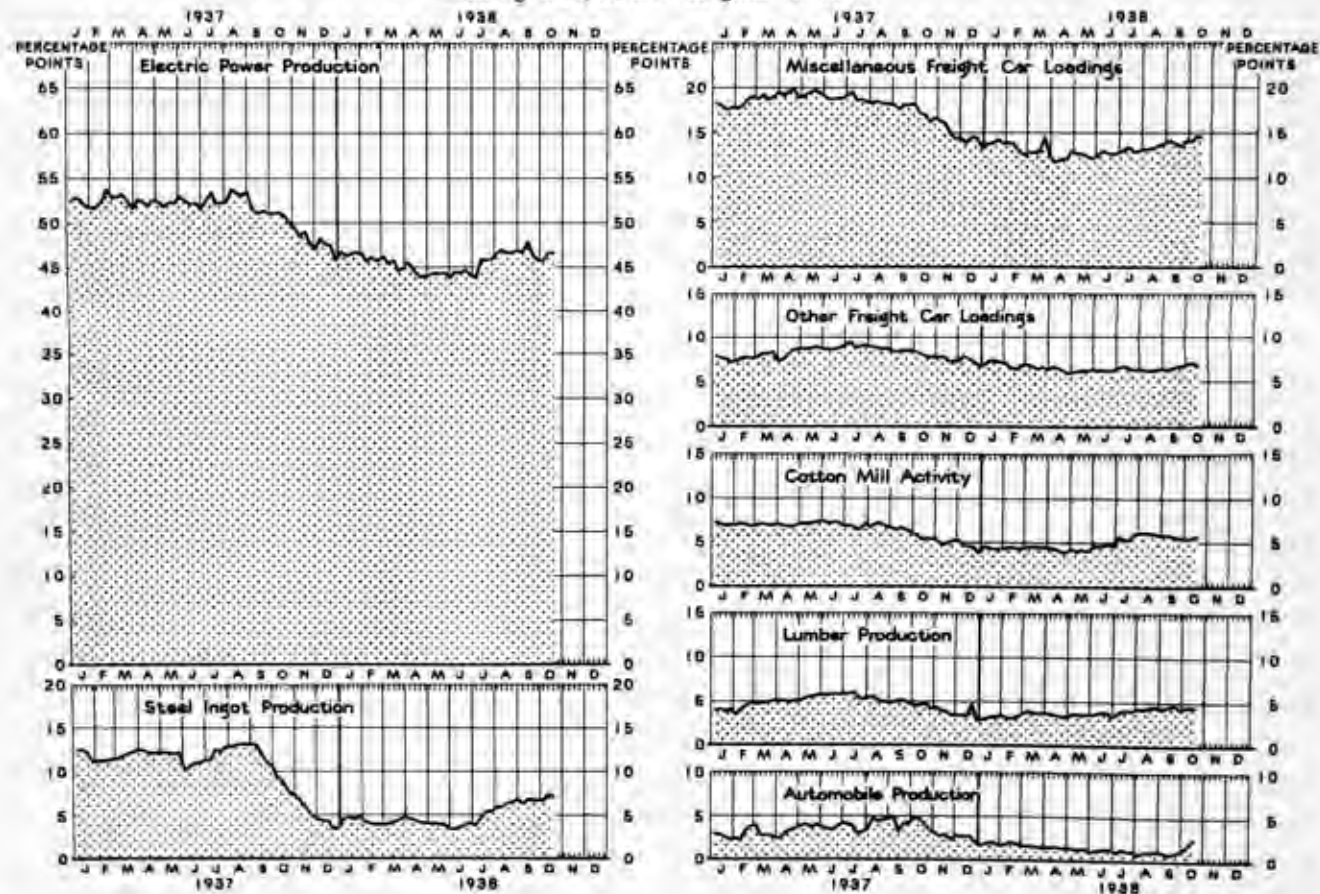
COMPARISON OF BUSINESS INDICES

Seasonally Adjusted

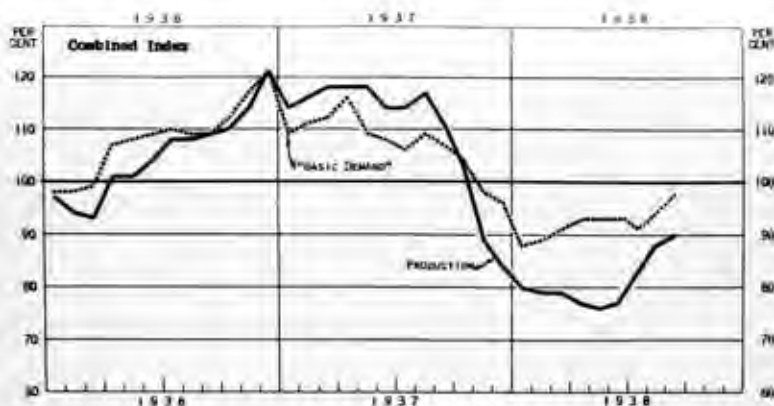


COMPONENTS OF N.Y. TIMES INDEX OF BUSINESS ACTIVITY

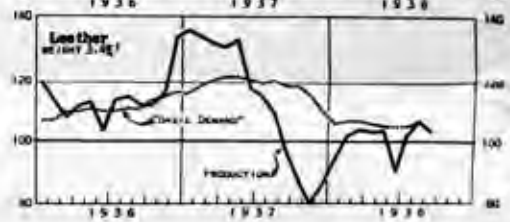
