

10/30/39 190-A

Dear Mr. Morgenthau:-

You may not have heard of the projected 11 states Western Conference referred to in this public letter from John L. to Gov. Olson of California. Anna Roosevelt + John Boettiger have been working on it for many months with Howard Costigan of the Washington (state) Commonwealth Federation, Gov. Olson and other liberals including the several prominent
(over)

Hollywood writers and screen
people comprising the
Motion Picture Democratic
Committee. I am deeply
disturbed and incensed
by John L's letter which
by no means squares
with the facts and which
is a typical squeeze-
play proposition politically.
He conferred with no one
on this other than Lee
Pressman so far as I can
ascertain. His ruthless
attack on Marshall
Dimock who has really
shown himself a true &
active friend of labor in his

brief sojourn in the 190-B
Department of Labor, and
his similar characterization
of Norman Lyttel (Senator
Schwellenbach's man) is,
in my opinion, unforgivable.
And as for the Burton
wheeler sentence — well,
I told you last night
my feelings about that
fellow's role. The
President, of course, knows
all about the projected
conference, as does Jim
Farley. John T. must
know that. This letter
(over)

of his is typical of the
strong-arm political
tactics and rule-or-ruin
policy which cause me
such acute and painful
difference of opinion with
John L. I talked with
him this morning
intimately on other
matters and he didn't
mention this letter which
he had just dictated.
If he had I would have
fought him tooth and
nail on it and will still
on the methods it
represents. I pass this

on to you before it 190-C
appears tomorrow because
I thought you might
want to know. I'm
familiar with much of
the background of
the 11 states business which
I think has genuine
politically potential
significance. I'll be
glad to tell you what
I know if you wish me
to. I am frankly very
much troubled.

We had a grand time
(over)

with you last evening and
both wish there were
more like you two in
key positions.

I will get word to
you on the other matter
of which we spoke. It
will take me a few
days to be sure of my
facts.

Yours sincerely,
Gardner Jackson

P.S. Excuse this scrawl which I
hope you'll cast away. I am at
my eye doctor with drops in my
eyes so everything is hopelessly blurred

Press Information

For Release, Morning Papers
Tuesday, October 31, 1939

The following letter was today sent by Chairman John L. Lewis, of Labor's Non-Partisan League, to Governor Gilbert L. Olson of California:

"During our personal conference in San Francisco on October 15, we discussed the proposed Conference of progressive leaders of eleven Western States, then being organized by Mr. Norman N. Littell, Assistant to the Attorney General in Charge of the Lands Division, Department of Justice, and Mr. Marshall E. Dimock, Second Assistant Secretary of the Department of Labor. You will recall that we were in substantial agreement that these gentlemen were pursuing an unwise course by their secret methods of organization and their exclusion of labor participation.

"Since our conference, Messrs. Littell and Dimock have continued their work in secret and are prepared to issue the call and assemble the Conference for some date in January, in Salt Lake City or some other convenient city. The secret agenda for the Conference has been completed and the organizers of this Conference are awaiting disposition of the Neutrality Bill by Congress before the issuance of their public call for the Conference.

"Labor's Non-Partisan League is opposed to the holding of this Conference for the following reasons:

- a. The source of its conception and the surreptitious manner in which its organizers have worked.
- b. The doubtful source of its finances. An anonymous individual in California is counted upon to provide a plentitude of money.
- c. The questionable legality under the Hatch Act of the activities of Littell and Dimock.
- d. The slight to Senator Burton K. Wheeler and other great liberals in the West who have not been consulted and who are slated to be excluded from the Conference.
- e. The exclusion of labor from the privilege of making suggestions for a legitimate program.
- f. The secret plans to use the Conference to launch a third-term boom.

"I doubt that the President has knowledge of or would approve the plans of these overzealous individuals responsible for this program. Aside from his recent public utterances, his rebuke of Secretary Wallace through a White House Secretary, Stephen Early, should carry conviction.

"You are advised that Labor's Non-Partisan League has issued instructions to its various Chairmen in the eleven affected states to refrain from any participation in the proposed Conference, if later called to assemble in Salt Lake City or elsewhere.

"With my personal compliments, I am

Sincerely yours."

COLOMBIA

Suggested Agenda for Conference at Treasury Department,A. Prospects of a successful debt settlement of Colombia's outstanding debt.

1. Present status of debt settlement negotiations between the foreign bondholders and the Colombian Government.
2. How much are the foreign bondholders likely to accept as a minimum?
3. What is Colombia's capacity to pay?
 - (a) Can she raise the funds internally (1) for the Federal debt? (2) for the local government debt?
 - (b) Can she raise the necessary foreign exchange?
4. Possibility of developing ~~the~~^a flexible scale of debt payments.
5. Status of sterling debt settlement.
6. Will she be able to service ~~the~~^a new debt as well as settlement of the old?

B. Desirability of extending credits to Colombia.

1. What are Colombia's short-term needs to meet emergency exchange situation?

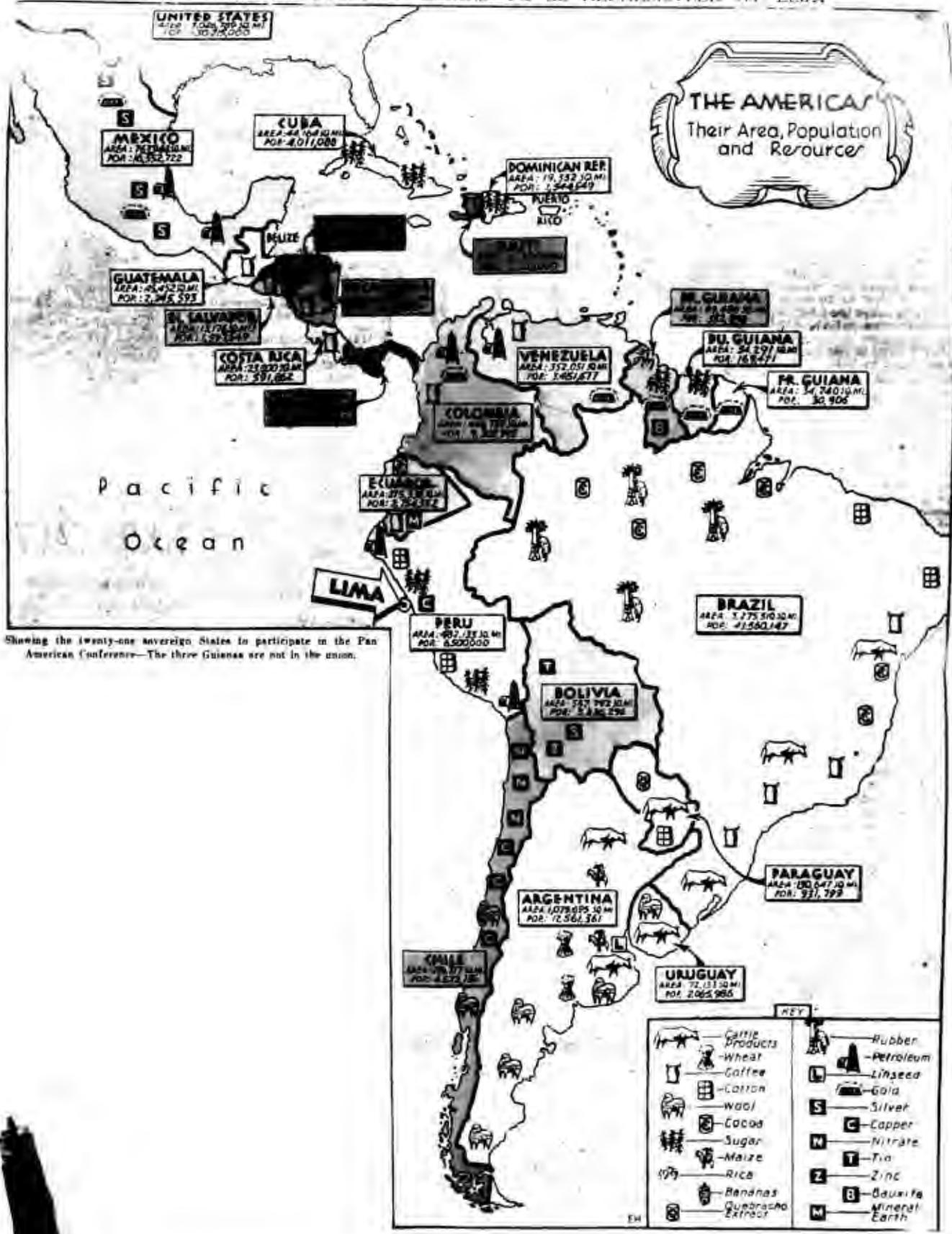
(More information needed as to the acuteness and cause of the emergency situation.)
2. Long-term needs.
 - (a) For monetary stabilization.
 - (b) For economic development.

C. Colombia's foreign trade prospects.

1. Effect of war on Colombia's trade.
2. Long-term trends.

D. Prospect of Colombia attracting foreign private capital.

THE LANDS OF THE NEW WORLD TO BE REPRESENTED AT LIMA



Showing the twenty-one sovereign States to participate in the Pan American Conference—The three Guianas are not in the union.

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TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE October 31, 1939

TO Secretary Morgenthau
FROM Mr. White
Subject: Colombia

1. The Debt Situation:

(a) Colombia has an internal Federal debt of 78,500,000 pesos (\$45 millions) which has been serviced continually. About one-half consists of a floating debt. About one-half of the internal Federal debt is held by the Cental Bank. The larger part of the bonds bears interest rates of 6 and 7 percent although about one-fourth bears interest from 3 to 4 percent. The 7 percent domestic bonds are now selling at about 88. The current Budget carries an expenditure of \$5 1/2 millions to service the internal debt and external short-term debt.

(b) She has an external short-term debt of \$19.3 millions contracted in 1930 (at a time when Colombian bonds were not marketable) which is being serviced in full. It carries a low rate of interest and is held almost entirely by the National City Bank, so far as we know. It was originally granted with conditions involving revision of budgetary procedure and alteration of the administration of railways.

(c) The external long-term (national and municipal) totals \$159 millions -- exclusive of \$55 millions of interest arrears -- of which \$82 millions is local Government obligations. The debt is largely a dollar debt, there being only \$12 millions in sterling obligations out of \$159 millions.

(d) Colombia is now in complete default on her long-term external debt -- both national and local. Partial default began in 1931 and complete default in 1934. Interest arrears on her defaulted national obligations have now reached \$22 millions, the arrears on local debt are \$33 millions. Full service on the national debt, would take \$4.7 millions, and on the local Governments' debts \$5.8 millions; these figures compare with a national budgeted expenditure of \$50 millions annually and local Government expenditures of perhaps \$35 millions.

Local Government external bonds have been selling for \$12 to \$20 for many years and it is reported that a large volume of them have been repurchased by the local Governments but we have no definite data on the matter.

(e) The present government of Colombia have publicly stated their intention of meeting their external obligations honorably. As recently as September 28, 1939, ex-President Lopez who was in New York with the rumored purpose of speeding debt settlement negotiations assured the Pan-American Society that Colombia would resume payment of its foreign obligations and that budgetary provisions had already been made. We do not have any information as to the details of the offer made by Lopez when he was up here last month, but it is our understanding that the officials in the State Department considered it a reasonable offer. Last year Colombia offered to pay 1½ to 3 percent (varying with her export situation) with amortization suspended for seven years, and no scaling down of the principal on the national debt. The offer was not accepted. At that time the Federal Government authorized the local Governments to negotiate separate debt settlement on the condition that they did not offer better terms than the bondholders got from the National Government.

2. Colombia's Federal budget is in good shape.

Colombia has been operating under a balanced Federal budget since 1935. This year it appears that she may have a slight surplus. The structure and administration of the Federal tax system has been improved during the past five years. The Federal revenue during the first eight months of this year shows a substantial increase over the first eight months of last year (\$32 millions as against \$27 millions). We have no data on the status of the State and local public finance.

Colombia expects increased revenue from her greatly expanded oil production which will have its full effect for the first time next year. There will be some loss of revenue from the reduced imports but probably not enough to offset the gain in revenue.

The 1940 Budget carries \$1.9 millions for servicing her external Federal debt. That amounts to 2½ percent of the outstanding Federal debt.

3. Colombia's Foreign Exchange Situation:

(a) We have no evidence, as yet, of any weakening of Colombian exchange during the past couple of months. Though her gold holdings declined during the first seven months, such decline was largely seasonal. During August she increased her gold and foreign exchange holdings by some \$2 millions, bringing up her foreign exchange assets to \$24 millions, which is approximately as much as she has had in the last few years. We do not know her present holdings.

Her exchange has been comparatively stable at 57¢ on the dollar since 1935. Exchange restrictions have been in effect since 1931.

Exclusive of the foreign exchange needed to service her debt, Colombia needs approximately \$12 millions a year to meet her adverse balance of payments. Half of this sum is to supply exchange for the foreign enterprises in Colombia -- chiefly Standard Oil affiliates and United Fruit.

4. Colombia's Foreign Trade Position:

Colombia has had a favorable trade balance for many years, but in the first six months of 1939 her imports rose by some \$9 millions while her exports did not increase. This is exclusive of gold exports. During the first six months gold exports almost doubled (from \$6 millions to \$11 millions) only part of which arose from expanded production.

Her chief exports are coffee - 54 percent, oil - 20 percent, and bananas - 4 percent. The United States is her most important customer, purchasing 60 percent of her exports and selling her 53 percent of her imports. Germany was second, selling her 17 percent of her imports and taking 14 percent of her exports. United Kingdom and Canada came next on the list.

Colombia sells much more to the United States than she buys, while she buys more from Germany and the United Kingdom than she sells them. Our sales to Colombia have increased by 30 percent during the first eight months of this year, while our purchases from Colombia increased only 10 percent.

5. Effects of the War:

Colombia will lose her sales to Germany. Last year these amounted to about \$1 million a month, chiefly coffee, but this loss should, during the coming year, be largely compensated for by (a) her increased production and export of gold, and (b) a substantial increased output of oil.

Since the United States takes 80 percent of Colombia's coffee and Canada substantial amounts, and since Colombian coffee is of such a quality as to be less sensitive to a decline in coffee demand, the loss of the German coffee market should not be a serious one for her foreign exchange situation. Altogether it would seem that a continuation of the war should, during the coming year, leave Colombia as favorably situated as ever.

It must be borne in mind, however, that coffee plays so important a role in her export trade (54 percent) that any substantial decline in coffee prices beyond their present low level would seriously reduce her supply of foreign exchange and seriously affect her domestic economy.

6. What does Colombia need at this time?

It is possible that Colombia may be in need of a \$5 or \$10 million short-term credit to tide her over the present emergency situation. However, not having her trade figures for the past few months nor her gold holdings since September 1, we cannot say definitely whether she is in an acute emergency. If Colombia does have an emergency situation she is a good risk for a \$10 million loan in view of her expanding oil and gold industry and her general excellent economic situation.

7. Colombia needs long-term capital:

Colombia's economic situation was good up to the outbreak of the war, her future very promising, her population large (9 million), her feelings toward America pleasant, and her strategic importance for the Canal great. Politically Colombia comes closer to being a true democracy than any other state in South America.

Colombia could, in our opinion, fruitfully use long-term loans of \$10 million a year for the next several years; for improvement of her transportation system, a further extension of her domestic industries, and further agricultural reform. Colombia also is desirous of re-purchasing her railways now owned by British interests and probably would desire to substitute a domestic debt for a foreign debt.

COLOMBIA

Prepared by the Division of Monetary Research

chiefly by S. G. Hanson

Summary

COLOMBIA

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SUMMARY INFORMATIONPublic Finance

1. Annual expenditures by national government \$50 million, by local governments \$35 million.
2. Budget balanced since 1935 but this is without servicing external long-term debt. For eight months of 1939 revenues are ahead of 1938 and exceed expenditures slightly.
3. Tax system improved since 1935-36. Income and excess profits tax revamped.
4. Chief sources of revenue: Customs, 30-35 percent; income and excess profits, 20 percent.
5. Chief expenditures: National defense, 17 percent; debt service, 11 percent; public works, 20 percent; education, 9 percent.
6. National budget for 1940 carries \$1.9 million for resumption of service on external debt, if it is resumed.
7. Revaluation of gold in 1938 netted 16,000,000 pesos of which half was used for paying off government debt, five sixteenths for public works, three sixteenths for an exchange stabilization fund.

Public Debt

1. External long-term debt is in full default. It amounts to \$159 million, of which \$82 is local governments and \$77 national government. Interest arrears total \$22 million on national government debt. Ninety percent is in dollar bonds.
2. External short-term debt, largely contracted in 1930, is \$19 million and is being serviced.
3. Internal debt of \$45 million is being serviced; half is held by the Central Bank. Internal debt did not expand notably after 1934.

4. Negotiation of debt settlement has been badly bungled by American bondholders' committees.
5. Local government issues and issues of the Agricultural Mortgage Bank guaranteed by the national government are believed to have been repurchased in considerable quantities by the debtors.
6. No graft or corruption attached to the original dollar flotations, but there was much waste and extravagance; one third of proceeds was used productively.

Foreign Direct Investments

1. Total \$150 million, of which American \$125, British \$10 to \$15. British largely in railways, American in oil, bananas, mining.
2. American investment dates from World War.
3. Remission of profits was permitted during depression.
4. Government recently rewrote petroleum code so as to attract direct investments.

Trade

1. In 1938, exports were \$92 million, imports \$89 million. For the first six months of 1939, imports, \$55.1 million; exports, \$48.2 million.
2. United States trade position very strong; we sell 50 percent of imports, buy 59 percent of exports. Germany second with 17 and 14 percent. United Kingdom supplies 11 percent of imports. Canada is third best market with 9 percent.
3. Normally she has heavily favorable balance of trade with United States, unfavorable balances with Germany and United Kingdom.
4. Germany made great gains during the 1930's.
5. Chief exports: Coffee 54 percent, oil 19 percent, gold 17 percent, bananas 4 percent. Germany had taken 14 percent, being especially important market for coffee (15 percent) and bananas (15 to 20 percent).
6. Imports during first half of 1939 were unusually heavy partly in anticipation of war shortages and partly for business expansion.

Industry

1. Bulk of population is concerned with agriculture although oil and gold account for one third of exports and are increasing relative to farming. Are still not self-sufficing for food, although have abundant arable land made unattractive by transport difficulties.
2. Competitive position of basic industries is strong. Coffee is mild, used for blending, suffers less than Brazilian in volume and price if war softens the market. Leading producer in world of mild coffee, and second only to Brazil in total coffee production.
3. Bananas are American trade; much trouble with labor and with planters.
4. Failure to break up large estates is major social problem. Peasants' revolt in 1934 was ended with promise of making land available for ownership, but have failed to do so.
5. Oil and gold are expanding under foreign ownership, largely. Platinum and emeralds have long held important world trade position. Hides are exported in large quantities but potential increase is small.
6. Manufacturing of consumption goods is expanding behind high tariff walls. An uneconomic development. No heavy industry of importance is likely.

American-Colombian Relations

1. Relations strained for quarter of century by Panama incident. Panama had been province of Colombia. Its movement to independence facilitated building of Panama Canal. Roosevelt said "I took Panama." In 1922 we apologized to Colombia and paid \$25 million to soothe feelings. Oil had just been discovered and we wanted to exploit oil.
2. Is strong economic basis for close political relation. We take 59 percent of exports and sell 50 percent of imports. Economies are complementary. We take three fourths of coffee which is basis of really national economy. We hold 90 percent of external debt and have made 90 percent of direct investments.