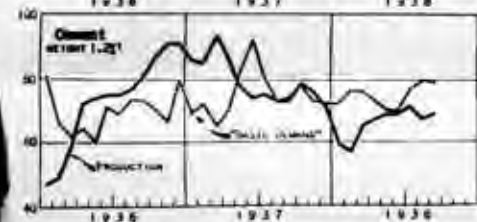
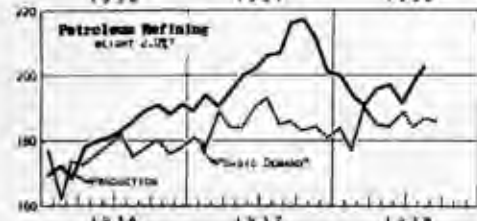
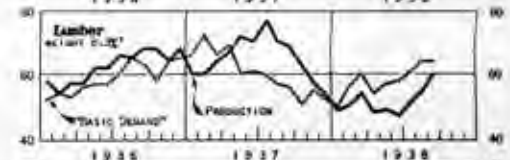
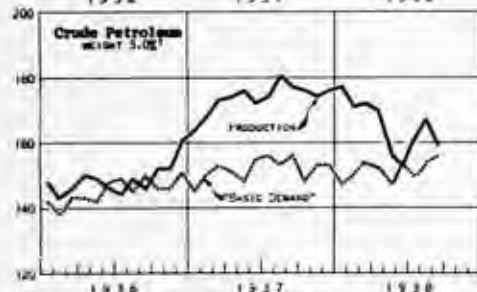
Showing Respective Weights in Index



137
ESTIMATED BASIC DEMAND COMPARED WITH PRODUCTION, BY INDUSTRIES
1923 = 100, Adjusted



Selected Industrial Groups

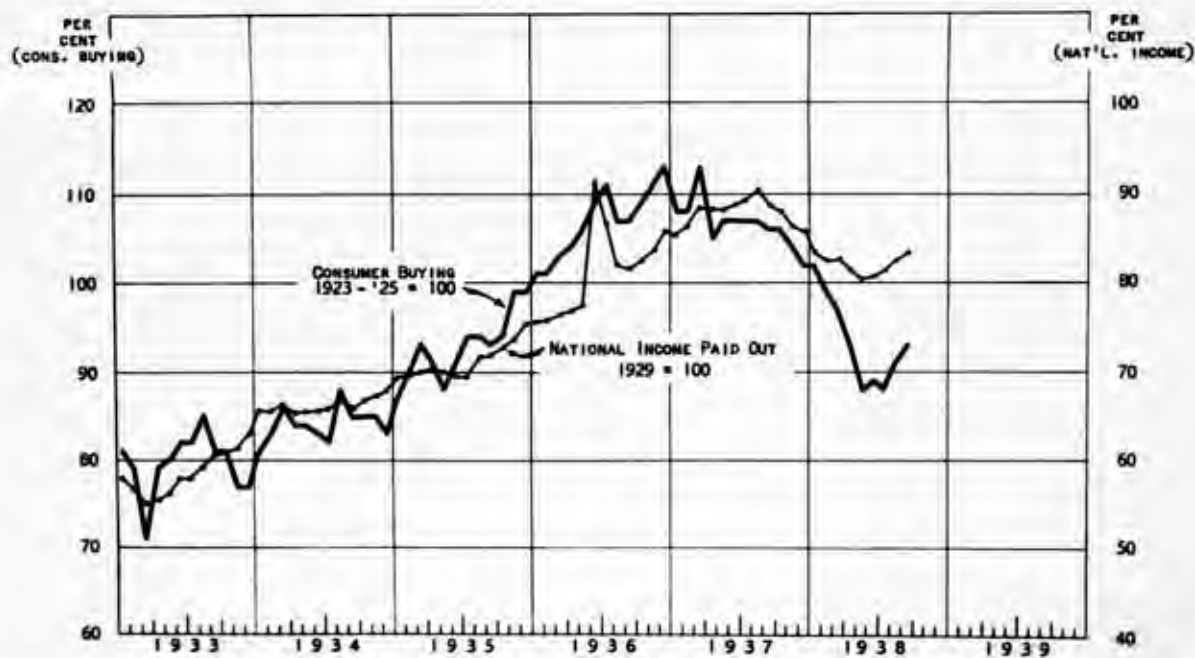
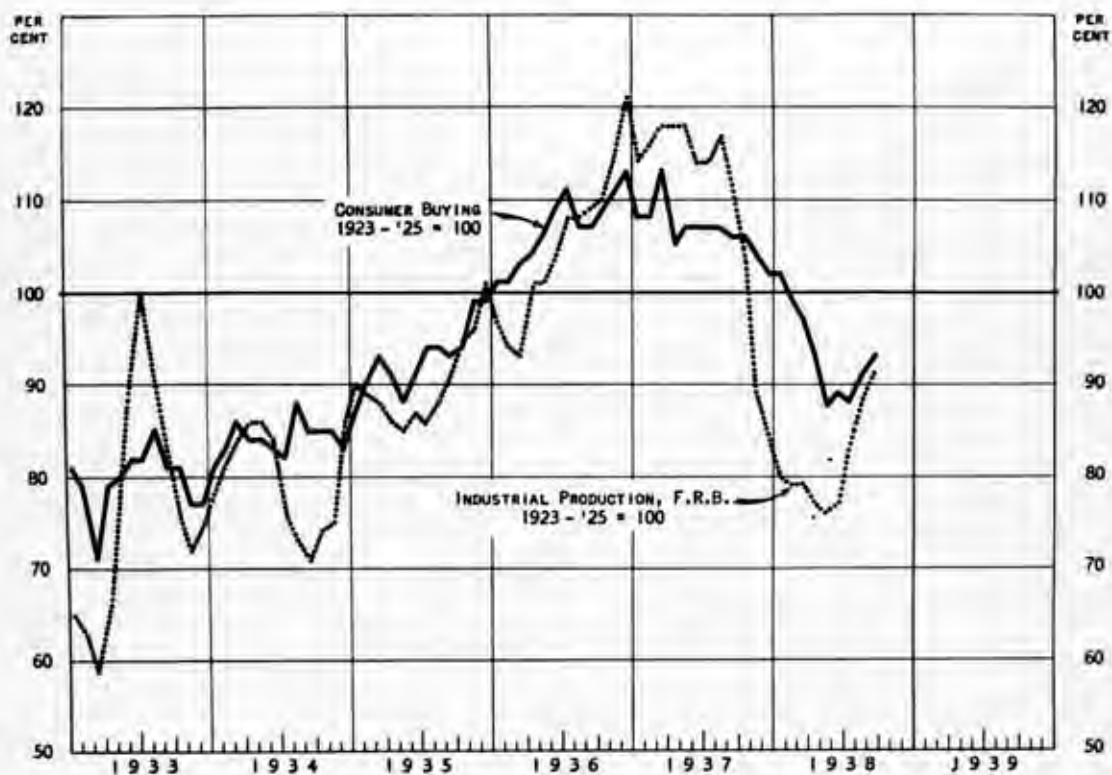