3. Signed reciprocal trade agreement in 1936.
4. She has been pro-United States at the inter-American conferences. Powerful force for democracy. Favors belligerent neutrality pro-allies. Has strong strategic position relative to Panama Canal. Since her internal air transport company is German with German reserve officers as pilots, we have asked her to take steps adequately to protect herself against potential effect of such penetration.

Banking Structure

1. There is a Central Bank, 3 government-constituted mortgage banks, 10 native commercial banks, 4 foreign banks, 3 miscellaneous credit institutions.
2. Foreign banks do perhaps one fourth of commercial banking business. National City Bank of New York is the American bank but its position is much less important than our trade position merits.
3. Central Bank was established in 1923 on Kemmerer recommendations. Was reorganized 1933. Kemmerer recommendations much criticized as impracticable. Is permitted by law to deal directly with public. Government names 3 of 9 directors; holds less than half of the stock; rest held by banks and local interests. Its autonomy was preserved during depression. Government borrowing from it was heavy during 1930-34, but no increase thereafter.
4. Government guarantees obligations of Mortgage Banks. While the Agricultural Mortgage Bank is in default on bonds, it has continued to pay interest on its stock even if held abroad. In 1932 government set up a Central Mortgage Bank to relieve other banks of some of burdens of depression.

Technical Assistance

1. Colombia has been firm believer in use of foreign technicians. Has had Kemmerer finance advisers, German educational mission, Swiss customs and military missions, Belgian telegraphic mission, etc.
2. Kemmerer's work was widely criticized; much of his recommendations proved impracticable.

Foreign Exchange

1. Exchange restrictions since 1931. Heavy depreciation of peso (43 percent).
2. In 1939 had import licensing, prior permits for imports, exchange restrictions; permitted remission of earnings; there was no free market; there were clearing arrangements with Germany and Japan and special arrangement with Italy.
3. In November 1938, revalued gold, established exchange stabilization fund of \$1.7 million, stabilized exchange rate at 1.75 pesos to dollar.
4. Produced \$1,000,000 more gold than was exported in 1934-38. In 1939 up to August 31, gold and foreign exchange holdings fell by \$2.3 million. Has \$23 million in gold and produces \$18 million annually, with output rising.

Natural Endowment

1. Area twice that of France; population 8,700,000, third largest in South America.
2. Lies in tropics but on the uplands where the bulk of the population lives the climate is healthy and stimulating.
3. Unfavorable topography made costly the building of transport facilities and impeded growth of national spirit by isolation of communities that intensified individualistic spirits.
4. Is close to United States (1,700 miles) and strategically close to Panama Canal.
5. Leading gold producer in South America (\$18 million annually). Enormous potential producer of oil; platinum and emerald production among leaders in world trade; copper, lead and zinc deposits are uncertain in extent and undeveloped as yet.
6. Have no great deposits of iron, and although coal reserves are great, future power requirements will be met by oil and water power. No likelihood of an important heavy industry.

7. Climate and soil suitable for fine cash crops of coffee, bananas and eventually cotton and tobacco in good quantities. But are still not self-sufficing on foodstuffs, despite much arable land. Inadequacy of transport facilities obstructs development.

Population

1. 8,700,000; mestizo is dominant element; 5 percent pure Negroes for coastland work.
2. Catholic influence very strong.
3. Language is Spanish.
4. Over 50 percent illiterate; Catholic influence in education is great.
5. Have failed to attract sizeable European immigration; failure to break up feudal-like large estates and unlikelihood of newcomer reaching ownership of his land is obstruction.
6. Capital is Bogota with population of 260,000.
7. Have developed amazingly strong nationalistic spirit despite earlier individualistic spirits of isolated communities.
8. Are a conservative people but as long as avoid solution of land problem, there is an easy base for stirring up unrest.

Transportation

1. Unfavorable topography and large size of country delayed transportation.
2. 2,500 miles of railways of which 80 percent government owned and balance British.
3. Large expenditures on roads and rails since influx of American money in 1920's, but plans were uncoordinated and thus much wasted.
4. River navigation is important but slow and arduous.
5. Have plan for spending \$5 million on highways in next three years. Have been spending 20 percent of budget on public works.

Political

1. President Eduardo Santos elected 1938. Liberal Party has ruled since 1930. Like its opposition it too is made up of large landowners but it is more anti-clerical. Adopted middle-of-road conciliatory program. Failed to attack land problem despite a revolt by peasants in 1934 on that issue.
2. Close approach to true democracy. Free press and free speech.
3. Growing nationalistic spirit will ultimately react to disadvantage of foreign capital but meanwhile publicly proclaim desire to attract capital.
4. Flood of new revenue from expanding oil industry will enable government to evade issues and maintain status quo.
5. 1932-34 Leticia dispute with Peru caused expanded military expenditures, though settled peacefully. Have been unable to deflate military since then.

Recommendations

Natural
Resources

NATURAL ENDOWMENT

1. Colombia is the fourth largest country in South America in area and third in population. Area is twice that of France, about 440,000 square miles. Population is 8,700,000.

2. Colombia lies geographically in the tropics, but at least one-half of the area by reason of its altitude is in the temperate or near temperate zone climatically. The mountains and high plateaus above the low valleys and coastlands are capable of supporting a vigorous people. And here, at altitudes 4,000 to 9,000 feet above sea level lives the bulk of the population in a healthy stimulating climate.

Before the white man came, the Chibchas dwelled on these same sebanas, and the Chibchas were an honored race; they were a vigorous well-integrated people with a considerable knowledge of agriculture and the arts and a respected form of government.

3. Topography has been a tragic barrier to construction of transport facilities. All the ports on both Caribbean and Pacific are cut off from the interior by steep mountains; communication is difficult except by the rivers flowing from mountains to the sea. River navigation is slow and arduous, involves much loading and unloading, and in certain seasons necessitates waiting for the rains.

4. Topography is responsible too for a long isolation of various areas which caused a development of an intensely individualistic spirit in each region. Intense local loyalties were developed. And yet, out of these local loyalties, long fighting for ideals developed the present strongly-centralized government. It is a proud achievement to have built up so strong a sense of nationality on the foundation of so many isolated communities.

5. Topographic areas are:

- a. Pacific coast - dense hot steaming forests, difficult of access and scantily inhabited.
- b. Western Cordillera - lowest and least continuous of the three great Andean ranges.
- c. Cauca Valley - famed for beauty and fertility.
- d. Central Cordillera - passes are few and high, 30 to 50 miles wide and extending north some 500 miles.

NATURAL ENDOWMENT
(Continued - 2)

- e. Magdalena Valley - long narrow valley which is the chief but imperfect route of access to interior uplands.
 - f. Eastern Cordillera - here are the most important high fertile sabanas where lives a large part of the population.
 - g. Llanos or plains sloping from foot of the Eastern Cordillera to the Orinoco and Amazon Rivers.
 - h. Caribbean coastal plain - hot lowlands, partly swamp, tropical area.
6. Proximity to the Panama Canal. It is closer to the United States (1,700 miles) than the other countries of South America.
 7. It is the only country in South America with extensive frontage on both the Atlantic and Pacific.
 8. River system is of quite extensive. Interior rivers like the Magdalena, Cauca and Atrato; and Colombia exercises sovereignty over part of the course of the great Amazon and Orinoco Rivers.
 9. The soil and climate are especially well-suited for the production of a mild, high-grade coffee, a wide area is suitable for bananas, and cotton and tobacco have definite expansibility here. Sugar cane could be developed although currently the country is still a net importer.
 10. The mineral endowment is magnificent: (Note: No adequate geological survey has yet been made.
 - a. Gold: Colombia is the leading producer in South America. Historically, she has been one of the great gold-producing areas of the world. Expansion possibilities exceed those of any other South American nation.
 - b. Copper, lead and zinc are known to be available, but thus far transport difficulties in the way of opening mines that require handling of materials on a tonnage basis have prevented a systematic search for such deposits suitable for modern mining methods. We know she has them but do not know if the deposits are of commercial importance.

NATURAL ENDOWMENT
(Continued - 3)

c. Petroleum: Magnificent reserves assure her a place of prominence as one of world's great producers of oil.

d. Platinum: One of the largest producers; for a time was the leading producer until Russia regained position in 1924; now challenges Canada for second place.

e. Emeralds: Is world's chief source.

f. Building stone and clay are widely distributed, but cement has continued to be imported because when cement mills are in the interior, transport costs make it cheaper to supply coastal cities from abroad.

g. Coal: Very large reserves have been reported. Often said to be largest in South America. It is true that coal is widely found and that where mined the coal has been of fair steam quality and found in beds of workable but not great thickness; it is broken and faulted and actual mining conditions are not too favorable. It shows signs of being satisfactory for cooking.

However, there has never been a local demand adequate to stimulate opening of big coal mines and there is no such known abundance of good cheap coal as would stimulate industries. Railways and small industrial plants have been supplies; household is very limited; homes are not heated.

Prediction is that coal will never achieve more than local restricted importance. When power requirements rise there will be oil and waterpower to serve.

h. Iron: Iron has been found at various points but never in such quantities as in the great producing areas of the world. Transportation difficulties making delivery difficult have enabled a few local centers to produce but they cannot hope to compete and survive import competition if ever transportation is adequate.

POPULATION

1. Population is 8,700,000, of which the dominant element is mestizo. While the Indian group has been better assimilated than in such countries as Ecuador, there is an Indian outlook among a large proportion of the population.

Five percent of the population is pure negro, comprising an important labor group in the coastlands, as stevedores or workers on the banana plantations.

2. Progress from the Indian viewpoint is in the direction of the aggressive North American rather than the European.

3. The small group of pure whites controls the best land and the government.

4. Catholic influence has been exceptionally strong. The Conservative party which controlled during the twentieth century up to 1930 was strongly pro-church. Under it the education and politics were largely dominated by the church. The present Liberal Government is somewhat less susceptible to church influence.

5. Language is Spanish.

6. There is considerable native pride in Bogota as the "Athens of South America." Position as a cultured area is rather desperately desired.

7. The flow of European immigration has failed to reach major proportions. She has failed to make immigration attractive or to pass laws favorable to its reception. Small-landholding is not encouraged notably.

8. Over 50 percent of the population is illiterate. Secondary schools are about one-fifth run by Government and 4/5 under private control; elementary schools are in Government hands. There are 17 university faculties, 13 agricultural colleges, six schools of dentistry.

9. Public health work has been of growing importance. Rockefeller Institution has helped greatly in control of tropical diseases, etc., and in organization of the local health service. The death rate is half that of Chile, and the natural increase double Chile's.

POPULATION
(Continued - 2)

10. Capital is Bogota, an inland city of 260,000; other cities are Baranquilla 140,000; Cartagena 100,000; Medellin 125,000; Manizalis 100,000. There is considerable difference between cities; Medellin, for example, is said to be especially enterprising, with its descendants of the original Spanish Jewish colony. Buenaventura is the hottest port in the tropics, and perhaps the dirtiest.

11. For an area once so isolated in individual communities, there is a surprising sense of nationality, a loyalty to things Colombian, which may express itself eventually in very drastic steps against foreign enterprise. However, for the time being, direct investments are being encouraged.

12. The people are naturally conservative and the dominance of the Catholic church would make for conservatism and opposition to such radical developments as communism. Yet, the narrow ownership of land has caused much unrest and in 1934 a peasants' revolt made it clear that the land problem must be solved.

TRANSPORTATION

1. Unfavorable topography, large size of the country, and unwillingness of developing traffic in reasonably short periods, have checked the construction of transportation facilities.

2. There are 2,500 miles of railways of which 80 percent are Government-owned. The British have \$10 million investment in railways. There is no single trunk line and the existing railways serve to tie up individual centers of population to a river or port or to provide communication round river bars and rapids.

Foreign railway building is confined largely to the pre-war period. Such lines were inadequate and have been considered unsatisfactory, so that since the World War and in the future railway building must be expected to be lodged in Government hands, probably through Government external loans.

3. During the 1920's the payment of \$25 millions by the United States Government in apology for the Panama incident, and the flood of capital from New York, caused an expansion of transportation facilities under Government construction. In 1924 and 1925, \$19 millions were spent on railway building.

4. Unfortunately, the public works programs of the 1920's were uncoordinated and inadequately planned. For example, an unnecessary railway connecting two valleys each of which had its own outlet to the sea was considered advisable. As the Federal Government tried to bore a tunnel for the railway through the mountain range separating the two valleys, local Governmental authorities were busy building an almost equally expensive road over the top of the same range.

Until 1922 there were no automobiles in Bogota and no paved streets. But the flood of New York money paved 60 miles of streets and the automobiles came.

5. River navigation has been important, but it is slow and arduous, involves much loading and unloading, and often seasonal waits for the rains.

6. In 1939, the Government approved a \$5 million highway construction program for three years, although the source of funds for this purpose was not quite clear.

7. In 1938 a railway was bought for \$6.5 millions from Belgian owners, with a credit arrangement that called for servicing regardless of defaulted debt.

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Political
History

POLITICAL SITUATION

1. Tradition of political instability. There are said to have been 27 civil wars, many constitutions. Civil wars culminated in the three year war of 1899-1902 when fatalities ran into the hundreds of thousands. That was the last major upheaval. Thereafter, until 1930 the Conservative party provided firm leadership relatively peaceful. Since 1930 the Liberal Party has successfully maintained itself in power with a middle-of-the-road program.

2. Conservative Party is composed of large landowners and the Catholic Church which is very strong here.

Liberal Party which fought long wars against the Conservative Party is also composed of large landowners, but it favors greater religious freedom and a loosening hold of the church on education and politics. Actually since they got into office in 1930 they have not been much more progressive than their opponents.

3. The degree to which democratic procedure prevails here was well illustrated in the election of 1930. Enrique Olaya Herrera, a young progressive, organized his campaign in very short time, carried it to the extremities of the country by airplane. Vacillation of the Archbishop who had long had preponderant influence lost him his political prestige and enabled the Olaya Liberal Party to sweep into power.

4. In 1934 the Liberal candidate Dr. Alfonso Lopez (who has been in this country this summer on what is reported to be debt negotiations) was so universally accepted that the Conservatives named no candidate and Lopez with a middle-of-the-road progressive program, was elected with practical unanimity.

5. Shortly after Lopez came into office, there was a peasants' revolt. Thousands of peasants driven to desperation by the ancient system of absentee landlordism arose in armed insurrection to demand title to the lands they and their forefathers had toiled on under virtual feudal bondage.

Lopez issued a statement recognizing the justice of their claims and promising reforms. He suppressed the revolt with armed force. Actually, however, he and his party never effected the land reforms and the feudal organization of society continues.

POLITICAL SITUATION
(Continued - 2)

6. Again in 1938 the Liberal Party candidate won. He is Eduardo Santos, now President.
7. The Liberal Party program on the whole has been conciliatory, although their new constitution of 1936 permits all forms of worship, to the great displeasure of the church group. The Constitution also carries vague provisions for the division of absentee-owned estates, etc., but nothing radical is likely to be done.
8. The Communist Party showed some strength during the elections of 1934. The area is not considered receptive to communism because the people are conservative and quite obedient to the dictates of the Church. But strikes in some regions, especially against foreign banana, etc. companies have been multiplying and communist influence has been suspected.
9. Despite the topographical barriers and the failure of the masses to participate with the small upper group in prosperity of the region, there has been a growing tendency to nationalism which does not brighten the outlook for foreign companies. United Fruit Company influence in the banana region has been distinctly challenged.
10. One difficulty with the coming boom in oil is that it will provide an easy source of immense revenues for the Government and thus prejudice the leaders to maintain the status quo, without serious effort to settle such problems as the land problem.
11. In 1932 a dispute with Peru over Leticia caused immense military expenditures. The dispute was settled peacefully in 1934, but not until the Colombian Government had so enlarged its military establishment as to provide difficulties since in bringing it now to a more practical level. Bombing planes were bought and German and American military technicians employed. Army was largely expanded.

FORM OF GOVERNMENT

1. Colombia is a democracy, paying more than lip service to the idea.
2. The President is elected for a four-year term by popular vote. He appoints his cabinet as well as local Government heads such as departmental governors, intendencias, comisarios. His term is four years.
3. There are two houses of Congress: House of Representatives and Senate. Senators are elected by departmental assemblies for a four-year term. Representatives are elected by popular vote for a two-year term. The House has currently 118 members, the Senate 57.
4. There are 14 departments (States) which enjoy only partial autonomy. They elect their local legislatures and still have right to manage their own finances. But their power to borrow abroad without sanction of the national Government has been restricted, as has been their power to service external debt.
5. Franchise is extended to those who can read and write and have either a minimum income or property of specified value.
6. There is a free press which avails itself fully of its privileges. Speech is free actually and theoretically.

Industry

INDUSTRY

1. Colombia is an agricultural country as far as the bulk of the population is concerned. While oil and gold account for one-third of exports and may increase relative to agricultural products, the volume of employment is relatively small in these industries. For the internal economy, coffee, livestock, domestically consumed foods, and bananas have more importance. There is a large area suitable for agriculture but transportation difficulties cause only a small portion to be used as yet.

2. The competitive position of basic industries in world markets is sound.

3. Coffee is a good mild quality, used largely for blending, occupying a position in the market superior to that of Brazilian coffee. It will suffer less in volume and price if the war softens the coffee market. Colombia is second to Brazil in coffee production and in supply of coffee to the United States, but it is the leading producer of mild coffee. Native ownership distinguishes coffee from other leading industries.

4. Banana industry depends on American exporters. Much Negro labor has been used. There has been much agitation for nationalization and in the industry the difficulties with labor and with native planters have been unusually frequent.

5. Hides form a minor agricultural export.

6. Landholdings are large and there is a disproportionately large population working on the land of others without hope of ever achieving land ownership. The discontent of this group forms a major social problem which is being evaded.

7. Oil and gold are expanding industries with a promising future. In platinum Colombia is one of the world's leading producers.

8. Manufacturing has been increasing behind heavy tariff protection and the depreciated currency. She continues to be a heavy food importer and textile importer and would do well to expand such production, if less economic activity must be undertaken, rather than manufacturing in which she has serious disadvantages. Cigars, cigarettes, textiles and flour are among major local manufactured goods.

American
Relations

AMERICAN-COLOMBIAN RELATIONS

1. Relations with Colombia were strained for a quarter of a century because of the Panama incident.

Panama had been a province of Colombia. Colombia had granted a concession to a French company for the building of a canal across the Isthmus. French company went bankrupt and American speculators bought up the stock and then lobbied Congress into voting the purchase of the French concession in 1902.

In 1903 the United States negotiated with Colombia for a lease of strips of land across the Isthmus bordering the proposed canal route, over which we would have political control and for which would make regular payments to Colombia. Colombian Senate refused to ratify. Hereafter a revolt broke out in Panama, Colombian troops had difficulty in arriving in time to quell the revolt, due to its refusal to American interference, and Panama declared herself independent. Quickly the United States recognized her independence (three days later), and Roosevelt could later say "I took Panama." The agreement with Panama was readily made and the canal built.

Under President Wilson a treaty expressing our regret and agreeing to pay Colombia \$25 millions in apology was drawn up but the Republicans in the Senate refused to ratify on the grounds it constituted a slur on Roosevelt.