NOTE: LATEST FIGURES ARE PRELIMINARY IN MOST CASES

TIME IN CHARTED INDEX

CONSUMER BUYING COMPARED WITH INDUSTRIAL PRODUCTION AND WITH NATIONAL INCOME

SEASONALLY ADJUSTED



INDICES OF NEW ORDERS Combined Index of New Orders and Selected Components

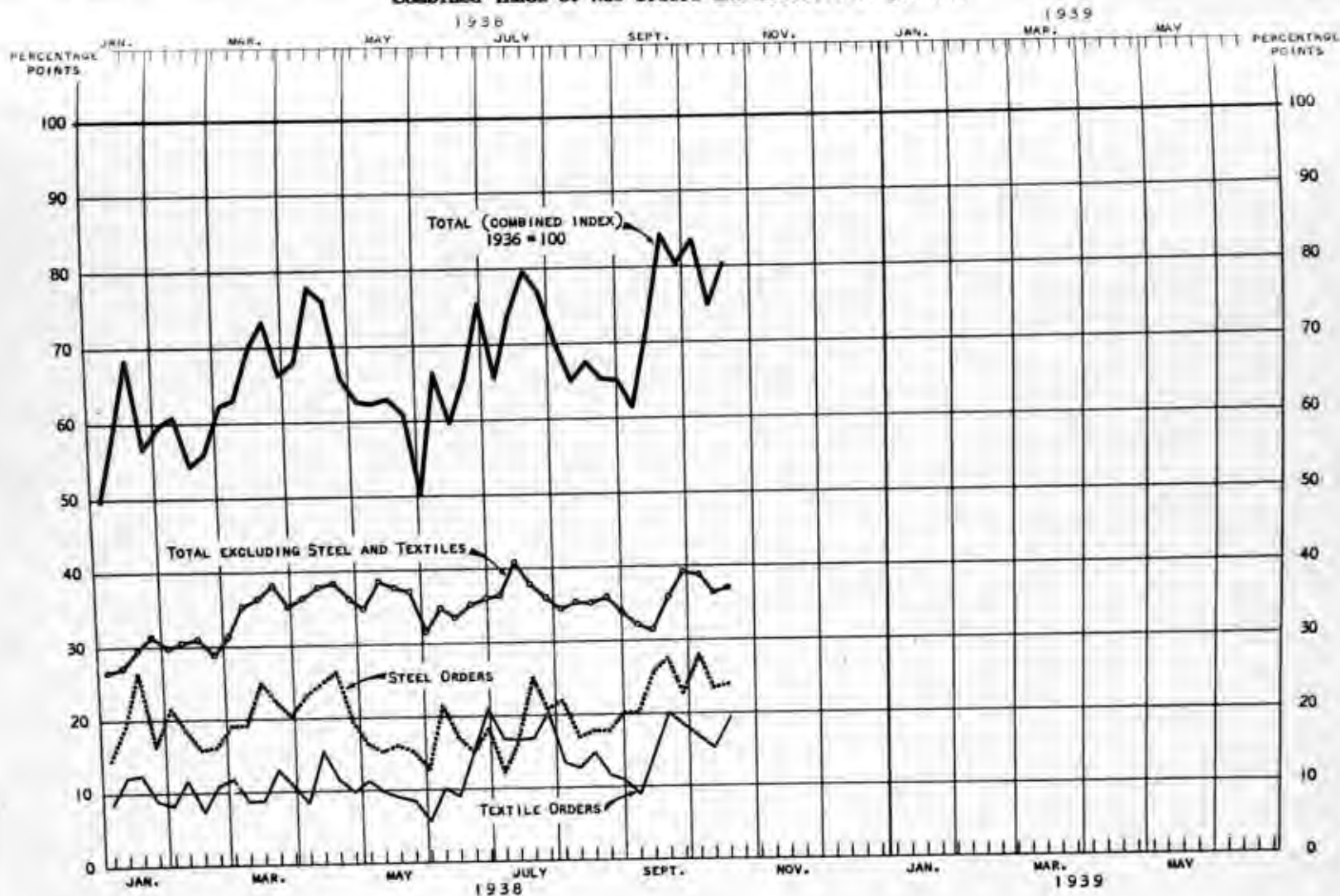


Chart 4
CONFIDENTIAL

TREASURY DEPARTMENT

340

INTER OFFICE COMMUNICATION

DATE: October 31, 1938

TO Secretary Morgenthau

FROM M. A. Harris

A Short Review of the U. S. GovernmentSecurity Market during the Past Week

Trading in U. S. Government securities for the second week was light but demand was of sufficient proportion to absorb readily the limited amount of offerings. Prices of Treasury bonds finished the week unchanged to 6/32nds higher whereas during the previous week losses of the same proportions were recorded. However, the demand was altogether for those issues due or callable after 1945.

In the note market activity was limited to a small demand for those issues due within the next two years and to some switching out of the longer maturities into the shorter maturities. The shorter notes are being purchased on the basis of their value as "rights". As a result of this limited activity short maturities finished the week 1 and 2/32nds higher and long maturities 2 to 4/32nds lower.

Guaranteed issues were firm and quiet.

Holding of U. S. Government securities and guaranteed obligations by reporting dealers increased \$10,300,000 during the past week. Below is shown holdings by groups and the changes for the week:

Dealers' Portfolios

(in millions of dollars)

	Holding Oct. 22	Holding Oct. 23	Change
Treasury bonds	20.9	26.7	+ 5.8
Treasury notes (1 year)	34.6	37.2	+ 2.6
Treasury notes (1-5 years)	6.1	6.5	+ 0.4
Treasury bills	6.1	6.1	0.0
H. O. L. C. bonds	1.1	0.2	- 0.9
F. F. M. C. bonds	6.2	8.6	+ 2.4
	<u>75.0</u>	<u>85.3</u>	<u>+ 10.3</u>

New Security Issues

Corporate financing totaled about \$109,000,000 last week as compared to \$137,000,000 the previous week. \$41,450,000 was for new capital. As was true in the previous week, two offerings accounted for practically all of the above total. These two offerings were the Wisconsin Electric Power Company issue which consisted of \$55,000,000 first mortgage 3 1/2% due in 1968 at 103 1/2% and the Firestone Tire and Rubber Company issue which consisted of \$50,000,000 3 1/2% ten-year debentures at 99 1/2%. Both offerings met with strong demand, particularly the latter issue, and were readily absorbed by the market. The Wisconsin Electric issue went to a slight premium and the Firestone issue to a premium of about two points on the first day they were offered.

Corporate Bond Market

Prices generally showed small net gains over levels prevailing at the close of the previous week. Trading was made up largely of rallies and declines with no definite trend. Volume was fairly large at times but tended to dry up on recessions and also on recoveries after fractional movements one way or the other. Second grade rails and speculative issues

were the most active groups and, as groups, had the larger gains. However, rails are lower this morning (Monday) as a result of the announcement by the board appointed by the President to investigate the wage dispute. Moody's AAA bond price average reached a new high for the year on Friday; in fact, the average then was the highest since January 1937.

The Federal Reserve System Account

The only transactions were the replacement of last week's bill maturity amounting to \$27,478,000 by the purchases in the market of a like par amount of the new bill issue dated January 25, 1938 and the exchange in the market of \$4,260,000 bills dated January 4, 1938 for a like par amount of the new bills.

Treasury Investment Accounts

Other than the purchase of \$44,000 2-3/4s of 1958/63 for the account of the District of Columbia Teachers Retirement Fund, there were no transactions.

October 31, 1939.
2:26 p.m.

HMJr: Hello.

Operator: Nathan Straus. Go ahead.

HMJr: Hello.

Nathan
Straus: Hello, Henry.

HMJr: Hello, Nathan. Well evidently you don't have very much confidence in me.

S: Why's that?

HMJr: Well, when you -

S: I - I only run away and go up to Boston when you're looking out for things. No, not much.

HMJr: No, but when we left here I said I'd write a letter to the President on your problem and before I'd send it, I'd show it to you.

S: Yes.

HMJr: But in the meantime, you shoot a letter over on your own.

S: Oh, Henry, I asked to see your letter and was told I could not see it because you were not there, my boy.

HMJr: Well, it wasn't finished.

S: Couldn't see it.

HMJr: Well, it wasn't finished.

S: It was said that the Secretary was away and I could not see it, and therefore coming up here today, I thought the thing to do was to write out what I would have put in yours if you'd let me, and send you a copy.

HMJr: Well -

S: You were sent a copy before it went over to the President, didn't you?

HMJr: Pardon.

- 2 -

S: You got a copy of my letter to the President.

HMJr: I got a copy this morning.

S: You got a copy before the President got it, because I was given those orders.

HMJr: Yes, but I - I didn't send mine because I told you I'd show it to you before I sent it.

S: Well, that was just it, and I wasn't going to be there, and I didn't know what else to do. You were away.

HMJr: Well there's - I was here.

S: I could have stayed over today, but I didn't want to do it. I didn't want to come back.

HMJr: I was in the office Saturday.

S: Well now they called up and asked for the letter. They spoke to your man, I think Foley, and the word came back to me -

HMJr: Well, why didn't they ask - Foley isn't running the office of the Secretary of the Treasury. Both Mrs. Klotz and I were here Saturday. McReynolds was here Saturday.

S: Now, I - I didn't do that myself, to tell you the truth. I asked them when I could see the letter, because I was going to wait over. I didn't leave until five o'clock, and the word came back that Foley was drafting the letter for you, or was it - it wasn't Mr. Oliphant, it was Foley, and that he could not show it to me because you were not there.

HMJr: Well, I've explained often enough that if you want something from me come to my office.

S: Oh, well I do but they said you were out - you were out, I'm awfully sorry.

HMJr: No, they - I was here, Mrs. Klotz was here, McReynolds was here.

S: I did not make any effort to do that. I was there the whole day 'til five o'clock, and when I heard I couldn't see the letter I got them to fix up

- 3 -

this thing which I would have put into yours.

HMJr: Well, the letter wasn't finished. I only saw it this morning.

S: I get you. Well, that may have been the explanation.

HMJr: But when we agree that you're going to see a letter, you see a letter.

S: Well, of course, then I would have had to stay over, that's true, which I didn't want to do. That's true.

HMJr: Well, I feel very badly about it that - having agreed - to shoot a letter over to the President.

S: Oh, gosh, Henry, I'm awfully sorry.

HMJr: Well, so - I mean I was very much upset about it.

S: Oh I'm terribly sorry.

HMJr: Yes.

S: Well now what - what should I have done? You mean I should have stayed over and seen the letter rather than writing.

HMJr: Well, or else get - call me up and say I'm not going to be here, what - what would you suggest, or ask somebody who's attached to me - in my office. Ed Foley is - is an assistant to Oliphant. He's got nothing to do with my - this is - this was a man to man agreement between the two of us.