By Harding's time, however, oil was discovered and oilmen wanted friendly relations. Quickly Republican votes were switched over in favor of a Colombian treaty and the treaty went through in 1922. Oil production started the same year. Standard Oil was long the only producer of oil and the largest single taxpayer.

2. Mellon interests (Gulf Oil) long held the Barco Concession for an area larger than Rhode Island, about 200 miles from the Caribbean and worth fabulous sums for its potential oil production. Colombia twice cancelled the concession claiming the terms had not been met. The State Department pressed for restoration in 1928 but nothing happened. In May 1931 the last four million dollars of a loan floated in New York was unaccountably held up and in June 1931 Colombia restored the Barco Concession to the Mellons and a few days later Colombia got the \$4 millions. The State Department has made it clear that it had nothing to do with this strange coincidence. Since then the Mellons sold their concession to Texas Corporation and the Secor-Vacuum Corporation.

AMERICAN-COLOMBIAN RELATIONS
(Continued - 2)

3. We have a strong economic basis for intimate political relations with Colombia. We take 54 percent of her exports and sell 50 percent of imports. More than three-fourths of the chief native crop around which the economy centers (coffee) goes to the United States. We hold the larger part of the external debt and have made more than 90 percent of the direct investments in Colombia.

4. A reciprocal trade agreement was signed with Colombia in 1936.

5. Colombia's position at the Inter-American Conferences has been in line with our policy. She has been a powerful force for democracy and has had an active press against fascist penetration. Despite this fact, a score of German reserve army pilots have been flying the internal air transport planes which are largely german-controlled. Germans obtained oil land concessions in recent years, totalling at least 88,000 square kilometers, according to the press. During the current war, she has come out for belligerent neutrality pro-Allies.

Trade

TRADE

1. In 1938 exports were \$92 millions including gold, imports \$89 millions. For the first 6 months of 1939, imports were \$55.1 millions, exports \$48.2 millions.

2. American trade position is very strong. We furnished 50 percent of her imports and took 59 percent of her exports in 1938. Germany was in second place, selling 17 percent and buying 14 percent, United Kingdom supplied 11 percent of imports. Canada ranks third as a buyer with 9.5 percent.

3. Normally Colombia has a heavily favorable balance of trade with the United States which covers unfavorable balances with Germany and the United Kingdom.

4. In recent years exports to Germany had been rising; while annual exports to Germany averaged \$12 millions from 1936-38, the average was only \$2 to \$3 millions from 1931-1933. Imports from Germany ran \$4 to \$5 millions in 1931-33, and \$14-\$15 millions in 1936-38.

5. Chief exports are coffee 54 percent, oil 19 percent, gold 17 percent, bananas 4 percent. German purchases of coffee (15 percent) and bananas (15 to 20 percent) had been important. War might be expected to weaken coffee exports while oil and gold industries continue their expansion.

6. The nature of imports is such as to make difficult any great reduction while the economy is geared to the current-scale of exports and to plans for development. Colombia normally runs 20 million pesos of textile imports \$5 to \$6 millions food, \$7 to \$10 millions iron and steel products, \$10 millions mining and textile machinery and equipment. She imports wheat, raw cotton, rice and sugar and in her present desire for greater self-sufficiency in food may be able to cut this down somewhat.

Domestic manufacturing will ultimately reduce textile imports but it will be a non-economic manufacturing development. Cotton imports on the surface appear to be an unnecessary strain on foreign exchange resources, but domestic textile manufacturing industry cannot yet use the high quality domestic cotton.

TRADE
(Continued - 2)

7. Leading products imported from Germany in 1937 are listed in the order of importance: tablets and pills, aniline dyes, iron and steel tubes, brewing machinery, agricultural tools, arts and craft tools, locomotives, barbed wire, cement, hops, glass bottles, quinine and salts, electric bulbs, textile machinery, printing machinery, cotton drill, office equipment, copper and wire cables, etc.

8. During the first half of 1939 importations have been unusually heavy, due partly to the uncertainty in the European situation and apprehension of difficulty in securing supplies later in the year.

Trade Balances of Colombia
(Millions of pesos)

Year:	Trade Balance	Balance with United States	Balance with Germany	Balance with United Kingdom
1938	+ 4	+20	-6	- 18
1937	+15	+40	-4	- 30
1936	+37	+45	-4	- 20
1935	+36	+50	-5	- 16
1934	+65	+66	-6	- 8
1933	+22	+31	-5	- 4
1932	+40	+41	-2	- 5
1931	+57	+64	-2	- 5
1930	+50	+63	-4	- 4
1929	+ 1	+37	-15	- 12

Colombian Foreign Trade in 1937-38
(Millions of pesos)

Country of Origin or Destination	Imports		Exports	
	1937	1938	1937	1938
Total	169	159	184 ^{1/}	168 ^{2/}
United States	78	79	118 ^{1/}	99 ^{2/}
Germany	22	27	18	21
United Kingdom	29	17	-	-
France	5	5	7	6
Czecho-Slovakia	3	3	-	-
Belgium and Luxemburg	4	3	1	-
Italy	1	1	2	1
Netherlands	2	1	1	1
Sweden	1	2	-	-
Switzerland	1	1	-	-
Canada	3	2	10	14
Japan	-	-	-	-
Curacao	1	-	18	16
All Others	13	11	2	2
Percent of total:				
United States	46.5	49.9	64.1	59.0
United Kingdom	17.4	11.1	.4	.4
Germany	13.2	17.4	10.3	12.8
Italy	.9	1.2	1.5	1.2
Japan	.2	.2	.1	.1
Curacao	.4	.3	10.1	10.0

^{1/} Including 32,018,665 pesos in gold bars.

^{2/} Including 18,780,402 pesos in gold bars.

Value of Exports
(In millions of pesos)

Year	Total Imports	Total Exports	Balance of Trade	Exports of:						Coffee prices : medellin : U. S. cents
				Coffee	Gold	Petroleum	Bananas	Hides	Platinum	
1938	159	168	+ 9	89	19	37	9	3.9	1.6	11.51
1937	169	182	+ 13	99	32	35	7	5.0	2.7	12.19
1936	134	158	+ 24	91	21	28	8	3.5	3.1	11.99
1935	119	143	+ 24	79	19	29	9	2.7	2.1	10.85
1934	98	152	+ 54	82	29	28	6	2.9	2.7	14.35
1933	50	72	+ 22	49	5	10	5	1.5	1.2	11.05
1932	31	70	+ 39	43	3	16	6	0.9	0.5	12.26
1931	41	98	+ 57	55	18	16	5	1.6	1.2	16.85
1930	63	112	+ 49	62	9	26	9	3.4	1.9	18.36
1929	126	127	+ 1	77	5	27	9	3.9	2.6	18.58
1928	148	133		88	1	26	9	3.6	3.3	28.14
1927	126	109		71	1	23	5	3.2	3.3	26.60
1926	111	111		86	1	10	5	2.7	4.4	29.65
1925	89	84		67	1	-	5	3.2	4.0	29.03
1924	56	86		69	2	-	4	2.9	3.9	26.60
1923	61	60		45	4	-	4	2.6	3.6	19.30

LEADING IMPORTS
(Millions of pesos)

	: 1938	: 1937	: 1936
Cotton	1.9	1.9	1.4
Autos, trucks and chassis	7.3	7.4	6.2
Rice	1.3	1.3	0.9
Cotton Driles	3.0	3.8	2.4
Pharmaceutical specialties	4.4	1.8	1.2
Iron and steel bars and sheets	4.0	2.8	2.9
Silk yarn	1.4	1.6	0.9
Tires	2.2	2.3	1.6
Mining machinery	4.2	5.4	2.8
Textile machinery	2.8	3.4	0.7
Farm machinery	2.5	1.2	0.7
Wool cloth	2.3	3.9	2.9
Paper	1.5	1.3	0.7
Cotton textiles	4.8	7.3	6.2
Iron and steel tubes	6.6	3.5	1.6

Volume of Exports

(Thousands of bags)

Year :	Coffee Total (Bags)	Coffee to U.S. (Bags)	Gold (Troy ounces)	Petroleum (Barrels)	Bananas (Tons)	Hides (Tons)	Tobacco (Tons)	Platinum (Troy ounces)
1938	4,262	3,362	310	18,450	195	7.0	4.9	29
1937	4,156	3,095	524	17,740	153	7.7	2.1	29
1936	3,980	2,819	340	16,130	160	7.7	1.5	41
1935	3,785	2,868	311	15,950	155	6.9	2.4	39
1934	3,142	2,612	513	16,500	144	7.1	1.6	55
1933	3,280	2,755		11,806	135			
1932	3,184	2,804						
1931	3,017	2,751						
1930	3,117	2,854						
1929	2,835	2,621						
1928	2,659	2,385						
1927	2,356	2,115						

Foreign Trade of Colombia*

Year:	(In millions of pesos)			(In millions of dollars)		
	Total : imports	Total : exports	Balance	Total : imports	Total : exports	Balance
1928	149	134	- 15	145	131	- 15
1929	126	127	-	122	122	-
1930	63	113	50	61	109	49
1931	41	98	57	40	95	55
1932	30	100	70	29	95	66
1933	50	73	24	41	60	19
1934	88	152	65	54	94	40
1935	107	143	36	60	80	20
1936	120	158	38	69	90	21
1937 ^{1/}	170	183	13	96	104	8
1938	159	168	9	89	94	2

* Includes gold.

^{1/} Since January 1, 1937, trade computed on C.I.F. basis.

Public
Finance

PUBLIC FINANCE

1. Annual expenditures of the National Government are about 150 millions.

2. The budget has been balanced since 1934, although there was a deficit of about \$2 millions in 1938 which was more than covered by the carried-over surplus of \$4 millions. There was a carry-over surplus of \$2 millions on December 31, 1938. It should be remembered, however, that external long-term debt is not being serviced.

For the first eight months of 1939, revenues and expenditures have been running ahead of 1938. Heavy importations have increased customs receipts. For eight months of 1939 revenues are \$32.6 millions, expenditures \$32 millions. For eight months of 1938 revenues were \$27.1 millions.

3. Total cost of Government in Colombia probably runs \$85 millions, of which National is \$50 millions, provincial expenditures \$22 millions, municipal \$10 millions. National income probably does not exceed \$400,000,000.

4. Under current conditions, debt service on internal and short-term debt which is being serviced takes only 11 percent of revenue, which is an unusually low debt burden for a Latin American country to carry. Adequate service on the external long-term debt would raise the proportion to about 18 percent of current expenditures.

5. Since 1935-36 the administration and structure of the revenue system have been improved. Introduction of the excess-profits tax and patrimony tax and the reorganized improved yield of the income tax have been advantageous.

An income tax was introduced in 1916 and reorganized by the Kemmerer advisory commissions, but it has been slow to develop into an adequate revenue-producer.

6. The use of double budgets (ordinary and extraordinary) confuses somewhat comparisons of revenues and expenditures.

7. Chief sources of revenue are: customs 30-35 percent, income and excess profits tax 20 percent.

8. Chief expenditures: national defense 17 percent, debt service 11 percent, public works 20 percent, education 9 percent. There are certain encouraging features of the expenditures: education and public health are receiving increasing appropriations; public works expenditures are large and better used than in previous decades.

PUBLIC FINANCE
(Continued - 2)

The military establishment is an unfortunate consequence of the threatened trouble with Peru over Leticia in 1932-34 which ended peacefully. At that time an excessive military establishment was created which it has proven impossible to scale down once the trouble was averted.

9. The budget of 1939 provided 9,991,000 pesos for public debt of which 3,900,000 was scheduled for external debt. The budget for 1940 allots 3,283,000 pesos for service on external debt should it be resumed.

For 1940 a considerable extension of public works was intended. Various projects have come before Congress and met with approval: one calls for 15,000,000 pesos of national railway bonds to be issued internally at the rate of 4,000,000 per year to be used for railway extensions, construction of new terminal at Bogota, and a railway shop. Another project is for a hydroelectric plant on the Cauca or Palo rivers to supply electric power to the surrounding area and to meet future requirements of the Pacific railway; it would be financed 51 percent by the National Government.

10. In the revaluation of gold authorized by law of November 19, 1938, profits of 16,000,000 pesos were assigned thus: 8 million for reducing Government's debt to the Central Bank, 5 million to be used by the Government for public works, 3 million for formation of an exchange stabilization fund.

11. From 1929 to 1934, deficits totalled 60 million pesos. Deficits arose out of reduced revenues, continuation of public works, and the Leticia military preparations. Extraordinary funds were found to finance these deficits.

Government borrowings at the Central Bank increased steadily after 1930 because of these deficits. At the end of June 1930 direct loans to the Government were only 4.1 million pesos out of total Bank's assets of 52.3 millions. By the end of 1934, direct advances to Government were 41.8 millions out of 90 millions in assets. Nor does this latter figure include advances to the banks and to public against the security of Government bonds and bills, which the Central Bank was empowered to make by the law of 1930.

Since 1934, however, internal debt has not been expanded and the table below indicates the failure to expand loans from the Central Bank:

PUBLIC FINANCE
(Continued - 3)

Total credit operations of Central Bank
with national and other official
Governments and authorities:

(In millions of pesos)

1934	41.4
1935	45.4
1936	45.4
1937	45.8
1938	38.2
1939	37.3
(August)	

(Note: In November 1938 revaluation of
gold profits were allotted (8,000,000)
to reduce Government indebtedness.

PUBLIC FINANCE
(Continued - 4)
(In millions of pesos)

Year	Ordinary Revenues	Ordinary Expenditures	Balance
1926	60.6	67.4	- 6.8
1927	86.2	84.4	+ 1.8
1928	107.5	115.1	- 7.6
1929	75.2	85.5	- 7.3
1930	54.3	60.9	- 6.6
1931	53.7	52.0	+ 1.7
1932	44.6	46.2	- 1.7
1933	39.8	62.7	- 22.9
1934	53.4	74.9	- 21.6
1935	57.4	61.1	- 3.7
1936	70.1	69.3	+ 0.7
1937	82.6	77.5	+ 5.0
1938	83.0	88.4	- 5.4

(In millions of pesos)

Year	Ordinary Revenues	Ordinary Expenditures
1938	84.0	88.2
1937	80.3	78.6
1936	70.1	68.1
1935	57.4	56.8
1934	45.4	41.9

PUBLIC FINANCE
(Continued - 5)

SOURCES OF REVENUE

Year	Ordinary Revenues	Total Taxes	Customs	Tax on Sale of Gold	Excess- Profits and Patri- mony Tax	Income Tax	Inheri- tance Tax	Oil Royalties
1938	84.4	68.4	30.6	1.9	6.3	11.4	1.4	2.7
1937	82.6	69.3	34.3	6.0	5.3	10.2	0.9	2.1
1936	70.1	59.7	30.0	5.6	4.2	8.7	0.7	1.9
1935	57.4	46.4	27.5	5.3	-	4.3	0.6	2.2
1934	45.4	36.3	24.6	-	-	2.0	0.6	1.2

PUBLIC FINANCE
(Continued - 6)EXPENDITURES
(000,000 pesos)

	1939	1938	1937	1936	1935	1934	1933	1932	1931	1930	1929
Debt Service:							11.5				
External	3.9	2.3	3.9	3.4	2.7	1.9		5.5	5.6		
Internal	6.0	8.6	7.5	8.8	6.1	7.7		3.9	5.5		
War	14.0	13.0	12.8	14.0	14.5	24.4	3.8	3.8	4.0	4.3	7.7
Education	7.9	6.8	6.0	6.0	2.5	1.5	1.2	1.5	1.2	3.3	7.2
Public Health		3.5	3.7	3.2	2.4		2.2	2.0	-		
Public Works	18.9	15.2	18.2	12.2	10.0	7.5		5.9	2.6	14.2	29.8
Labor, Health and Welfare	5.2										
Total	89.2	83.6	85.7	73.0	61.1	63.1		46.1	52.1	62.0	84.0

Notes: Reorganized Executive Departments for 1939, therefore not strictly comparable.
Reorganized Revenue Collection System in 1936.

Public
Debt

PUBLIC DEBT

1. Colombia has an internal debt of 78,500,000 pesos (\$45 millions) which has been serviced continually.
2. She has an external short-term debt of \$19.3 millions contracted in 1930 which is being serviced in full. It is renewed from time to time with provision for interest and amortization.
3. The external long-term debt (national and municipal) totals \$159 millions, of which \$82 millions is local Governmental obligations and \$77 millions national Government obligations. The debt is largely a dollar debt, there being only \$12 millions in sterling obligations out of \$159 millions.
4. Colombia is now in complete default on her long-term external debt. Partial default began in 1931 and complete default in 1934. Interest arrears on her defaulted national obligations have now reached \$22 millions. Full service on the national debt would take \$4.7 millions, on the local Government's debts \$5.8 millions; these figures compare with a national budgeted expenditure of \$50 millions annually and local Government expenditures of perhaps \$35 millions.
5. The present government of Colombia have publicly stated their intention of meeting their external obligations honorably. As recently as September 28, 1939, ex-President Lopez who was in New York with the rumored purpose of speeding debt settlement negotiations assured the Pan-American Society that Colombia would resume payment of its foreign obligations and that budgetary provisions had already been made.
6. In 1935 it was estimated that 40 percent of the National Government bonds and 15 percent of local Government bonds were held outside the United States.
7. Debt negotiations have been badly mishandled by American bondholders representatives. Various bondholders' committees that undertook negotiations are believed to have bungled the job sadly.
8. It has been reported that a considerable quantity of the guaranteed Agricultural Mortgage Bank bonds and bonds of certain local Governments have been repurchased. The loans of the local Governments were mostly secured by local revenues and taxes in one case, Baranquilla, deposits in pesos for interest have been made regularly. Elsewhere American trustees have begun action to enforce the original contract and attach local pledged income (Tolima, Cali). It is said that their efforts were hampered by the reduction in the floating supply of these bonds through extensive repurchase by the debtors.

PUBLIC DEBT
(Continued - 2)

9. Some idea of the basis of settlement that would be acceptable to Colombia is indicated by the negotiations with holders of bonds of the Mortgage Bank of Bogota. In October 1938 negotiations were completed whereby holders of sterling bonds of Mortgage Bank of Bogota, whose securities had not been guaranteed by the Government, accepted bonds in local currency to a value representing a scaling down of 47 percent of principle. The Government guaranteed the new issue. Conversion was 415 pesos of the new issue for each £100 sterling plus accrued interest. New issue carried sinking fund, a 50-year issue in pesos, 4 percent interest. Conversion represented a scaling down to an interest rate of 1.88 percent.

The Council of the Corporation of Foreign Bondholders (British) did not object to the settlement because it was not a Government-guaranteed issue. But it states that it will continue to object to conversion of obligations into local currency because these make bondholders take the risk of fluctuations in rate of exchange previously borne by debtors, and they might make it impossible in case of need for their Governments to undertake diplomatic intervention on their behalf.

10. The Minister of Finance in the Lopez Administration (1934-38) proposed the following basis for an external debt settlement:

- a. Renew interest payments at 1½ percent for the first four years.
- b. If exports increase in coffee, gold and oil so as to provide transfer capacity, raise the interest payments for the following 3 years to 2 percent.
- c. Afterwards, if exports continue to increase transfer capacity, pay 2 percent for the next four years and 1 percent amortization annually.
- d. The maximum interest to be paid thereafter shall be 3 percent.
- e. National Government will authorize local Governments to negotiate similar debt settlements but they must not offer better terms than bondholders got from National Government.
- f. Local Governments would be authorized to convert their outstanding issues into bonds of local currency at 4 percent and a minimum amortization of 30 years. Conversion would not be at over 83 percent.