S: But you told Oliphant, in my presence, to consult with Foley and get the letter drafted Henry.

HMJr: That's right.

S: You'll find that in the record.

HMJr: Yes.

S: And then on the basis of that I said I wanted to see the letter. Foley said to our people that it wasn't ready or that you were away. As I understood

- 4 -

it, you were away. I think that's what he said.

HMJr: Well - well, the letter wasn't finished.

S: Oh, then I didn't get it.

HMJr: It was finished this morning, and when you were here, we didn't know you weren't going to be here Monday.

S: No, but you told me, if you recall it, in the record, that you'd show it to me on Saturday morning.

HMJr: Well that I don't remember.

S: Because otherwise I would surely have stayed over.

HMJr: But before -

S: The thing that worries me about it is that you should feel badly, but I'm terribly sorry.

HMJr: Well, I feel - I was very much upset to think that after we had an agreement that - you'd go and shoot a letter to the President.

S: But Henry, you wanted - what's the good - if you feel that way about it - I'm terribly sorry, I can't say any more.

HMJr: Well, it's over there. Well then - we'll -

S: What do you want me to do about it now?

HMJr: Well there's nothing you can do about it now. He's got the letter, I don't know what he'll do with it, and we'll go ahead and finish our letter - it's finished now and I'll send it over.

S: Has your letter gone over.

HMJr: No.

S: I thought you were going to take your letter over. I thought you were going to discuss both letters with him, that's what you said.

HMJr: No. I said that I wouldn't send any letter over until you had seen it, so I wasn't going to take it over.

- 5 -

- S: That's correct. I thought you were going to take it over, you said, at your luncheon on Monday.
- HMJr: Yes, and I haven't done a thing. I didn't bring up the subject because I hadn't had a chance to talk to you.
- S: Well, I suppose the mistake I made was going away, I didn't want to break this date.
- HMJr: Well, I mean -
- S: I hope you get it settled up, one way or the other, because it's much more important to me to have you satisfied than there is to do anything else.
- HMJr: Well - I'll - I mean I don't know when I'll see the President again now, but I'll have to wait, that's all.
- S: Well, I'm awfully sorry because it's very embarrassing for me to have this thing delayed.
- HMJr: Yes. Well, you'll have to be embarrassed, that's all, at least as far - as a matter of fact, as you pointed out, I mean I've got nothing to say about it anyway.
- S: I know Henry, but that isn't my attitude, either toward you or toward the Secretary of the Treasury.
- HMJr: Yes. Well, we - I don't know when I'll see him again, but I tried this morning and I couldn't - and so I - I told you the letter wouldn't go until you had seen it, so -
- S: Well now, I'm - Henry - I'm going to be here tomorrow on this speech with Senator Wagner.
- HMJr: Yes.
- S: I'm going out next day to Detroit to dedicate the project out there, and I will be back in Washington on Thursday morning. May I call you up then?
- HMJr: No, I won't be - I sent your office a copy of the letter and told them to get it to you.
- S: Yes, and what am I to do when I get it.

- 8 -

HMJr: You can do anything you want with it. You can tell me you like it or you don't like it. Do anything that you want with it.

S: Send it back to you then.

HMJr: Yes, with your comments.

S: That's swell.

HMJr: I'm not going to send it over until I get your comments.

S: Well that isn't at all what I thought. I thought you definitely were going to show it to the President today.

HMJr: No, I said I wouldn't until you had seen it.

S: Yes, sir.

HMJr: So after I get your comments I'll sign it and send it over.

S: All right.

HMJr: All right, Nathan.

S: I'm awfully sorry Henry.

HMJr: So am I. Goodbye.

S: Goodbye.

October 31, 1938. 349
3:03 p.m.

WMJr: Hello.

Operator: Mayor LaGuardia.

WMJr: Thank you.

L: Go head.

WMJr: Hello.

Mayor LaGuardia: Hello, Mr. Secretary.

WMJr: How are you?

L: Fine, how are you?

WMJr: I'm very well.

L: Good.

WMJr: When I - when you spoke to me last about these free dinners on these boats -

L: The what? - Oh, yes.

WMJr: I left it this way, that if you didn't hear from me again there wouldn't be any more.

L: Yes.

WMJr: Now, this is what happened. A man by the name of McCormick -

L: That's right.

WMJr: In Admiral Land's office, - he says he's fixed it up with a fellow by the name of McKenzie -

L: Yes, the dock commissioner.

WMJr: That there will be another one.

L: Another one?

WMJr: Yes. It will be given on the Ar - a ship by the name of the Argentine. Now, that's the message that I got, and inasmuch as I'm very careful about how I give my word, I wanted to make sure that you understood that.

- 2 -

L: I - I saw a letter from McCormick to - to McKenzie, in which he said that the Uruguay. would be the last one.

HMJr: Well now they say they're going to give a dinner on the ship called the Argentine.

L: Well, they'd better take it to Hoboken - we're going to cancel the lease.

HMJr: Well, now you - you - do you mind - can't McKenzie fight this out with Admiral Land's office?

L: Sure.

HMJr: I mean as long as they seemed to have agreed.

L: Yes.

HMJr: But your man McKenzie definitely has agreed to this.

L: Well if he has, it's all right.

HMJr: But McK - they say - Admiral Land's office say that McKenzie has definitely agreed to a dinner on the Argentine.

L: I see. All right, thanks, Mr. Secretary, I'll take it up with the Commissioner at once.

HMJr: Now that leaves me out, now?

L: Yes. But hereafter it's O. K. with -

HMJr: No, you'd better - no, you'd better - you - if you don't mind this is too - I don't - doing business through a third party, you see?

L: Yes.

HMJr: And if you said to me, "Morgenthau, will you or won't you", I could give you a yes or no.

L: Yes.

HMJr: But this is McCormick to McKenzie to you.

L: Well, as Mayor, I can call upon you for extra custom guards, as I - I can't police those docks.

- 3 -

HMJr: You can call on me for anything.

L: All right, I'll ask for extra custom guards because I can't police the docks.

HMJr: Well, I - the way I'd like to leave it with you Mr. Mayor, is this, I'm not going to do another darned thing, unless I hear from you again.

L: O.K.

HMJr: I mean, in other words, I'm washing my hands of it.

L: Yes.

HMJr: And if you want me, I'm here.

L: Yes.

HMJr: How's that?

L: All right. Thank you so much.

HMJr: You're welcome.

EDA

A portion of this telegram must be closely paraphrased before being communicated to anyone (B)

BERLIN (PART AIR)

Undated

Received October 31, 1938
7:10 a.m.

Secretary of State

Washington

581.

29. FOR TREASURY FROM HEATH.

(GRAY) September figures are not yet available but during August the recorded national debt increased 826 million marks to a total of 23,762 million marks. This last figure does not include tax credit certificates outstanding in the amount of 118 million marks. Neither does it include the total of unrecorded "special bills" billions of marks of which were issued up to March 31 of this year to finance increased production and employment. So far the injunction to secrecy regarding the amount of "special bills" outstanding still obtains. The last of these bills matured in August and all of them unless renewed should have been passed to the Reichsbank or its subsidiaries. The press asserts that there are no more "special bills" held by the private banks. "Special bills" undoubtedly constitute a large, possibly the greater part of the bill holdings of the Reichsbank and Gold Discount Bank which on September 30 aggregated 10.5 billion marks.

During the first five months of the Reichs fiscal year which

EDA - 2 - #581, Rec'd October 31, 7:10 a.m. from Berlin

which began on April 1st there has been an increase in the recorded debt of 4,664 million marks. There is an offset to this increase in the fact that during this time some 338 million marks of the total of 2,230 million marks of tax credit certificates issued during 1932-1935 were retired. These certificates have never been included, however, in the statement of the total national debt. There is also undoubtedly some offset of an unknown amount in the redemption by the Government of special bills. Also it may be argued that the issuance in June of 376 million marks of long term bonds in exchange for the stock of the Austrian Central Bank was offset by the assets of that institution.

Making large allowances for this redemption and exchange transactions, however, there must have been a net increase of the Government debt during the five months ending August 31 of at least 3,500 million marks or roughly 55% of reported revenues for those months which totaled 6,291 million marks.

Of the August debt increase 525 million marks was in short term, 301 million marks in long term debts. The German financial press asserts that in October there will be a decrease in short term debt which has been mounting recently at the rate of 500 million marks per month.

As previously reported provisional estimates put Government revenue for the six months period ending

September

EDA - 3 - #581, Rec'd October 31, 7:10 a.m. from Berlin

September 30 at 8,304 million marks an increase of 22% over the corresponding period of 1937.

While in part the increase in taxes shown so far this year is due to better business conditions it is unquestionably in the main due to more efficient collections and increases in tax rates reported in previous telegrams. The German Government is taking a steadily increasing percentage of national income in taxes and in compulsory investment in Government securities as well. As regards compulsory investment it is to be noted that German municipalities were ordered to invest in the Reichs loan just floated. It is reported that during the fiscal year they are expected to acquire 500 million marks of long term Reich issues.

Secretary Brinkmann pointed out in a recent speech at Dusseldorf that Government taxes and social contributions (old age unemployment insurance, et cetera) took only 11.3% of the 1913 national income of 45.7 billion marks; 22.2% of the 1925 national income of 60 billion marks whereas they took 23.8 billion marks or 33.5% of the 1937 national income of 71 billion marks.