PUBLIC DEBT
(Continued - 3)

g. Under this plan the service in dollars would be:

National bonds	\$1,050,000
Departmental	900,000
Municipal	<u>330,000</u>
	\$2,280,000

11. History of the external long-term debt:

a. Up to the Colombian bonds were floated almost exclusively in Europe. The volume of external debt was small and price paid was high, for Colombia was considered a poor credit risk. In 1923 external debt amounted to only £3,600,000.

b. During the 1920's dollar bonds to the amount of \$170 millions were sold by National and local Governments. Of this total, \$60 millions were national Government bonds, \$67.5 departmental, \$26.1 municipal, and \$16 agricultural mortgage bank bonds guaranteed by the National Government. Sterling borrowings during this period were limited to £1,200,000 for the Agricultural Mortgage Bank. We ignore here the non-guaranteed bonds of various banks to the amount of \$22,000,000 and £3,400,000; of these dollar bonds \$12.4 millions are still outstanding.

c. Fraud and corruption did not characterize the flotation of these dollar bonds, but waste and extravagance in the use of proceeds was notable. It has been reliably estimated that not more than one-third were productively used. When it is realized that annual service charges originally contracted ran 7.7 percent on net proceeds for National Government and over 10 percent for local Governments, it will be seen that a very high productivity would have been required even had the proceeds been productively used. Oddly, enough, some of the projects for which financing is currently sought are the same ones for which these dollar bonds purported to have been floated.

Bankers' gross and net margins were heavy. Gross margins were 5.34 percent on all the dollar bonds, but on the departmental and municipal issues the average mounted to 8 percent.

PUBLIC DEBT
(Continued - 4)

12. Internal debt:

a. During the 1930's the internal debt rose. Public distribution is narrow with the Central Bank holding about half of the internal debt. Military difficulties with Peru increased the burden already initiated by depression. Internal funded debt was 22.3 million pesos on December 31, 1931, and 35.4 million on December 31, 1932. By September 30, 1934, it had reached 48.7 million pesos. Since then it has remained in the vicinity of 50 million pesos, and the total internal debt has remained around 75 to 80 million pesos.

13. Short-term external loans:

a. In 1930 a banking syndicate headed by the National City Bank arranged a global credit to the amount of \$20 millions. At that time Colombian bonds were no longer marketable. This loan has been serviced faithfully during the depression. The syndicate fixed these conditions as requisite for the loan: -

- (1) Balancing of budget for 1931.
- (2) Placing of State railways in hands of an autonomous corporation with a distinct budget and accountability, and that the same corporation also handle the ports.
- (3) A law fixing debt limit such as that borrowings shall not exceed a debt service requirement of 30 percent of ordinary revenue.
- (4) Reorganize office of comptroller-general and certain fiscal organizations.
- (5) A law assuring the legality of this loan.

Some delay attended the delivery of the last \$4 millions of this credit on the question of whether the budget had actually been balanced. Also, it has been reported that the Government attitude toward an oil concession was involved.

PUBLIC DEBT
(Continued - 5)

14. Debt service record:

a. The Colombian Government, when confronted with a transfer problem in 1930-31 at first tried to preserve its own credit by prohibiting on October 31, 1931, the transfer of funds by the political subdivisions and private mortgage banks for the service of their external debts, and reserved the available exchange for its own use.

b. January 1, 1932, sinking fund payments on national external debt and nationally-guaranteed Mortgage Bank bonds were suspended.

c. Finally, the Government announced that coupons maturing on these loans from April 1, 1933, to January 1, 1934, would be paid one-third in cash and two-thirds in scrip.

d. After that date, cash payments were suspended entirely and coupons maturing during 1934 were paid only in scrip.

e. After January 1, 1935, even the scrip payments were discontinued.

f. Colombia showed a laudable desire to maintain service by continuing full service as long as she did (to November 1, 1931). The trouble with Peru ruined a budding recovery and destroyed hopes of weathering the depression with a credit record held high.

g. She serviced her internal debt, and also the short-term external credit of \$20,000,000 (original) contracted in 1930. On the latter, service was at 3 percent and \$100,000 amortization.

h. Baranquilla is the only entity which since 1931 has provided for and maintained bond service payments, though exchange restrictions compelled them to be retained on deposit in local banks.

mbia

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PUBLIC DEBT
(Continued - 6)

Debt Structure

External Bonds:

National Government - dollar bonds	\$ 51,200,000
dollar scrip	\$ 3,100,000
National Government - guaranteed dollar bonds of Agricultural Mort- gage Bank	\$ 10,300,000
National Government - sterling bonds	£ 1,500,000
National Government - guaranteed sterling bonds of Agricultural Mortgage Bank	£ 1,130,000
Departmental Dollar Bonds	\$ 60,000,000
Municipal dollar bonds	<u>\$ 22,100,000</u>
Total calculated in dollars	\$159,000,000

(Note: Interest arrears on the National Government's external debt has reached \$21,600,000).

Internal debt of National Government (July 1939):

Funded debt	52,000,000 pesos
Debt to Central Bank	21,000,000 pesos
Loans from banks and other domestic concerns	<u>5,500,000 pesos</u>
Total	78,500,000 pesos

(Note: In July 1939, the Central Bank held 15,300,000 of internal bonds in addition to direct Government borrowing so that it was creditor for 46 percent of internal debt.)

External short-term banking credits:

Short-term loan of 1930 by American banking syndicate with 1/5 French participation	\$ 17,000,000
Other short-term credits	<u>2,300,000</u>
Total	\$ 19,300,000

(Note: These short-term credits have been serviced faithfully. At the end of 1938 they were extended for three years.)

Regreded Unclassified

Debt of National Government
(In millions)

	: 1933		: 1934		: 1935		: 1936		: 1937	
	:Pesos:	\$								
External										
Consolidated	61.3	59.7	61.1	59.4	58.4	56.8	62.9	61.2	63.5	61.8
Scrip	1.7	1.6	5.0	4.9	4.7	4.6				
Floating	21.1	20.5	21.3	20.7	37.8	36.8	37.4	36.4	33.9	33.0
Total	24.1	81.8	87.4	85.0	100.9	98.2	100.3	97.7	97.5	94.9
Internal										
Consolidated	33.9	21.7	38.1	24.5	53.9	30.7	51.1	29.6	47.4	25.7
Floating	35.3	22.6	44.3	28.6	29.8	17.0	27.4	15.8	29.3	15.9
Total	69.3	44.3	82.3	53.2	83.7	47.7	78.6	45.1	76.7	41.6
Total	153.4	126.1	169.7	138.2	184.6	145.9	178.9	142.8	174.1	136.5

External debt converted to dollars at original par of exchange; internal debt converted at December rate.

Direct
Investments

[Redacted]



FOREIGN DIRECT INVESTMENTS

1. Total \$150 millions, of which \$125 millions is American and \$10 to \$15 millions British. American investment is largely in oil, bananas, mining. British have about \$8 millions in railways and the balance in miscellaneous projects.

2. American investments date from the World War. In 1913 our direct and portfolio investment totaled only \$4 millions; by 1920 it had reached \$30 and by 1929, \$260 millions. Meanwhile, the British investment remained unchanged around \$35 millions. By 1928-29 Standard Oil of New Jersey was accounting for 20 percent of Colombian exports.

3. The latest American large-scale project is the pipe line from the Barco Concession to the new port of Coveñas. Capacity is 25,000 barrels daily, with possibility of rise to 70,000 barrels by installation of additional pump stations. Construction of this line was started in February 1938 but the mountainous terrain made work difficult; the line passes through jungle and over a spur of the Andes mountains. In its construction 10 airplanes were used to carry 11,000,000 tons of freight.

There are 69 producing wells on the Barco Concession, which is owned by the Colombian Petroleum Company which is owned jointly by the Texas Corporation and the Socony Vacuum. Investment in it is said to be \$18 millions in the pipe line and \$22 millions in developmental work.

4. The Liberal Party, now in power, has recently passed a petroleum code designed to attract more investments. It appears that this Government is headed for capital attraction, following the Venezuelan example rather than the Mexican example. Nevertheless, it should never be forgotten that there is a strong feeling for nationalization in Colombia and that excesses and abuses would not long be tolerated. The influence the banana companies once had in the banana region has been largely reduced.

Foreign
Exchange

FOREIGN EXCHANGE

1. In 1939 import licensing, prior permits for importation, and exchange restrictions were in force.

Remission of earnings was permitted, although at times slight delays were reported in the granting of exchange for other than essential imports. There was not, however, a definite establishment of import categories (indispensable, necessary, luxury).

There were clearing arrangements with Germany and Japan, and special arrangements with Italy, Spain and Denmark.

There was no free market, although there was a bootleg rate.

After August 1, 1939, the ruling was rescinded whereby 10 percent of the export bills delivered to the Control Authority had to be sold at a specially low price.

In August 1939 the Bank suspended its purchase of compensation marks in order not to increase its holdings. What its holdings were on the eve of war is not known.

2. A stabilization fund of 3,000,000 pesos was created out of the profits of gold revaluation in November 19, 1938. By this Monetary Stabilization Law the peso was stabilized at 1.75 to the dollar; the monetary unit was specified as a coin of 900 parts fine gold, weighing 0.56424 grams; the Bank was to compute its gold values on this basis.

The profits of revaluation were 16,000,000 pesos of which 8 were assigned for payment of Government debt to the Central Bank, 5 for Government account to be used for public works, 3 millions for formation of a stabilization fund.

In 1938 the exchange rate fixed by the Bank had fallen from 1.83 to the dollar to 1.78 on July 13, to 176.50 on October 5, to 175.5 on October 19, 1938.

3. Exchange restrictions date from September 1931. Rates were maintained at their former parities (1.05 pesos to dollar) until February 1933 when the price of the dollar was raised to 1.16. After the United States suspended the gold standard it was decided on April 21, 1933, to maintain dollar rate unchanged and to quote other currencies on the basis of their prices in New York.

FOREIGN EXCHANGE
(Continued - 2)

Later in 1933 official dollar rate was raised several times until it reached 1.26 to the dollar. At the same time the system of exchange control was relaxed and as early as April 1933 exemptions from obligation to sell foreign exchange proceeds to the Central Bank were granted for a number of commodities; for all other commodities new regulations of September 1933 required only 15 percent of export proceeds to be delivered to the Central Bank.

In 1935 importers were required to file copies of their orders; after August 1, 1936, import permits were required. In the spring of 1939 orders for goods were no longer to be placed abroad until prior permission of Control Authority had been received.

After the middle of 1935, 85 percent of exchange purchased by banks was being assigned to Exchange Control Board and balance used for Government requirements.

4. Depreciation of exchange since 1923 is shown in the table below:

Exchange Value of the Peso
(Cents per peso)

Year	Exchange Value
1923	95.2
1924	99.2
1925	98.4
1926	98.5
1927	97.7
1928	97.7
1929	96.6
1930	96.5
1931	96.3
1932	95.3
1934	61.4
1935	55.9
1936	57.1
1937	56.5
1938	55.9
1939 (August)	55.9

FOREIGN EXCHANGE
(Continued - 3)

5. From 1934 to 1938 (five years) Colombia produced more gold than she exported - 2,025,000 ounces compared with 1,989,000 ounces. From January to July 1939 she exported somewhat more than production, the loss of gold being about \$4 millions. She has \$23 millions in gold and produces \$18 millions annually, with output rising.

Export and Production of Gold
(In thousands of troy ounces)

Year	Exports	Production
1934	513.0	344.1
1935	310.3	329.0
1936	340.5	389.5
1937	524.4	442.2
1938	300.6	520.7
1939- Jan- July	421.4	328.4

6. The future of the peso under war conditions depends on the price of coffee, the expansion plans of foreign oil companies, and the continued increase in gold production. Immediately the loss of the German market decreases annual exchange availabilities for imports by \$12 millions. Coffee amounting to over half of total exports had gone three-fourths to the United States; due to its superior competitive position it should be able to maintain a volume and price more adequately than Brazilian coffee. Oil is likely to expand and gold also.

Balance of
Payments

THE BALANCE OF PAYMENTS

Disregarding the temporary dislocation caused by the war, a potential balance of payments to indicate transfer capacity on debt service is presented below:

Export-potential	165 to 210 million pesos
Import-potential (defined as the figure below which imports cannot be cut without excessive interference with wider national politics)	140 to 175 million pesos
Balance of Trade	15 to 25 million pesos
Other credits (port dues, foreign expenditures in Colombia, etc.)	2 to 4 million pesos
Potential credit of 20 million pesos	
Against which:	
Short-term credit servicing	4 million pesos
Non-corporate requirements abroad	2
Miscellaneous	2
Oil and banana Co. remittances	<u>9*</u>
	17

* Usually it is calculated that exchange created by oil and bananas is not fully available since 50 percent is likely to be left abroad. If oil exports are put at 37 and bananas at 8, there is total of 45 million pesos involved. Let us assume that developmental possibilities attract reinvestment of larger share of profits so that only 20 percent of export values will be unavailable, i.e., 20 percent will be sent home as dividends, etc., 9,000,000 pesos.

This leaves a balance of 3 to 5 million pesos available for external debt service.

Banking

BANKING STRUCTURE

1. There is a Central Bank, three Government-constituted mortgage banks, 10 native commercial banks, four foreign banks, one native savings institution, a municipal credit bank, and an Agricultural, Industrial and Mining Credit Institute.

2. The four foreign banks account for probably less than one-fourth of the commercial banking business. They are: Royal Bank of Canada, Bank of London and South America, National City Bank of New York, Banco Frances e Italiano para la America del Sud. The German Overseas bank is not represented here but there is a German institution called Banco Aleman Antioquena.

The National City Bank of New York occupies a position in the banking structure much inferior to the American trade position with Colombia.

3. The Central Bank was established on the recommendations of the Kemmerer Commission in 1923. Considerable revision of the original organic law was necessary and there has been much adverse comment on the work of the Kemmerer Commission. The law was modified in 1933.

Shares are divided into A shares without voting power held by the Government, B shares held by native banks and C shares held by foreign banks, both groups of banks holding shares of value equal to 15 percent of the paid-up capital and surplus, D shares held by the public.

Directors are appointed three by the Government, two by native banks, one by foreign banks, one by holders of D shares, one by National federation of coffee vendors, one by chambers of commerce and the agricultural societies. Governor of the bank is elected by seven affirmative votes.

Autonomy of the Bank has been preserved. The Bank has been praised by Government officials for its aid during the Leticia crisis which required heavy military expenditures, for buying the bulk of issue of coffee bounty bonds during the depression, for its aid in unfreezing debts owing to commercial banks, and for its exchange control work.

Nationalization of the Central Bank has been persistently agitated for.

The Central Bank is permitted by law to deal directly with the public.

BANKING STRUCTURE
(Continued - 2)

4. In 1932 the Government undertook to deal with frozen bank debts. February 11, 1932, there was set up the Colombian Credit Corporation, a private corporation whose shares were held only by commercial banks wishing to use its services; aim was gradual liquidation of frozen obligations held by the banks. Decree of April 22, 1932, enabled repayment of frozen commercial credits to banks partly in state bonds at nominal value; in turn the banks could borrow up to the face value on the security of these bonds at the Central Bank.

5. In 1932 there was set up the Central Mortgage Bank with a capital of 20,000,000 pesos, of which 12 was to be furnished by the Central Bank and the rest by other banks chiefly. It began operations in August 1932. For its first three years it was limited to mortgage loans whose proceeds would be devoted exclusively to repayment of obligations to commercial and mortgage banks. It was authorized to issue bonds carrying a Government guarantee.

There was also the Banco Agricola Hipotecario and Banco Hipotecario de Bogota whose obligations carry Government guarantees. Bonds of the latter have been in default, but on its stock it has paid dividends both to internal and external holders.

6. In 1937 a law provided for the establishment of a system of territorial credit banks to supplement the Central Mortgage Bank which is the official mortgage institution now. These new institutions would make loans only by real property, only in agricultural regions not previously served by existing official banks, be limited to 3,000 pesos loans per piece of property, charge a rate of interest 2 percent over the charges of the existing Central Mortgage Bank. Capital would be provided 50 percent by departmental government, 25 percent by municipal and 25 percent by outsiders. If the latter two did not take their share of the subscriptions, Central Mortgage Bank could take the stock. These territorial banks were aimed to be small-man's credit institutions, of which there is a great need.

7. A project for a postal savings system was legislated on in October 1937.

8. Discount rate of the Central Bank was reduced by stages from 9 percent at the end of 1929 to 4 percent in August 1933 since when it has not been increased or lowered.

BANKING ACTIVITIES
(In millions of pesos)

Average	: 1934	: 1935	: 1936	: 1937	: 1938	: Jan.-July : 1939
A. Central Banks	-	-	-	-	-	-
Gold and foreign exchange	18.7	25.9	34.6	42.6	44.0	43.7
Credit operations	48.5	50.5	62.6	61.3	63.3	56.2
Notes in circulation	36.3	37.8	45.9	51.7	51.7	55.0
Deposits	27.3	27.4	31.0	39.8	41.6	40.7
B. Other Banks	43.8	49.0	61.0	76.3	82.9	92.4
Commercial loans	75.6	76.7	85.7	97.0	98.9	111.5
Deposits, including savings	43.3	42.4	44.3	48.0	50.3	53.0
Mortgage Loans						
C. Money						
Fiduciary circulation	58.2	64.3	73.4	79.3	79.4	83.1
Money in hands of public	54.5	57.1	63.3	71.6	73.5	77.3

Technical
Assistance

TECHNICAL ASSISTANCE

1. Colombia has repeatedly asserted its faith in the use of foreign technical assistance. During the 1920's she received the assistance of an American financial mission (Kemmerer), a German educational mission, a Swiss military mission, a Belgian tele-graphic mission, a Swiss Customs mission, and various other foreign assistance.

2. Her technicians are highly receptive to ideas developed abroad and the strong pride in national effort has not interfered with the use of such assistance.

3. Kemmerer work on national banking and finance has been widely criticized in Colombia, as elsewhere where it was furnished. Much of the work has been undone by subsequent legislation, much of it proved impracticable and unsatisfactory.

PLAIN

London

Dated October 31, 1939

Rec'd 7:45 a.m.

Secretary of State,
Washington.

2223, October 31.

In view of the interchanges arising out of the second paragraph of telegram 1842, September 27, 6 p.m., I caused the information contained in your 1267, October 21, 1 p.m., to be brought to the attention of the British Treasury with whom rests the ultimate responsibility for the regulation of foreign exchange and because this is an important policy matter for us. The British Treasury has now sent a letter enclosing its suggested reply to the Department of Commerce's inquiry: "Both Ministry of Food and private importers are allowed to pay for goods imported from the United States of America either in dollars or in sterling. Treasury on the whole prefer payment to be made in dollars where this does not upset trade customs, but have not laid down any fixed rule. "There is no question of asking American exporters to accept payment in blocked sterling. Dollars at the official rate are granted for all goods which have been or will be actually imported. If goods are on the import restriction list, the
American

- 2 -

American exporter should satisfy himself that an import licence has been or will be granted. No such inquiry is of course necessary in the case of goods not on the import restriction list, and in the case of goods purchased by or on behalf of government departments. "It is not the policy of the United Kingdom Government to make purchases on condition that the exporter can arrange to accept payment in goods or in sterling which will not be remitted and any suggestions for purchases on these terms were made owing to a misunderstanding. Treasury would be glad to be informed of any such suggestions made in order that they may explain to those concerned that such suggestions are not desirable."

KENNEDY

McL

PARAPHRASE OF TELEGRAM SENT

TO: The American Embassy, Lima, Peru

NO.: 66

DATE: October 31, 1939

The Department would like to have information by telegraph regarding the following points. This information is desired in connection with the study which we are making of Peruvian requests for short-term credits.

1. The latest position of the Central Bank, including foreign exchange, gold, credits to the Government, banking rediscounts, deposits, and note circulation. (The latest statement which we have here is one dated June 30.)
2. Import and export statistics since June.
3. What is the volume of transfer of interest and dividends taking place at the present time? What is the volume of capital movement?
4. Is there an accumulated back-log of commercial exchange?

HULL

RECEIVED

OCT 31 1939

TELETYPE UNIT

EA:EB

October 31, 1939

The Secretary

New York just 'phoned that they had received subscriptions aggregating \$210⁰⁰. The issue is very popular and we can expect huge over-subscriptions according to Rouse.

Stopping of \$50⁰⁰ in bills was a surprise and a regret, but most people thought it was a good idea for you to keep in the hole.

SWB

10/31

OCT 31 1939

My dear Congressmen:

Reference is made to your telephone conversation with Mr. Hanes relative to the commercial credit provision in Section 3 of the Neutrality Act.

In February, 1936 Congress, in amending the then existing Neutrality Act, included the following provision:

"SEC. 1a. Whenever the President shall have issued his proclamation as provided for in section 1 of this Act, it shall thereafter during the period of the war be unlawful for any person within the United States to purchase, sell, or exchange bonds, securities, or other obligations of the government of any belligerent country, or of any political subdivision thereof, or of any person acting for or on behalf of such government, issued after the date of such proclamation, or to make any loan or extend any credit to any such government or person: Provided, That if the President shall find that such action will serve to protect the commercial or other interests of the United States or its nationals, he may, in his discretion, and to such extent and under such regulations as he may prescribe, except from the operation of this section ordinary commercial credits and short-term obligations in aid of legal transactions and of a character customarily used in normal peace-time commercial transactions."

No substantial change was made in the proviso relating to commercial credits when the Act was otherwise amended in 1937. When the neutrality legislation was considered in the House of Representatives last spring the following proviso was included with respect to commercial credits:

Provided, That if the President shall find that such action will serve to protect the commercial or other interests of the United States or its citizens, he may, in his discretion, and to such extent and under such regulations as he may prescribe, except from the operation of this section for a period of not more than ninety days without renewals ordinary

File to Mr. Thompson

By hand

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commercial credits and short-time obligations in aid of legal transactions and of a character customarily used in normal peacetime commercial transactions; the President shall make public every ninety days any and all exceptions granted under this proviso, together with the amounts of credits involved."

The provision with respect to commercial credits, etc., was eliminated in the bill passed by the Senate on October 27, 1939.

There are enclosed copies of the President's Regulation Concerning Credits to Belligerents issued on September 6, 1939 and the amendment of September 11, 1939, which authorize the Secretary of the Treasury to administer the provisions of this regulation and to promulgate such rules and regulations not inconsistent with law that may be necessary and proper to carry out such provisions. The Secretary of the Treasury promptly formed an advisory committee to consult with him in connection with the administration of the President's regulation. Such committee consisted of Under Secretary of the Treasury John W. Hanes and representatives of the Departments of State and Commerce. The advisory committee has met on a number of occasions to consider problems arising in connection with the administration of the President's regulation. It has not appeared necessary to issue further formal regulations governing this problem. However, the Treasury Department has made arrangements whereby persons having questions concerning the problem may go to the Federal Reserve banks for information. If the Federal Reserve banks have any doubts with respect to the inquiry, it is referred to the Treasury Department for decision. Furthermore, inquiries have come directly to the Treasury Department in Washington.

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The Treasury Department has not made public those inquiries which it has received and the disposition made thereof. It is, however, appropriate to note that very few inquiries have been received with respect to this matter, and the inquiries received have presented comparatively simple problems.

I am also enclosing, in accordance with your request, copies of proclamations issued by the President pursuant to Section 1 of the Neutrality Act.

I trust this gives you the information which you desire.

Very truly yours,

(Signed) H. Morgenthau, Jr.

Secretary of the Treasury.

Hon. John H. Vorys,
House of Representatives.

Enclosures

JWP:agt 10/30/39

D. Cohen
November 21, 1938

COPY

STATEMENT OF FACTS

In April, 1933, Joseph Schenck, head of United Artists, Inc., entered into a contract with Darryl Zanuck for Zanuck's personal services as a producer and director of motion pictures.

In May, 1933, Twentieth Century Pictures, Inc., was incorporated. Joseph M. Schenck and William Goetz were sole stockholders of record. Goetz acted as trustee of the Mayer Family Trust which his father-in-law, Louis B. Mayer, had created.

Schenck invested \$350,000 in Twentieth Century. The Mayer Family Trust also invested \$350,000 in the enterprise. Schenck and Goetz each received 3,500 shares of preferred stock having a par value of \$100 a share.

The common stock of Twentieth Century consisted of 100 shares. Schenck and Goetz each received 50 shares.

Upon the organization of Twentieth Century, Schenck assigned to Twentieth Century a written personal service contract between Zanuck and himself which provided for a weekly salary of \$4,000 plus 10 per cent of the net profits.

Zanuck's personal service contract was revoked in March, 1934. A new written contract was made under which Zanuck was permitted to buy 10 shares of the common stock owned by Schenck and 10 shares of the common stock owned by Goetz at a nominal price of \$100 a share. His salary was reduced from \$4,000 to \$2,000 a week and he was permitted to retain \$100,000 which had been advanced to him by Schenck in anticipation of Zanuck's 10 per cent share of the net earnings under the original personal service contract.

Zanuck then had a 20 per cent interest in Twentieth Century for the nominal sum of \$2,000.

In his tax return for the year 1934 Zanuck did not report the income represented by his purchase of these 20 shares at a nominal price of \$100 a share. In September 1936 a revenue agent reopened Zanuck's return for the year 1934, and recommended that Zanuck and his wife be assessed an additional tax of approximately \$100,000 based upon a book value of \$10,100 per share.

In August, 1938, a merger was effected between Twentieth Century, Inc., and Fox Film Corporation under a plan of reorganization which required Twentieth Century, Inc., to transfer all of its assets to Fox Film Corporation in exchange for stock in Fox Film Corporation. The name of Fox Film Corporation after the merger was Twentieth Century-Fox Film Corporation. The name of the old Twentieth Century Pictures, Inc., was changed to E-G-Z Corporation, and it was shortly afterward dissolved.

In effecting the merger two classes of stock were issued. The preferred stock represented the assets of both corporations. The book value of Fox assets was approximately \$57,000,000. The book value of Century assets was approximately \$4,000,000. Preferred stock in the amount of 1,328,000 shares was issued, each share being valued for purposes of the merger at about \$20 a share. Fox stockholders received 1,228,000 shares of preferred stock and Century stock holders received 100,000 shares of preferred stock on the basis of the respective assets of the two corporations.

- 2 -

The common stock was treated for purposes of the reorganization as if it had no monetary value. The old stockholders of Fox received the new common stock on the basis of one-half share of common for each share of new preferred, i. e., \$15,000 shares of common stock. An equal amount of common stock was issued to stockholders of Century.

When received by Century the preferred stock was allocated in accordance with the stockholdings of record, that is 40 per cent to Schenck, 40 per cent to Goetz and 20 per cent to Zanuck. The common stock was divided on the basis of 35 per cent to Schenck, 35 per cent to Goetz and 30 per cent to Zanuck. Although Schenck through manipulation of the asset value per share of preferred stock apparently made it appear to Zanuck that Zanuck was receiving 30 per cent of the preferred as well as 30 per cent of the common and that Goetz and he only 35 per cent of the preferred, this was not actually the fact. This trickery of Zanuck is relevant only because it tends to establish that stock holdings of the taxpayers were in fact the same as they were of record, namely 40 per cent in Schenck, 40 per cent in Goetz and 20 per cent in Zanuck.

The actual distribution among Century stockholders of the new preferred stock in Twentieth Century-Fox was as follows:

	<u>Total Shares</u>	<u>Zanuck</u>	<u>Goetz</u>	<u>Schenck</u>
Preferred stockholders: 10,000 at \$20	22,000	--	11,000(50%)	11,000(50%)
Common stockholders: New Preferred Stock (Basis 30-40-40)	<u>110,000</u>	<u>22,000(20%)</u>	<u>44,000(40%)</u>	<u>44,000(40%)</u>
	122,000	22,000	55,000	55,000

The purported distribution among Century stockholders of new preferred stock in Twentieth Century-Fox was as follows:

	<u>Total Shares</u>	<u>Zanuck</u>	<u>Goetz</u>	<u>Schenck</u>
Preferred stockholders: 10,000 at \$12 per share (asset value reached working backward on Zanuck's orders)	30,000	--	30,000	30,000
New Preferred stock Common stockholders (Basis 30-35-35)	<u>78,000</u>	<u>16,000(20%)</u>	<u>26,000(33%)</u>	<u>36,000(45%)</u>
	108,000	16,000	56,000	56,000

The distribution among Century stockholders of the new common stock in Twentieth Century-Fox was as follows:

	<u>Total Shares</u>	<u>Zanuck</u>	<u>Goetz</u>	<u>Schenck</u>
	212,000	106,000(50%)	114,000(53%)	114,000(53%)

The 615,000 shares of common stock of Fox received by Century and later distributed to Schenk, Goetz and Zanuck when Century dissolved may have been paid for the good will and the cancellation of personal service contracts which Century had with Zanuck and Schenk.

Century which had a high earnings record might have refused to enter into the merger without adequate compensation for the risk in the form of a 50 per cent out of future earnings. This would ordinarily be accomplished through an equal distribution of the common stock between Fox and Century since the preferred stock had been issued against the assets.

There is nothing in the Internal Revenue Code which appears to require that after a merger the new stock holdings be in the same ratio as the asset value of the merged corporation in order to constitute a nontaxable reorganization.

The very fact that there is a reorganization implies a bargaining power on the part of the corporations which are parties to the reorganization. If one party is able through superior bargaining power to obtain what appears to be a disproportionate amount, this excess may be ascribed to the superiority of that party's bargaining position.

But that is not all that there is to this case. The manner in which the common stock allocated to Century is divided among the shareholders in Century is persuasive evidence that here is something which is not a normal reorganization, nor germane to a normal reorganization. After providing for the return of the capital invested in preferred stock in Century, the new preferred stock was distributed to the common stockholders in Century in accordance with their stockholdings.

The 35-35-30 division of common stock was not in accordance with the holdings of 40-40-20, and was not in accordance with usual corporate practice upon liquidation after a reorganization.

Shareholders in Century might, of course, make a private deal among themselves. But if there were such a private internal arrangement among the stockholders of Century, it was extraneous to the reorganization. It was the lark on the back of the eagle.

This is illustrated by article XI of the plan of merger which provided that Century and its stockholders agreed to transfer the new preferred and new common stock to the stockholders of Century "in the proportions set forth in Exhibit E hereto attached and made a part hereof, solely in exchange for the Century stock held by such Century stockholders." Having in mind Zanuck's stock in Century and the proportions set forth in Exhibit E (which were not in accordance with the actual stockholdings), it is rather apparent that there was entrusted upon the reorganization plan an artifice not germane to the reorganization. The purpose was to cloak the income received by Zanuck with the immunity of a nontaxable reorganization.

In addition to the distribution to which Zanuck was entitled by reason of the distribution of Fox stock to Century stockholders, Zanuck had apparently exacted a further consideration in return for his consent as a common stockholder of Century to the reorganization plus his entering into a new personal service contract with Twentieth Century Fox.

Of course, cash need not pass in order that taxable income be realized. Instead of receiving cash, Zanuck received stock over and above his pro rata share in Century. This income is taxable and should have been returned by Zanuck in his 1935 return.

The facts disclosed by the investigation tend to show that Zanuck willfully attempted to evade his income tax. Curiously, however, the deficiency due to Zanuck's fraud is diminished to the extent of the fraud perpetrated by Schenck on Zanuck. In other words, if the preferred stock, as distinguished from the common stock, of the new Twentieth Century Fox Film Corporation was distributed to Zanuck on a 40-40-20 basis in accordance with his basic holdings in Century, then the amount which he got to boot over his proportionate share consists of about 82,000 shares of common stock. On the other hand, if the new preferred stock was distributed on a 35-35-30 basis, as Zanuck has been led to believe by Schenck, the deficiency in Zanuck's income tax due to Zanuck's fraud is increased by the market value of the excess shares of preferred stock which he received.

Were it not for the disproportionate distribution, the non-taxability of the reorganization would probably not be questioned. But this fact, considered in the light of such events as the withholding of Exhibit E from the plan of merger submitted for a ruling by the Commissioner of Internal Revenue, the attempts to conceal the telegraphic communications between Zanuck and Schenck showing the true nature of the transaction, the submission of apparently false and misleading affidavits to the Bureau of Internal Revenue, the obvious evasiveness of Zanuck and Schenck when questioned at the Department of Justice, the evidence of the bribery by Zanuck's former business agent of the Internal Revenue Agent who first found that Zanuck had failed to report his 1934 income properly, and similar indications of intent to conceal, warrants a grand jury investigation for the purpose of shedding more light on the criminal aspects of the case.

In addition to establishing Zanuck's civil and criminal liability such a grand jury investigation might also bring out more fully the motives back of Schenck's sudden altruistic endeavors to protect Zanuck, as well as Schenck's own civil and criminal liability in connection with his deduction for a share loss on the sale of stock and false deductions for business expenses, as asserted in the letter to the Acting Assistant Attorney General from the Acting Commissioner of Internal Revenue dated July 14, 1939.

The reports of the Intelligence Unit upon which the tax liability in this case is predicated disclose utter lack of respect for law and a contempt for civic obligations by several of the principals involved. In assessing income taxes, the Government must rely to a large extent upon the disclosure by taxpayers of all relevant facts. To discourage fraudulent attempts to evade taxes, Congress has, therefore, imposed criminal as well as civil sanctions. The utility of the fraud penalty as a remedial sanction in safeguarding the revenues of the Government is not impaired by the collateral use of the criminal sanction; and indictment and trial for the making of a fraudulent return is more effective as a deterrent than a hearing before the Board of Tax Appeals in a civil case. The oft-quoted rule which excludes from consideration the motive of tax avoidance is not pertinent to a situation such as this in which taxpayers knowingly try to hide the truth.

PARAPHRASE OF TELEGRAM RECEIVED
FROM: American Embassy, Paris, France
DATE: October 31, 1939, 1 p.m.
No.: 2616
FOR THE TREASURY DEPARTMENT.

Reference is made to telegram No. 1331 of October 30 from you.

The brief and superficial article published by Gaillaux is for the most part propaganda for the tabloid reading public. The article consists largely of a rehash of previously published material. In the beginning of his statement he quotes at some length the view which Dr. Brinkmann supposedly delivered in an address a short time before his "nervous breakdown" and which was published in the March 18, 1939 issue of the AGENCE ECONOMIQUE ET FINANCIERE. Despatch No. 4072 of March 21, 1939 from the Embassy contained the full text of that article. It was not cabled at the time apparently due to the fact its authenticity was questionable.

END SECTION ONE.

BULLITT.

EA:LVV

RFP

GRAY

Paris

Dated October 31, 1939

Rec'd 2:15 p.m.

Secretary of State

Washington

2616, October 31, 1 p.m. (SECTION TWO)

Caillaux quotes Brinkmann as saying: "all our reserves are entirely exhausted. By the methods which we have employed we have arrived at a much lower quality of production and a cost of production considerably higher (***) we have had even to pay for a cannon a price for which we should normally receive ten cannons and even that cannon is of an inferior quality as has been proved beyond question". With this as a preamble Caillaux discusses lightly "three essential things to consider: the lack of food supply for the people; the question of oil and that of iron ore". He then proceeds to "borrow" from the recent sensational book of Lajos "Germany's war chances" to show that the German foodstuff situation is worse than in 1914; he quotes no figures in this respect. After a general assertion that the German population is "under-nourished" he hastens to add that "it is hardly probable that foodstuffs restrictions will determine the issue of the conflict". Turning to oil he says that through its efforts toward autarchy Germany in 1937 was able to produce by
synthetic

RFP -2- #2616, October 31, 1 p.m. (SECTION TWO) from Paris
synthetic means some 35.9% of the 5,150,000 tons consumed.

BULLITT

HPD

REB

GRAY

Paris

Dated October 31, 1939

Rec'd 3:50 p. m.

Secretary of State,
Washington.

2616, October 31, 1 p. m. (SECTION THREE)

German economists, he says, estimate war time petroleum needs at not less than 15 or 20 million tons per annum and some of these at 30 or even 40 million tons. Taking the most favorable minimum of 15 million tons he asks where it is to be found. He states that Rumanian production fell from 8,700,000 tons in 1936 to 6,350,000 tons in 1938 and at the most Germany could obtain there but 4 or 5 million tons of its indispensable imports. As for Russia he quotes a recent issue of the ECONOMIST (September 2) to the effect that Russian exports have fallen from 6,000,000 in 1932 to 11,600 tons in 1938 that all these exports hitherto pass through the Black Sea and that lack of tank cars will prevent "appreciable quantities from reaching Germany" (presumably by overland routes). He stresses the authenticity of ECONOMIST articles and the importance of oil in modern motorized and air warfare. He asks whether "the Germans have not shown a singular lack of foresight in basing their strategic conceptions on a liquid of which they do not even possess the smallest portion."

BULLITT

CSB

RFP

GRAY

Paris

Dated October 31, 1939

Rec'd 3:08 p.m.

Secretary of State

Washington

2616, October 31, 1 p.m. SECTION FOUR)

He then turns to iron ore of which German production in 1937 he says was but 8,620,000 tons compared to imports of 20,620,000 tons. (Curiously enough he omits mention of the important percentage of the imports furnished by France (thousand?) namely 7,133 million tons.) Sweden of course will be the principal source of supply and he points out that the greater part of Swedish iron ore exports hitherto have come through the Atlantic port of Narvik which is vulnerable to British blockade. To ship quantities of iron ore to Germany by the Baltic he says "would necessitate the construction of a special railway". He then mentions Germany's desperate efforts to increase iron and steel production through the requisitioning of park gates, iron grill doors, et cetera. He intimated that the Turks revealed on March 1, 1939, that six steel ships produced by Krupp and recently delivered to Turkey "had immediately to be withdrawn from circulation and subjected to a complete overhauling". As authority he cites the newspaper TAN. Caillaux then proceeds to devote the

remainder

RFP -2- #2016, October 31, 1 p.m. SECTION FOUR from Paris
remainder of his article to cursory examination of German
psychology and the theory that Germany through its
appliance to science has narrowed German intelligence with
respect to "general ideas". He concludes his article with the
following paragraph:

BULLITT

WWC

PARTIAL PARAPHRASE, SECTION FIVE OF TELEGRAM NO. 2616 of October 31, 1939, from the American Embassy, Paris

"The policies of all nations derive from their geography" are the words of a conqueror who happened to think strongly. The history of the great people, whose defects Tacitus defined some 1800 years ago when he measured their perpetual uneasiness, their continual instability, is the most glaring vindication of the Napoleonic formula".