According to figures just issued savings deposits during the first nine months of the calendar year increased by 1,237 million marks as compared with 983 million marks for the first

three

- 4 -

three quarters of 1937. (In 1928 such deposits increased 2.36 billion marks) this increase was obtained despite net withdrawals of 156 million marks in September.

Employment at the end of September showed an increase of 15,000 to a total of 20,850,000 an increase of 1,200,000 over September 1937. Unemployment reached a new low of

156,000 of which only 76,000 were fully employable. Unfilled positions totaled 318,000.

Despite the gains listed above, the millennium for the working man in Germany has not yet arrived, as is shown by the Winter Help organization's annual report. This organization was obliged to come to the aid of 8.9 million people last winter, spending 417 million marks in giving such assistance. For the period 1936-37 10.7 million received aid. A further reduction in the per capita butter ration of Berlin householders was put into effect this week, being reduced to 180 grams; after the Czech-Sudeten acquisition it was decreased from 250 grams to 200 grams.

WILSON.

EA:LWW

REB

PLAIN 

London

Dated October 31, 1938

Rec'd 3:30 p. m.

Secretary of State,
Washington.

1267, October 31, 6 p. m.

FOR TREASURY FROM BUTTERWORTH.

In connection with Nos. 1219, October 20, 6 p. m.,
1189, October 15, 1 p. m. and previous references in
the TIMES to the dollar-sterling situation to-
day's TIMES comment may be of interest.

"Recent reports of a protest from Washington concerning the depreciation of sterling would appear to have got the matter somewhat out of perspective. While the United States authorities may naturally have shown some concern over the recommencement of a sharp decline in sterling only a few days after the Munich Agreement and may well have given expression of its anxiety around that time there is no reason to believe that there is any dissatisfaction with the trend of events since that decline was arrested or that there is any dogmatic view in Washington that sterling ought to stand higher. Indeed the policy of our own exchange account since the
end

REB

2-#1267, From London, Oct. 31, 6p.m.

end of the decline has been one to which Washington could hardly take exception. While the authorities may in any case have considered that a substantial recovery in the rate would be the best means of re-establishing confidence in the currency and preventing any renewal of a run on sterling there were signs that they went out of their way to fulfill the spirit of the Tripartite Agreement in the fullest possible degree. Indeed the control has in recent weeks desisted from buying dollars even when circumstances have temporarily arisen in which the pre-crisis days such a policy would probably have been followed. It would certainly be very unnatural if Washington were to start expressing dissatisfaction with London's behaviour at this stage.

The exchange account's policy has been far from unsuccessful in checking the run on sterling and conserving gold reserves. The foreign exchange market has returned to normal and although support for sterling both by sales of dollars and by sales of gold in the bullion market has continued spasmodically it has been moderate and on a decreasing scale. Since the major decline in sterling was arrested in fact expenditure of the account's reserves has

REB

3-#1267, From London, Oct. 31, 6p.m.

has been very small. Moreover it must be remembered that the exchange account continues to replenish its gold reserves constantly from its regular sources. In this connection it is worth noting that the amount of South African gold which the account has accumulated -- which has not come into the import figures -- may be substantial. Since the South African Reserve Bank first started to restrict shipments in early August prior to discontinuing them entirely it has probably had something in excess of £12,000,000 of gold sold to it by the South African producers. Between £2,000,000 and £3,000,000 of this has been added to the reserve bank's own gold stock but it may be presumed that the exchange account has acquired most of the remainder and likewise that the account is still acquiring from the reserve bank the bulk of the current output amounting to well over £1,000,000 a week as it always has done in the past. How long the newly mined gold will continue to be retained in South Africa is naturally uncertain. But for the time being -- although there were of course special reasons for the shipments being discontinued -- it may be regarded as an interesting development of the policy

REB

4-#1267, From London, Oct. 31, 6p.m.

policy of keeping a part of the exchange account's gold reserves in the dominions on strategical grounds."

With Paris still closed the volume of trading in the foreign exchange market has been small despite the extent of the fluctuations. The dollar opened at 4.76 1/2 somewhat bid and moved to 1/8 during gold fixing at which point the British authorities intervened. After the absorption of the resultant dollars the rate moved to 4.75 3/4 at which point the British authorities again intervened to push it back to 4.76. But New York came in a buyer of dollars and the rate moved back towards 4.75 1/2. Gold was fixed at 146 S 1/2D with the British fund supplying over 200 of the 294 bars.

The franc was offered until near the close and at one time the three months' franc moved to over 6 francs discount. Nevertheless the city does not in general expect a further devaluation at this time.

KENNEDY

WWC