In local circles the article did not attract such attention, and we wonder how much of it was really written by Faillaux; the article appeared in the newspaper on an inside page. Since the war French publications of varying degrees of seriousness have of course published various statements on the economy of Germany, based on stale and probably incomplete statistics, or propaganda or guess work. The Embassy has not been reporting them on the assumption that our Embassy at Berlin has been sending you more reliable data of that nature, something on the order of that contained in Berlin's telegram No. 110 of February 9, which gave an excellent survey.

END MESSAGE.

RECEIVED

HULLITT.

1939

TELETYPE UNIT
U.S. DEPARTMENT OF STATE
WASHINGTON, D.C.

EA:LNW



EDA

GRAY
LONDON

Dated October 31, 1939
Received 5:05 p.m.

Secretary of State
Washington

2230, October 31, 8 p.m.

FOR THE SECRETARY OF THE TREASURY. STRICTLY CONFIDENTIAL.

Whigham came in to see me today and gave me a revised list of securities which now total about \$809,000,000. Included in this however is \$80,000,000 worth of Dominion and Colonial securities which may not be very easily handled in American markets. Included also in this figure is \$42,000,000 worth of securities sold during the last two months: \$24,000,000 in September and for the first 20 odd days of October 18,000,000, but they granted quite a few permissions for sales last week, and what the final figure for October will be, I do not know.

This \$809,000,000 is made up as follows: governments 47,000,000 foreign, municipal and provincial 7,000,000 Dominion and Colonial 81,000,000 utility 94,000,000 railroads 80,000 industrial bonds 364,000 industrial stocks 386,000,000 industrial supplementary 92,000,000 bank, insurance and trust 22,000,000.

On the B list, which are the securities that will

be

EDA - 2 - #2230, October 31, 8 p.m. from London

be very much slower to handle, the total is about \$125,000,000 made up as follows: foreign governments, municipals, et cetera 1,000,000 utility 25,000,000 railroads 20,000,000 industrial 69,000,000 banks, insurance and trust 11,000,000.

Butterworth is taking these corrected lists with him on the plane next Wednesday.

One of the great difficulties that Whigham finds himself in the midst of with the Treasury is that for the British Government to take possession of these securities they must give out the list. To my way of thinking, if they ever give out this list, you can kiss the market "good bye" as far as most of these securities are concerned, unless we have a wildly bullish American market. So I have urged strongly that this should not be done and he has now proposed to the Treasury a scheme to eliminate the publishing of the list. Whether this will be accepted or not, I do not know. I do know it will be very bad for us if a list is ever made public of these securities.

He has made a list of approximately seventy odd securities on which he thinks he can reasonably soon raise something over \$400,000,000 and since the total they want to raise for the first year is \$500,000,000, if this liquidation works out as he plans, he will be

well

EBA - 3 - #2230, October 31, 8 p.m. from London

280

well satisfied. He is going to give me the list of securities that make up this total and I will send it to you just as soon as I have it.

As a matter of information he told me he saw the plans yesterday for the new loan and he said the British Government are hoping to raise 500,000,000 pounds. He of course knows they wont reach it. The rate will be somewhere between $2\frac{1}{2}$ and 3% and they have plans for forced distribution of the bonds that are not taken which he says makes very unpleasant reading. He was loath to give the details so I did not press him.

KENNEDY

RR

RECEIVED

NOV 1 1941

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AC

GRAY

Paris

Dated October 31, 1939

Rec'd 7 p.m.

Secretary of State

Washington

2625, October 31, 7 p.m.

FOR THE TREASURY.

A decree published in the Journal Officiel this morning suspends the issue of the eighteen month bonds issued by the Autonomous National Defense Board under authorization of July 12, 1938 (Embassy's despatch No. 2621 of July 13, 1938) from today. (These are not to be confused with the two year armament bonds launched this past summer, telegram No. 1236, July 1, 1 p.m.). A further decree provides that beginning today ordinary Treasury bills with maturities of six months and one year will be issued under the name of "armament bonds", the former to bear two and one half per cent interest and the latter one per cent. This decree is intended to stimulate public interest in purchases of short term Government issues and is supplemented by a further decree setting up a "national committee" charged with supporting the Government's (war) effort notably by propaganda

for

- 2 - #2625, October 31, 7 p.m. from Paris

for the subscription to armament bonds permitting this committee which is designed on a smaller scale and by more Gallic methods as a sort of counterpart to our wartime liberty loan committees includes twenty-four distinguished French public men headed by General Nollet, President of the Autonomous National Defense Board. It includes representatives of the Prime Minister, the Ministers of Finance, Armament, Broadcasting, the General Commissioner of Information, and Communication: Cardinal Verdier, Pastor Boegner, President of the Protestant Federation of France, Grand Rabbi Schwartz, the Governor of the Bank of France, the Presidents of the Paris Stock Exchange, Bar and Medical Associations, the Chamber of Commerce, the President of the Academy of Agriculture, et cetera.

(END SECTION ONE)

BULLITT

DDM

AC

GRAY

Paris

Dated October 31, 1939

Rec'd 7:29 p.m.

Secretary of State

Washington

2625, October 31, 7 p.m. (SECTION TWO).

Reynaud in addressing a fight talk to the above-mentioned national committee today at its organization meeting announced that in contrast to the last war where no "complete budget" was voted he is presenting in a few days a budget "which exclusive of military expenses of course amounts to ^{OVER} 66,000,000,000 francs and which will be balanced". He added that in spite of "gigantic expenditures" made abroad, French foreign exchange reserves have not been touched thanks to the return of capital which still continues. He added, "You can say that deposits in savings banks exceed withdrawals, that the circulation of bank notes is decreasing and that French rentes are at quotations higher after two months of war than on the eve of Munich."

The Journal Officiel likewise publishes the forms for the declarations of assets held abroad

which

which as provided in the pertinent decrees (our telegrams numbers 2028, September 18, 1 p.m. and 2394, October 9, 7 p.m.) must be submitted December 1 covering holdings as of November 15. Copies will be forwarded by mail.

A further measure in this morning's Journal Officiel authorizes the ministries of Agriculture, Finance and Commerce to grant rebates not exceeding 60 francs per quintal for certain quantities of sugar imported prior to November 1 with a view to maintaining necessary stocks. (END SECTION TWO).

BULLITT

DDM

HSM

GRAY

Paris

Dated October 31, 1939

Rec'd 7:35 p. m.

Secretary of State,
Washington.

2625, October 31, 7 p. m. (SECTION THREE).

The month end liquidation passed off quite satisfactorily with a carry-over rate of one half per cent compared to three-quarters per cent a month ago and one-half per cent for the mid-month liquidation. The curb rate was reduced from seven and a half per cent to five and a half per cent. Rentes continued their recent advance moving up from seventy centimes to one franc twenty-five. The Italian Cabinet changes which are most welcome here in part accounted for a further advance of Suez of 440 francs. The recent better tone of the Paris stock market is due in part to the possibly over-optimistic belief that the lack of activity on the western front may be from "hesitation". (Bourse circles thus seem to overlook the fact that the heavy rains of the past fortnight would in any event have prevented large scale operations.)

After November 2 the securities market will be open from 11:30 to 1:30 from Monday to Friday instead of the 12 to 2:30 hours previously prevailing.

BULLITT

WVC
RR

ISM

GRAY

Paris

Dated October 31, 1939

Rec'd 7:47 p.m.

Secretary of State,
Washington.

2625, October 31, 7 p. m. (SECTION FOUR).

Today's financial press carries the following communique issued by the Caisse Generale de Reports et de Depots (our telegram No. 2615, October 30, 7 p. m.):

"All deposits entrusted to the bank are covered by immediately available assets. The Mandelsohn credit is not included in these assets and the loss which may result therefrom will not affect the capital. The Caisse Generale de Reports et de Depots will continue its operations as in the past and will maintain full activity on the bourse". Agence Economique et Financiere indicates that the foregoing occasioned no surprise in Belgium in view of earlier rumors but holds that shareholders will inevitably suffer.

The same official reports that the Swiss Federal Government yesterday approved the budget for 1939 at a level of 596,500,000 Swiss francs with a deficit of 73,000,000. (END OF MESSAGE).

BULLITT

DDM

October 31, 1939
10:19 a.m.

HMJr: Hello.

Operator: Mr. Welles is out of his office for a little while.
I'll have him call you. She says she can reach him
in a little while.

HMJr: O. K.

O: All right.

11:45 a.m.

Operator: Go ahead.

HMJr: Hello.

Sumner
Welles: Good morning, Henry.

HMJr: How are you?

W: I'm fine, thanks.

HMJr: Sumner, I don't know whether you have any new ideas
on this thing.

W: Well, I have two.

HMJr: Good.

W: I have talked with Mr. Hull.....

HMJr: Yeah.

W:with regard to our talk yesterday evening.

HMJr: Yeah.

W: And he feels that he couldn't spare Pasvolsky now.

HMJr: I see.

W: He needs him here to do certain work for him.

HMJr: (Laughs) Excuse me if I laugh.

W: And my own personal suggestion is -- I don't know what you think of it.....

HMJr: Yeah.

W:if you wouldn't consider trying to get Roswell Magill to go.

HMJr: No. No -- I -- he's no use on that sort of thing.

W: You think he would not.

HMJr: No.

W: He did a very good job for the Cuban government, you know.

HMJr: Well that was his field, which is taxes, and when he was here in the Treasury he took no interest in anything except taxes.

W: Um-hm.

HMJr: He's excellent on taxes but not on.....

W: Yeah.

HMJr: No.

W: Well, that's too.....

HMJr: And I -- I had to -- oh gosh, I had to go down on my knees and kiss his big toe to get him to do that.

WH: Um-hm.

HMJr: The Cuban one.

W: Yeah. Well, how about you?

HMJr: Well, the only thing -- the only thing that I've got is I thought about it -- was this that as of Friday Mr. Duggan was to go and I'd like very much to see him go and represent us as well as you and then we'd be pleased to let Cotton and Hanson and Schmidt go also - all three.

W: All right. That may be the best suggestion but I'd better talk it over with Mr. Hull.

- 3 -

HMJr: Ah.....

W: Can I let you know and I'll see you at three this afternoon?

HMJr: Oh, surely. Surely, but we'd like to see Duggan go. And we'd give him these three men.

W: All right, Henry.

HMJr: Hanson talks Spanish and Schmidt talks Portugese.

W: Um-hm.

HMJr: So that.....

W: All right. Well, I'll take that up before I see you.

HMJr: Righto.

W: Thanks.

HMJr: Thank you.

W: Goodbye.

October 31, 1939
12:05 p.m.

Eddie
Greenbaum: Hello.

HMJr: Eddie.....

G: Yes, Henry.

HMJr: I'm calling you up on Treasury business.

G: Yeah.

HMJr: We have a very difficult tax case. Whether -- the difference between Justice and the Treasury and in -- and within the Treasury. I've never done this before but I'm asking three people to come down for the Treasury, if they'll come, and listen to our own Treasury lawyers to advise me and I'm asking you and Magill and Knollenberg.

G: Yeah.

HMJr: This is entirely agreeable to Foley, Hanes and Guy Helvering. They're all tickled to death. See?

G: Yeah.

HMJr: It's -- the case is the reorganization of Twentieth Century Fox and I take it you have nothing to do with those people.

G: No, I'm not in on that.

HMJr: And it -- it's due to outside pressure, - I don't want to find myself being unduly tough or unduly soft, you see?

G: Yeah.

HMJr: But there are outside people who have interested themselves in it. Now, it's largely a matter of charity on your part. We can pay you the magnificent sum of \$25 a day and your expenses and railroad fare.

G: Oh, I'll be willing to do it.

HMJr: But I think -- I think it would take about two days.

G: Well, have you set any time for it?

HMJr: Well, I would like to make it this Thursday and Friday if possible. I haven't -- you're the first person I've talked to. I don't know how the others are fixed.

G: Ah -- you'd want to know right away, wouldn't you?

HMJr: Yeah, I'd like to have you people tell me and I told the people here in the Treasury if -- whatever -- if it's unanimous I'll abide by whatever you people say and Hanes says he'll do the same.

G: Yeah. Well let me call you back later - I'll phone you early this afternoon as to whether I could rearrange things for those days.

HMJr: It's -- it's a very big case, terrific political pressure on Justice to drop it, you see?

G: Well Henry, let me call you back later in the day on those days because.....

HMJr: And I'm not -- I'm not going to -- I'm not telling the Justice that I'm asking you people. It will be purely a Treasury matter.

G: Yeah, that's to advise Treasury.

HMJr: Yeah.

G: Yeah.

HMJr: Yeah.

G: Is it something that would be detrimental to wait until next week - Monday or Tuesday or.....

HMJr: I'm afraid -- yeah because.....

G:is there a rush that it has to be done this week?

HMJr: I tell you why.

G: I'm kind of scheduling my time.

- 3 -

HMJr: Well I'll tell you why. There are really three pieces to it. There's only one part that I'm bothered - the one piece - these fellows involved who were -- it's the Mayer estate of -- Getts' son-in-law is in it and Schenck and Zanuck. See?

G: Yeah.

HMJr: We claim that they bribed Treasury agents and we've dropped it. The -- what do you call it -- statute of limitations expires on November 10th on that part of it, you see?

G: Yeah.

HMJr: And they are in the midst of presenting it to Grand Jury.

G: Well then it is a hurry thing that way?

HMJr: There is -- I mean, this is a very minor part of it.

G: Yeah, but this.....

HMJr: But there is a statute of limitation running against us.

G: Yeah.

HMJr: See?

G: Well, I'll phone to you early this afternoon if I can rearrange things for those dates.

HMJr: But I would -- I say, I've never done this before but everybody said it was a happy solution.

G: Well I can see you want to get some sort of an impartial.....

HMJr: Yes.

G:that work on it.

HMJr: Yes, because it's -- it's never happened before that we've had such a direct cleavage not only in our Department but as between our own people and -- and the Department of Justice.

G: Have you asked Magill and Knollenberg yet?

HMJr: No, I called you first.

G: I see. Well, I'll say definitely that I'll do it.

HMJr: Swell.

G: But I can't say definitely that I'll come down -- well that would mean coming down tomorrow night.

HMJr: Yeah.

G: And I can let you know that later in the afternoon.

HMJr: O. K.

G: All right, fine. Then you can sound them out of their timing too.

HMJr: Right.

G: All right, Henry.

October 31, 1939
12:11 p.m.

HMJr: How are you?

Roswell
Magill;

I'm glad to hear your voice. I didn't know what had happened to you.

HMJr: Well, I only call you up when I.....

M: You're in dire distress I suppose.

HMJr: Yeah, and I am again.

M: Well, I have had very agreeable conversations with your father and mother in recent weeks.

HMJr: Swell.

M: They seem to be in fine shape.

HMJr: Ros, what I'm calling up about is this: We have a most unusual situation. We have a case which has to do with the reorganization of the Twentieth Century Fox.

M: Yeah.

HMJr: There's disagreement between the Treasury and Justice and in the Treasury itself. Due to outside influence having been brought to bear, I made the suggestion this morning to all of the Treasury people involved that I would ask you, Eddie Greenbaum and Knollenberg to come down for two days and listen -- go into this thing and advise me what to do.

M: Yeah.

HMJr: This suggestion was entirely agreeable to everybody. They were enthusiastic about it.

M: Yeah.

HMJr: I've just talked to Eddie. Eddie said he will come. There's a statute of limitations running against us on November 10th on part of it.

M: Yeah.

- 2 -

HMJr: They bribed one of our employees.

M: Yeah.

HMJr: Which is only part - it's the least important part of it as far as advising me, you see?

M: Yeah.

HMJr: So there is some -- and that -- they started to present that in the Grand Jury in Los Angeles.

M: Yeah.

HMJr: I made the suggestion to Eddie, if it was possible, OF DOING it this Thursday and Friday.

M: Yeah.

HMJr: He said he wouldn't know until this afternoon, but he would make an effort to rearrange his plans.

M: Yeah.

HMJr: It's -- it's -- I'm not going to tell Justice about it and purely -- you'll be coming down to advise me informally, you see?

M: Yeah.

HMJr: I told the people here that whatever the three of you advised I'd accept it.

M: Yeah.

HMJr: And Hanes feels the same way.

M: Yeah. Well, Henry, I -- it's decidedly the sort of thing I'd like to do and I'd -- Thursday and Friday I think would be all right. I've got -- I have some engagements I can cancel -- I could cancel, but I think I could do that.

HMJr: Right.

M: I -- however, I run into this. The fact -- if it's the thing I -- I imagine it is.....

- 3 -

HMJr: Yeah.

M:Dr. Kline, who is a lawyer up here and also an accountant.....

HMJr: Yes, he's in it.

M:talked to me last summer about this thing and wanted to get me in it.

HMJr: Yeah.

M: And I said -- I talked the thing over with him and went over the facts with him somewhat and said I didn't want to get in it.

HMJr: Yeah.

M: And I therefore didn't get in it.

HMJr: Yeah.

M: Now, I -- I don't know, I -- I suppose in view of the fact that he -- I did have that talk with him and he disclosed to me some of the facts of the thing from his own side, that probably I should stay out of it from your side.

HMJr: No, I mean -- this is.....

M: As I say, I -- I didn't go into it, because -- well, some of these things you've said. It didn't look to me like much of a case for me to be mixed up with.

HMJr: Well -- I mean, you're not in it and so -- I mean, he -- I don't suppose he disclosed anything to you -- certainly from our standpoint there isn't any reason why you shouldn't.

M: I don't think he disclosed anything to me that is not in the records at all, as far as that's concerned.

HMJr: Well, I mean -- from our standpoint there'd be no reason why.

M: Yeah. Well I tell you what -- let me do, if I may, let -- let me call up Eddie.....

HMJr: Good.

M:and I'll talk to him a little about it and let you know.

HMJr: No, I mean -- of course, if you were in it would go out of the question but.....

M: Well I didn't want to get into it because it looked to me like a kind of an unsavory case and.....

HMJr: Well, it isn't -- I'm not -- the bribery part isn't the thing. It's the question of the capital gains in the thing.

M: Yeah.

HMJr: And there's complete disagreement in the Treasury and between the Treasury and the -- on account of the outside influence I want three fellows like you three to tell me -- well.....

M: Well, I think.....

HMJr:that this.....

M:needless to say I approve of that way of doing it. I'm glad to see that you're doing it. I think it's the thing to do.

HMJr: Yeah.

M: And I would like very much to help you out just as -- as I remember I did once before on that other big thing where we were -- having a quarrel with Justice.

HMJr: Yeah. Well, this.....

M: I'll call up Eddie.....

HMJr: You do that.

M:and -- and we'll see what we can do about it.

HMJr: And we'll give you the magnificent sum of your railroad fare and twenty five dollars a day and your expenses.

M: (Laughs) Well, I might let you pay my expenses but I won't let you pay me anything else.

HMJr: Not even your railroad fare?

M: You can -- might be -- I might let you do that.

HMJr: O. K.

M: Well how are you feeling, Henry?

HMJr: I feel pretty well.

M: Is -- how are things going along?

HMJr: They're going along all right.

M: I -- I think as far as the world is concerned that this tax program is -- I mean, the way that Johnnie is proceeding at it is being well-received.

HMJr: Well, I didn't call you because the President and I decided that we'd do nothing on taxes until we got this legislation out of the way.

M: Yeah.

HMJr: And that's why you didn't hear from me.

M: Yeah.

HMJr: But I got.....

M: Well I think that's right.

HMJr: I've got your memorandum in the safe.

M: Yeah. I see.

HMJr: I was much obliged.

M: Well, whenever you're ready let me know and I.....

HMJr: Well.....

M: -- I'd like a lot to work with you on it.

HMJr: Well, we do but we thought we wouldn't stir up the animals.

M: Yeah. Well, I think that's right.

HMJr: O. K.

M: Thank you, Henry. Goodbye.

October 31, 1939
12:16 p.m.

Bernard

Knollenberg: Hello.

HMJr: Henry Morgenthau, Jr.

K: How do you do? It's nice to hear your voice.

HMJr: How are you?

K: I'm very well, thank you.

HMJr: Well, I'm calling you up - I need a little help.

K: Fine.

HMJr: I'll tell you what it is, we have a very interesting tax case which involves the reorganization of the Twentieth Century Fox. I find myself in this position, that the Treasury is in complete disagreement with the Department of Justice and we have two schools of thought in the Treasury.

K: Yeah.

HMJr: Plus the fact that there are some very unpleasant outside influences which have been brought to bear.

K: Yes.

HMJr: Therefore, this morning when I listened to my own people I made the suggestion that -- I would ask three people to come in and listen to the Treasury's side and purely to advise me on an informal basis.

K: Yes.

HMJr: And then I was suggesting you and Ros Magill and Eddie Greenbaum.

K: Yes.

HMJr: I called up the other two gentlemen and they said they'd be delighted to come down.

K: Well I, of course, would be too.

HMJr: But -- and it's purely to advise the Treasury on what you people think is right and I told my people this morning that if you people were

unanimous, whatever you decide I would accept.

K: Yes.

HMJr: And Hanes said he'd do the same.

K: Fine.

HMJr: Now.....

K: That's very interesting and I'd love to do it.

HMJr: Now we have, on one part of it, they've bribed a Treasury employe and that statute of limitations expires on November 10th.

K: Yes.

HMJr: This part of it is the least controversial -- I mean, that is, just a sort of a by-product.

K: Yeah.

HMJr: An unpleasant one, but a by-product. Therefore, I suggested to Magill and Greenbaum this Thursday and Friday.

K: This -- this coming Thursday and Friday. Now just let me see. (Brief pause) Well, I could -- Thursday is all right. Unfortunately, I am -- am delivering the opening address at the Franklin Institute in their Franklin celebration on Friday afternoon.

HMJr: Where would that be?

K: That would be at Philadelphia.

HMJr: Well, you could give Thursday and Friday up until noon.

K: Well, yes -- no, I'd have to leave a little earlier even if I flew to Philadelphia because I have promised to talk to the Yale Club at lunch beforehand and I'd -- I'd hate to call it off at this stage.

HMJr: Well -- I -- I.....

K: Thursday and part of Friday -- Friday morning, I could come, but not beyond about eleven o'clock.

HMJr: Well, supposing -- I'm being a beggar, I can't be a chooser.

K: Yeah.

HMJr: Supposing I send word to these two men that you can be here, shall we say nine o'clock Thursday morning?

K: Yes.

HMJr: And can give us all of Thursday and part of Friday.

K: Yes, that's correct.

HMJr: Now can I -- may I leave it this way - that if you don't hear from me again you'll come to my office Thursday at nine?

K: Yes, that'll be fine.

HMJr: And the Treasury pays the magnificent sum of your railroad, your expenses and twenty-five dollars a day if you'll take it.

K: I realize that this is no get-rich quick.

HMJr: Yeah.

K: I'll be there at nine o'clock Thursday morning.

HMJr: Well, I just wanted to let you know that's what -- that's what we can do and that's.....

K: All right, fine.

HMJr: So, if you don't hear again I'll look for you Thursday.

K: Good. It'll be nice to see you again.

HMJr: And we'll have everything lined up.....

K: Under what Act is the -- is the question? I'd just like to read it over again.

HMJr: Gosh, they mentioned a 112 something.....

E: Well, 112 -- yes (b) probably, but that -- that same section was in several Acts with that same number. I wonder if you could have one -- your secretary drop me a line as to which Act it is.

HMJr: Ah -- do you want them to do that and maybe get off something tonight on it for you?

E: Well, it would be fine if they could. You see, if I could have a little of the background I could be listening in very much more intelligently.

HMJr: I'll have the Counsel send you up the papers tonight special delivery so that there'll be something -- care of Yale Library?

E: Yes, if you will.

HMJr: They'll be there in the morning.

E: Yeah. That's grand.

HMJr: Ever so much obliged.

E: Thank you.

HMJr: Goodbye.

E: Goodbye.

October 31, 1939
12:24 p.m.

HMJr: Hello.

James
Farley: Hello, Henry.

HMJr: Hello, Jim.

F: How are you?

HMJr: Wonderful.

F: Good. Henry, what did you ever decide, if anything,
on Tom Lynch's place? Are you just going to let that
coast?

HMJr: Whose?

F: Tom Lynch's vacancy where his wife.....

HMJr: Oh, I think, if I'm not mistaken, that I have here a
recommendation from the President and he said I should
talk to you about a man by the name of Flynn.

F: Ed Flynn?

HMJr: Brother.

F: Yeah.

HMJr: I think -- he recommended Ed Flynn's brother for
something.

F: Well, that's the place.

HMJr: And I'm having him investigated, but as I remember it
we parted company - he was in the alcohol business.

F: That's right.

HMJr: And we weren't satisfied with him.

F: That's right.

HMJr: So -- but I thought I'd go ahead and have a formal
report to satisfy.....

F: That's right. I know the story of all that. I'll talk
to you about it sometime.

HMJr: But that -- but that -- I'm 90 percent sure that's who he.....

F: I'm sure it is, because I talked with -- I told him that -- talked with him about that once.

HMJr: Yeah, I don't think we can take Ed Flynn's brother.

F: Well, what you ought to do, in my judgment, if you'll pardon the suggestion from me - what you ought to do is advance Harry to the place and then do what you want down below under him.

HMJr: Advance who?

F: Foley, the fellow he is the Appraiser there -- next -- Harry Foley from Westchester, you know.

HMJr: Yes.

F: Advance -- he's been in -- the surveyor of the hasn't he, or was Tom the surveyor?

HMJr: Yeah. Tom -- Tom was the Appraiser.

F: Well, this fellow is the surveyor then.

HMJr: I see.

F: Foley is the surveyor. Harry T. Foley, he used to be chairman of Westchester. He's been in there as long as Tom has.

HMJr: Yeah, but I think that this job of Tom Lynch's only pays seven.

F: Well, I think that -- well, I don't think the other one pays as much.

HMJr: You don't.

F: You look it up. I think the smart thing to do -- from an -- from an efficiency point of view would be to advance him, if that can be done, and then do what you want in Foley's place.

HMJr: O. K. I'll look into it. I've got no candidate.

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- F: Say -- well, I don't care personally. I'm not going to get in the middle of this one, you know.
- HMJr: Yeah.
- F: I talked with the boss once. He said he wanted to do something for Jim Townsend, see?
- HMJr: Oh.
- F: And I said to him, "If you want to do something for Townsend, I don't know how much ability Townsend has, but advance Foley to that spot and let Townsend have Foley's place, because I don't think it would be good judgment to put an outsider in in Lynch's place if you have....."
- HMJr: Have you told that to the President?
- F: Beg pardon?
- HMJr: Have you told that to the President?
- F: Oh yeah, I told him that a month ago.
- HMJr: O. K.
- F: See?
- HMJr: Well, I'll leave it this way. I won't do anything without talking to you first.
- F: Well, I don't -- personally, I haven't -- I'm not keen one way or the other. I'm not going to get excited about it.
- HMJr: I won't do anything, Jim, without talking to you.
- F: O. K., Henry. Goodbye.

October 31, 1939
3:03 p.m.

HMJr: Hello.

George
Harrison: Hello, Henry?

HMJr: Yes.

H: This is George Harrison.

HMJr: Hello.

H: I just wanted to let you know I presume this issue will be a success.

HMJr: I presume so.

H: (Laughs) Well, we're 910 now.

HMJr: Yeah, Mr. Jones just walked in here and he's smiling.

H: Yeah. (Laughs) I was -- tell him I was just going to call him too.

HMJr: All right.

H: But.....

HMJr: Well, she's all right. They like Jones' commodities.

H: Yeah, I think so. Well, I think they won't get much more than about eight per cent.

HMJr: Eight percent.

H: 'hat's our guess.

HMJr: O. K.

H: They're coming in very fast now.

HMJr: Jones will have to get busy and make some of these small business men loans.

H: (Laughs) Yes.

HMJr: O. K.

H: Very easy to do.

HMJr: All right.

H: All right.

HMJr: Goodbye.

H: Goodbye.

October 31, 1939
3:48 p.m.

HMJr: Hello.

Speaker

Bankhead: Henry?

HMJr: Yes, sir.

B: This is Bankhead.

HMJr: How are you?

B: I hate to interrupt you in a conference but you know they've got all sorts of things floating around up here.....

HMJr: Yeah.

B:on this neutrality fight. Especially the opposition, and they're trying to make the sinister suggestion now on the credits phase of the situation.....

HMJr: Yeah.

B:that there's an understanding of some sort that the Stabilization Fund, under your control, can be used -- for instance, firms in England or France might negotiate credits - that's what they're saying.

HMJr: Yes.

B: And then turn those credits or balances over to the governments of France and England under this Stabilization Fund. Well, nothing of that sort can be done under the law, can it?

HMJr: Well, Mr. Speaker, I went into that whole thing with -- in a letter with Senator Vandenberg and -- a copy of which I'd be glad to furnish you or to write you a letter myself. What we did was this - when I testified up on the Hill.....

G: Yes.

HMJr:they asked me that question and I gave them my word and my assurance that at that time we were not permitting the Stabilization Fund to be used in any manner in the way of a loan.

B: Yes.

HMJr: To assist these countries.....

B: Either to individuals or governments.

HMJr: Right. And then I furthermore said in answer to a question from Senator Taft that if I was approached by any government that was at war before taking any action, I would consult Congress for guidance.

B: Yes.

HMJr: And.....

B: Well now, will you send me a copy of that letter to Vandenberg this afternoon?

HMJr: I'll be glad to and I'll be glad to send up the whole thing and also send somebody -- send Ed Foley up with it.

B: Yes.

HMJr: Who is looking after it on the Hill for us.

B: Yes.

HMJr: How's that?

B: Well, I wish you would.

HMJr: How long will you be at your office?

B: Oh, I think I'll be here probably until 5:30.

HMJr: Well, he'll be up there within a half an hour.

B: All right, fine.

HMJr: And if you want anything in writing from me directly to you.....

B: Yes.

HMJr:you tell Ed Foley about it -- what you want, and I'll put my name to it.

B: All right, and you can send that up tomorrow morning.

HMJr: You bet.

B: All right, fine.

HMJr: How's that?

B: Fine.

HMJr: Anything to help.

B: All right. Thank you.

October 31, 1939
4:20 p.m.

HMJr: Hello.

Lauchlin
Currie: Hello, Mr. Secretary.

HMJr: Yes, Lauch.

C: I thought I'd tell you if you don't already know.

HMJr: No.

C: As a matter of interest that the President decided to hold up.....

HMJr: Pardon?

C: The President decided to hold up the thing - the estimates at this time.....

HMJr: No, I didn't know it.

C:and put them in with the January.....

HMJr: Oh.

C:one to cover both on the grounds -- I didn't -- he took this before I had a chance to talk about the -- any figures at all.

HMJr: He did what?

C: I mean, I didn't have a chance to talk about any of the detailed estimates at all.

HMJr: I see.

C: He said he was just sort of reluctant to put it out now and that in grounds of the emergency and the uncertainty.....

HMJr: Yes.

C:and nearness to this other budget coming.

HMJr: That's all right. Whatever he wants.

C: So.....

HMJr: It's unimportant.

C:that was the.....

HMJr: No, I don't -- I don't hear things that fast.

C: (Laughs) Well, I thought you might have because he thought he might possibly, if the question was raised at the press conference this afternoon, you see.

HMJr: No, I'm the last one in Washington to hear anything.

C: (Laughs) Well, you're the first one to have heard this.

HMJr: All right. The R.F.C. thing went over beautifully.

C: It did?

HMJr: Yeah.

C: Fine.

HMJr: I think it will be -- we'll get about 3 billion dollars' worth of subscriptions.

C: No.

HMJr: Something like that they say.

C: Good lord!

HMJr: And it's all right. It's -- we priced -- I priced it extra good, the first cash offering. The first cash offering to the public any country in the world, you know.

C: That's right, yeah.

HMJr: And it'll go around the world that things are good here and that's what I want.

C: That's fine.

HMJr: So we're all right now, for quite a while.

C: For another few days until something else comes along.

HMJr: No, I don't -- I mean, we're all right on financing.
C: Oh, yes, as far as cash is concerned, sure.
HMJr: Yeah.
C: Yeah. Well, that's fine.
HMJr: O. K. Thanks for calling.
C: Not at all. Goodbye.

RE TWENTIETH CENTURY-FOX
FILM CORPORATION

October 31, 1939.
9:30 A.M.

Present: Mr. Hanes
Mr. Gaston
Mr. Foley
Mr. Helvering
Mr. Ireby
Mr. Wenchel
Mr. Kades
Mrs Klotz

H.M.Jr: Now, where do we start, gentlemen? Guy?

Helvering: Well, I take it the purpose of this meeting is to discuss this California case.

H.M.Jr: Well, the Twentieth Century-Fox case, yes.

Helvering: As I stated to you the other morning, Mr. Secretary, there is no doubt in my mind, since I have reviewed the evidence in this case, that there was no question about having a tax case there. I was very firmly convinced and I still think what they did was to manipulate their proceedings so as to defraud the Government.

H.M.Jr: Let me see if I understand the case. I have got this memorandum here from Foley, see. Now, maybe I may over-simplify this. John, will you follow this? I am not going to talk about the Zanuck thing for the minute. I am just going to talk for a minute about where the Twentieth Century was merged with the Fox.

As I understand, there are two things at this point, one is that we claim that in this merger, that before the merger, Zanuck had 20 percent interest in Twentieth Century, that on the distribution of the new Twentieth Century-Fox stock that was distributed amongst the three of them, between Zanuck, Goetz and Schenck, on the 560-odd thousand shares of common stock....

Foley: 547,000.

H.M.Jr: 547,000. D. Zanuck got 30 percent of that.

Foley: 613,000. 547,000 was the proportion of the amount he received.

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- H.M.Jr: He didn't have any preferred stock, so that he got 30 percent of that, or 10 percent over and above what his interests were in the Twentieth Century, and we are contending that on that extra 10 percent, that is a gain which he should pay a tax on, is that right?
- Helvering: Right at that point, Mr. Secretary, the reorganization - when stocks are taken over in the same proportion in which they are held before, there is no tax due. It is a non-taxed reorganization. When they are taken over in a different proportion, it is taxable. These men found out - they knew they had taken over a disproportionate part of their former holdings. Therefore, they commenced these manipulations to make it appear that Zanuck had the stock way long before that, which he didn't have, and make it non-taxable, theoretically.
- H.M.Jr: I'm just going on the theory he had 20 percent and when he came out of the corporation, he had 30 percent. Right?
- Helvering: That is an exact statement.
- Irey: That is all right.
- H.M.Jr: Now, on the Zanuck part, just let's take the Zanuck part. Is there anybody here that questions that? I mean, has anybody got any doubts as far as Zanuck is concerned, that he got 10 percent - he got 30 percent of the 547,000 shares?
- Foley: He got 30 percent of 613,000 shares, which was the total common that went to the old company.
- H.M.Jr: He got 30 percent of....
- Foley:613,000 shares.
- H.M.Jr: And we contend that if he had kept the same proportion, he would have gotten 20 percent?
- Foley: Yes. There are two points, he would have only gotten 20 percent and the distribution of the common wouldn't

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have been nearly so much. It would have been 66,000 shares instead of 613,000.

- H.M.Jr: And the difference is what we claim he should pay a tax on?
- Helvering: No, the redistribution in different proportion from the original holdings is what makes the reorganization taxable and doesn't come under the....
- H.M.Jr: Then let's leave Zanuck aside. Let's do it the other way. Let's leave Zanuck to one side. Let me take the reorganization. The reorganization - there are how many shares, common shares?
- Hanes: 1,226,000 shares of preferred stock went to Fox. Half of that amount, or 613,000 shares of common, went to Zanuck. 1,226,000 shares....
- H.M.Jr: How many shares of common altogether?
- Hanes: There was twice 613,000.
- H.M.Jr: 1,226,000 shares of common stock, of which 613,000 went to the three boys?
- Foley: That is right, on the 35-35-30 basis.
- H.M.Jr: We will just leave that out for a minute. Now, as I get it, how much preferred stock did they receive to their interests?
- Hanes: Fox got 1,226,000 in the Century; the three boys, 132,000.
- H.M.Jr: If they had gotten the same amount of common stock....
- Hanes: 66,000.
- H.M.Jr: We deducted 66,000 from the 613,000?
- Foley: That is right, 547,000.
- H.M.Jr: Now, as I get it, the Bureau says that that 547,000 is taxable, is that right?
- Helvering: That is right.

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- H.M.Jr: And the Department of Justice says it isn't.
- Foley: And they say it is a legitimate part of the New York business reorganization.
- Hanes: Our case - this case says the tax liability is predicated on the excess of 547,00 shares over the 66,000 which they would have gotten from the reorganization had they taken proportionate shares.
- H.M.Jr: So we are trying to answer the Department of Justice - to collect the tax on 547,000 these three boys got?
- Hanes: Yes, you are claiming tax on 547,000 shares of stock.
- Foley: We are not asking them to collect it, Mr. Secretary, we are asking them to put them in jail because they failed to pay a tax.
- H.M.Jr: But they still would have to pay a tax, wouldn't they?
- Foley: Yes, but we would handle the civil case before the Board.
- H.M.Jr: Now, can somebody give me the position - I mean where is the disagreement between Justice and ourselves, what is the position they take?
- Wenchel: They take the position that the owners of Twentieth Century were in a bargaining position and therefore they could bargain to get more money.
- H.M.Jr: Will you repeat that?
- Wenchel: They take the position that the three holders of stock in Twentieth Century were in a bargaining position and therefore they could insist on a larger share of the distribution than the other stockholders, than Fox. Reduced to its lowest terms, that is their position.
- H.M.Jr: Aren't there other cases like this? This can't be the only reorganization which has taken place where one fellow has a lot of non-productive property and they want to get - they merge management of non-productive property and management insists on half the common stock. This can't be the first time this has taken place.

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- Wenchel: We take the position, Mr. Secretary, that we have to go behind the scene and find out what happened before this reorganization and when we do that, then we find this exchange of telegrams to the effect that, "I am not going in this unless I can get some money for my services. I've put all these services into this Century and I would rather stay in Century if I am not going to get something for my ability."
- H.M.Jr: Well, I would do the same thing. I mean, leaving out whether I would pay a tax on it, if I was in the place of those three men, I have got a nice little business and I put \$700,000 in it and it is going like a house afire and if somebody else comes along that has got \$37,000,000 worth of non-productive assets and says, "Come on, boys, make this good," before I give up my little business and give them my name, I am going to ask for a big piece of that common stock. I can see what motivated it. If I was in business, I would do just the same thing.
- Poley: Then they tried to cover it up, Mr. Secretary.
- H.M.Jr: That gets down to the question of law. I am just arguing - I mean, I can understand what motivated these boys, but what we are getting down to, I am trying to find out what is the difference between our boys....
- Poley: The Bureau and the Department....
- H.M.Jr: And the Department of Justice.
- Poley: That is it.
- Hanes: As I see it, the position is that we claim that that was not a statutory reorganization under Section 112(b)(4); the Department of Justice says it was a legitimate statutory reorganization or consolidation under Section 112(b)(4). That is where the whole difference is, as I see it.
- Irey: We claim it was an attempt to defraud and they say it was not.
- Hanes: The Secretary has hit upon exactly the same approach that I took with the lawyers last night, not knowing anything about the law, being ignorant of that side.

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I took the position of the ordinary approach to a business proposition, which in this case, in my opinion, we are wrong because this was, under Section 112(b)(4), if I can read the English language, a legitimate statutory reorganization. If it were done according to the statutes of the State under which it was formed, it was a legitimate reorganization. In simple terms, what happened was this, or what might have happened was this, and they would have been fools had they done anything else in my opinion. The Century had a great earning capacity. Fox Film had no earning capacity but a lot of assets. Fox Film had \$37,000,000 worth of assets but they weren't earning any money. They wanted brains and capacity and production ability, which this fellow, Darryl Zanuck, apparently had in great quantity. They said, "Let's get together and put our brains and your assets together; your theatres and my brains will make us enough money." These fellows said, "That is fine, but you have got a lot of non-earning assets. We are not going in on a basis with you other than we take the major share or at least half of the earning capacity that we can earn out of this proposition."

So, on the one hand they say, "In order to safeguard my assets of \$37,000,000, I will take out a first mortgage. I will take the first lien on the property to the full extent of the \$37,000,000." That is 1,226,000 shares of preferred stock. On my side, with the Century, I say, "I have got \$4,000,000 worth of assets, so I take \$4,000,000 worth of preferred stock." That is the entire value of the company. Any of the value from that point on rests only in the earning capacity, as we are able to make it from this day forward. So, the common stock has no value. The common stock is just a lien on the future earning capacity of the company. I take half, you take half. It has no value. I get 613,000 shares, you get 613,000 shares, but I have got my 4,000,000 of preferred, you have got your 37,000,000 of preferred. Up to that point, it is a complete statutory reorganization and entirely legal under Section 112(b)(4).

Halvering: Up to that point.

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Hanes: Yes. I am not talking about the individual distribution of these shares. It makes no difference, so far as this particular point is concerned, what they....

H.M.Jr:how they divide up amongst themselves.

Hanes: Up to this point, you have got a perfectly legitimate reorganization, and had Zanuck and these other fellows done anything other than that, they would have been absolutely blithering idiots, because they had a tremendous earning capacity and the other side had none. So, if we base our case on the fact that this was not a statutory reorganization - and as I take it, this memorandum says, "The tax liability is predicated upon the excess of 547,000 shares of common stock received by Century stockholders, which was apparently issued as compensation for personal service contracts required under the plan of reorganization." Now, just go one step further. We would never have any reorganizations of a bad company with a good company in order to make a sound earning structure if we took the position that you can't reorganize, and the company itself - not the stockholders, mind you, but the company itself - have got to take out the same interest in common stock as they formerly had in the company. We would never have any reorganizations, because such a thing as this couldn't happen. They get 547,000 shares which have no physical value but of great earning capacity. Hence, they may have a market value. If you tax the fellow on 547,000 shares, or \$7,000,000, immediately he pays the Government \$5,500,000 in tax. He is a dumb cluck if he takes that kind of a deal, because he is selling out his future earning capacity for \$5,500,000. So, you would effectively stop any reorganizations or any getting together of business and you would effectively stifle the business of the country. Therefore, you wrote into the statute 112(b)(4) just to take care of this kind of reorganization. So, up to that point, I think we are wrong.

H.M.Jr: Now, let me just ask you this. Let's change the shift a little bit. I am in the banking business and the XYZ company comes to me and says, "Now, Mr. Morgenthau, we would like to raise 10 million dollars," and I say, "Well, the company is all right but times are difficult and I will look into it." I say, "All right, I will sell a million shares at

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ten dollars preferred, and then we will issue a million stock. We will give the subscribers of the preferred stock 500,000 shares." But we are the only ones who can raise this money so I am going to keep 500,000 shares for my firm for my efforts, see, because, "If you get anywhere, all right, but if you need 10 million dollars and you want it, I want half of the property for my firm and my efforts," and I think that is done every day in Wall Street. It may not be just on that proportion. Now, that goes through. I have got 500,000 shares of this common stock as a bonus for getting them their 10 million dollars. Do I pay a tax on the 500,000?

Wenchel: Yes, sir, that is income. That is exactly what happened to Zanuck a year before that in old Century. I think the distinction, Mr. Secretary, is this, that if two corporations come together and perfect a reorganization, any exchanged stock or assets for stock as provided for in 112(b)(4), that is not taxable, but that is not what happened here. Here we have a situation where two individuals, Zanuck and Schenck, argued with Fox as to how much they were going to get if they came into the reorganization.

H.M.Jr: Sure.

Wenchel: And that is a different thing entirely.

H.M.Jr: No, that is what Hanes says.

Foley: If it were paid in cash or if it were a stock dividend, it would be taxable, and we say it is tied on as a bonus here and it isn't an integral part of the reorganization.

H.M.Jr: Now look, I have been worried about this thing for this reason, on account of the undue outside influence which has been injected into this case. The normal thing would be for me, in my position, to get extra tough. I don't want to get - the influence to be extra tough or extra soft by outside influence. It is just as bad to be extra tough as it is to be extra soft. I want to be fair. I think I have got a right to - as far as I know, I have never knowingly been either extra tough or extra soft. I make mistakes and hope I always will. I have got a suggestion to

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make which I have never done before. I have done it in other matters in the Treasury. I would like to bring in as consultants, three outside lawyers, Johnny, and the three that I would like to bring in as consultants - and as far as I am concerned, I would be willing, if the three were unanimous, to take their advice. I would like to bring in Roswell Magill, Knollenberg and Eddie Greenbaum. I would let the three of them sit down and listen to this case and if the three were unanimous, as far as I was concerned, I would take their advice, whatever they would say. Knollenberg, Roswell Magill and Eddie Greenbaum. I happened to have thought it over during the night. I woke up early this morning. You (Mr. Hanes) know all three.

Hanes: Sure.

H.M.Jr: I don't think there are three better men that you could get. What do you think of that idea, placing this whole case before them? I am not asking you to commit yourself on it, but if the three of them said unanimously, "This is what I would do," either go ahead or drop it, I, personally, would take their advice.

Halvering: Of course, this would be non-public.

H.K.Jr: Oh no, I don't want the Department of Justice or anybody. I just would invite them in and say, "Gentlemen, can you give us a week-end," and then let our people present the facts to them and let them say, "Well, this is what I advise the Undersecretary and the Secretary to do," but I want Hanes to be one hundred percent happy over this thing.

Hanes: I don't think you would find three better fellows in the whole country, as far as I am concerned.

H.M.Jr: You couldn't?

Hanes: No, I know you couldn't find three better fellows to do the job.

H.M.Jr: These men are all attorneys. As I say, I don't want to be - just because of outside influence, I don't want to be - I mean, a thing like this, the outside influence in this case is - you can't help but get

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angry over the thing and very much annoyed, but on account of it, I don't want to do something which isn't fair. Here is the difference of opinion, between the Treasury lawyers and Justice lawyers - I don't want to bang the desk and tell Frank Murphy he has got to do this thing.

- Hanes: Mr. Secretary, the very fact that there can be such a wide diversion of opinion between ourselves and the Department of Justice certainly says this to me, if nothing else, that there could have been the same difference of opinion between any other group of lawyers, so I can't get myself around to charging people with fraud, by intent, where we can't agree amongst ourselves. That is a difficult decision to make. When you go back to this other thing, I am not prepared to talk about the distribution of shares amongst themselves. I am just talking about the simple reorganization and that, in my opinion, which is not worth a tinker's damn so far as the legal side goes - I know that we set up that 112(b)(4) just to take care of the legitimate reorganizations, to provide for such emergencies as this, and this is, in my opinion, a statutory reorganization and as such, is not non-taxable. Now, you get to the other point of the distribution of shares, and as I say, I am not prepared to talk on that, and, personally, I think they owe us a tax there, but I am not sure about it.
- H.M.Jr: Well, would you be satisfied if I could get these three?
- Hanes: Absolutely.
- H.M.Jr: Ed?
- Foley: Oh, absolutely. As the lawyers say, this is a close case. This is one of the cases where the courts divide and it seems reasonable.
- H.M.Jr: You would take no offense?
- Foley: I would take absolutely no offense. It is the only thing for you and Mr. Hanes to do under the circumstances.
- H.M.Jr: How about you (Mr. Wenchel)?

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Wenchel: Absolutely, Mr. Secretary.

H.M.Jr: Guy?

Helvering: Yes.

H.M.Jr: Herbert?

Gaston: I do think it is a device that you should not resort to unless a case is extremely difficult. I think it is a device that you should resort to very, very seldom, because there is very great danger of its becoming public and exposing these particular men whom you call in to pressure. But if this is that kind of a case and if we can come to complete agreement on it, perhaps it is the thing to do, but I do think it is a rather dangerous precedent.

H.M.Jr: It is no more dangerous than the three bankers I called in to advise me on the Bank of America. It is exactly the same procedure. Here was a different agency in town disagreeing as to the procedure of the Bank of America. I called in three of the outstanding bankers around and they are advising the Office of the Secretary of the Treasury how to proceed.

Gaston: It is not so important as a major tax case.

H.M.Jr: The outside influence is the same, it happens to be the same person.

Gaston: Yes, I know that, the principle is the same, but the tax case is, I think, somewhat different. These men are all in private tax practice.

H.M.Jr: No, you are wrong.

Gaston: Knollenberg is, isn't he?

H.M.Jr: Greenbaum has no tax cases. That is the price he pays for being my friend.

Gaston: I guess Roswell Magill doesn't take any cases before the Treasury but he does act as advisor for law firms. Knollenberg hasn't any practice at all?

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- H.M.Jr: None. He is an employee of Yale University.
- Gaston: Roswell Magill is the only one, then, that is in tax practice?
- H.M.Jr: I went all through that and if I can't have Ros Magill come down to advise me, then it is just too bad. Greenbaum has no cases. He wouldn't even take a retainer from Mayor LaGuardia on the old Post-office case.
- Gaston: As to your getting a perfectly sincere, honest, highly competent opinion from those three men, I don't think there is the slightest doubt in the world.
- H.M.Jr: What do you think, Irej?
- Irej: I think it is a very happy solution of our stalemate here. It is the first fraud case I have ever seen where I thought this would be justified, but I think it is entirely justified now.
- H.M.Jr: You do?
- Irej: Yes, sir.
- Foley: Mr. Secretary, there is one element that you want to consider, and that is that this ought to be done fairly promptly.
- H.M.Jr: I will get on the phone right away.
- Foley: Because the case is still pending before the Grand Jury and the statute is about to run.
- H.M.Jr: I am not going to bother them in the bribery case.
- Foley: That has a very material effect on whether or not we can prove the conspiracy here to defraud. If you can get an indictment of Kadis and the person that was paid to bribe Kadis, Dover, I think that you have got a much better chance to prove criminal intent here, as far as this whole arrangement is concerned, than if you don't have the indictment.
- H.M.Jr: Ed, I consider this one of the most unusual cases in the sense of the circumstances around it, and

I would rather be slow and be late than to be the person responsible for putting these people in jail when they shouldn't be.

Foley: That is the only thing we were talking about, was whether we would go ahead and sue for the civil side and the fraud penalty is entirely up to us, that is not Justice's problem.

H.M.Jr: In this thing, should we lay the bribery of Kadis before these men, too?

Irey: That has quite a bearing on the case.

H.M.Jr: I don't see why. What I was thinking is that unless - well, you say no. What I was thinking is that the reorganization of the Twentieth Century-Fox, the block of stock that the three men got and the distribution among themselves, as to how they distribute the three, isn't that the case?

Wenchel: That is the case.

Foley: That certainly is the civil case, Mr. Secretary. There isn't anything to the civil case other than that.

H.M.Jr: It is also whether there was criminal intent or not.

Foley: Then when you are talking about criminal intent, all these other factors, I think, have a direct bearing. I think the fact that they approached an agent, that they made a car available to him, that they hired this girl....

Irey:and these telegrams.

Foley: All these telegrams went back and forth between these fellows, showing what they had in mind. I think all that has a direct bearing on the criminal side.

H.M.Jr: Let them decide how much they want to go into.

Irey: They can't read the case without knowing all of it anyhow.

Foley: This other factor....

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- H.M.Jr: Let them decide. They can go into as much as they want, but I will invite them down to do this part and say they can go into it as deeply as they wish to. Is that the way you would put it, John?
- Hanes: Yes, sir. Knollenberg was coming down here this week anyway, I think. He wrote me a letter and said he was on his way and wanted to see me.
- Foley: Now, you understand, Mr. Secretary, that the files are over in the Department of Justice and what we have here are only my files and part of the Chief Counsel's files and the stuff that Elmer has held out, but most of the stuff has been turned over to the Department of Justice and I think if they are going into everything we have, it would be necessary to get a lot of that stuff back, wouldn't it?
- Irey: Well, of course we have carbon copies of the greater part of that.
- H.M.Jr: That is a detail. Let me see if I can get them down. They can go down in this conference room downstairs and the stuff will be made available for them to read and they can send for whatever they want, if I can get them to do this. I am going to ask them to do this thing - I don't think I will offer them any pay. I am just going to ask them to do it as a personal favor.
- Gaston: Won't they have to be on the rolls as employees in order to be legally entitled to look at these documents?
- H.M.Jr: Well, ten dollars, more or less. What about that?
- Foley: I think that is probably correct.
- Hanes: On per diem.
- Helvering: Just pay them a per diem.
- H.M.Jr: Why not - is it agreeable to you, John, that I get busy right on the telephone?
- Hanes: Yes.

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- H.M.Jr: Then the Attorney General is coming to lunch. Well, he has asked for the lunch. I can just listen, right? As far as the Attorney General's office and ours are concerned, there is nothing waiting any decisions. They are trying this fellow Kadis, now, aren't they?
- Woley: Well, they are presenting evidence to the Grand Jury in connection with the income tax - failure to report income on the part of the man who is supposed to have gotten a \$100,000 bribe in that labor dispute.
- H.M.Jr: But they are not doing anything about this other thing?
- Woley: They are also presenting the Kadis case and they haven't begun, really, to present anything in so far as the main case is concerned.
- Irey: It was the understanding they would not do that.
- H.M.Jr: What is the maximum I should pay these men per day if I wanted to pay them, or if they wanted pay.
- Hanes: Twenty-five dollars a day.
- H.M.Jr: And five dollars per diem?
- Hanes: Yes.
- H.M.Jr: And their expenses here and back. Anybody got any doubts about doing it this way?
- Helvering: No, I am very happy to have those men come in and pass on the question.
- Irey: Just entirely clean up the situation, one way or the other.
- H.M.Jr: Let's let it go that way. I will get on the phone right away.

Prepared by: Mr. Murphy
Mr. Lindow
Mr. Tickton
Mr. Haas

TREASURY DEPARTMENT

CONFIDENTIAL

INTER OFFICE COMMUNICATION

DATE October 31, 1939

TO Secretary Morgenthau

FROM Mr. Haas *HAAS*

Subject: Current Developments in the High-Grade Securities Markets

SUMMARY

- (1) Long-term Government bonds advanced slightly, on net balance, during the past eight days, while short-term issues showed a small decline (Chart I). All maturity classes of United States securities have now recovered a substantial portion of their war crisis declines. The recovery in the case of the 1-3 year notes amounts to practically the entire ground lost. Longer bonds, on the other hand, have recovered only a little more than half of their declines. On Monday, October 30, the average yield on long-term Treasury bonds was unchanged from the previous week (Chart II).
- (2) The Federal Reserve banks allowed another \$12.5 millions of Treasury bills to run off last week (Chart III). Together with the new Treasury offerings, this brought the month's increase in the market supply of bills to \$168 millions. All of this increase, plus some of the bills previously held by non-banking holders was taken up by weekly reporting member banks, thereby reversing the previous trend (Chart IV).
- (3) High-grade corporate bonds advanced slightly last week (Chart II). Municipal bonds were also firm, the Dow-Jones average of yields of twenty 20-year bonds declining 3 basis points. State of New York bonds were considerably stronger than the run of municipals, the yield on the 3's of 1971 dropping 16 basis points during the week (Chart V). No new corporate issues were publicly offered last week; municipal issues offered were reported to have been sticky.
- (4) British Government securities were strong early last week. Consols reached a high of 68-3/8 on Thursday, but closed on Monday, October 30, at 67-7/8, to yield 3.71 percent (Chart VI). The Bank of England reduced its discount rate from 3 percent to 2 percent on Thursday, and British short-term money rates dropped sharply. French 3 percent perpetual rentes were practically unchanged last week, but jumped more than a point over the week-end.

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I. United States Bonds and Notes

Long-term Government bonds advanced slightly, on net balance, during the past eight days, while short-term issues showed small declines (Chart I). Both the long and short ends of the market were weak on Thursday and Friday, but by Monday the net losses for the week had been made up in the case of the longer maturities. The average yield of all long-term Treasury bonds showed small fluctuations during the week, and on Monday, October 30, was unchanged from the previous week at 2.50 percent (Chart II).

The relative movement of different maturities of Treasury securities during the past eight days is shown in the following table:

	Average price change		
	Week ended Oct. 28	Monday, Oct. 30	Total
(In thirty-seconds)			
<u>Notes</u>			
1 to 3 years	- 3	+ 2	- 1
3 to 5 years	- 4	+ 2	- 2
<u>Bonds</u>			
Under 5 years to call	0	+ 3	+ 3
5 to 15 years to call	+ 6	+ 8	+14
15 years and over to call ..	- 8	+11	+ 3

The mixed trend in price movements last week was due to some extent to the adjustments made by the market following the announcement of the new Treasury note offering. Substantial switching from rights into other Treasury notes and intermediate bonds and guaranteed issues, which was reported on Tuesday and Wednesday, caused a more than proportional advance in some of these issues.

Chart I shows that all maturity classes of United States securities have now recovered a substantial portion of the decline suffered as a result of the war crisis. One- to three-year

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notes have recovered practically the entire ground lost since August 19, the day before the beginning of the severe phase of the war crisis, while the other short notes and short bonds are at levels approximating those at the beginning of September. Medium- and long-term bonds, however, have recovered little more than half of the declines suffered since August 19. The longs, it should be observed, continued to decline for nearly three weeks after the prices on short securities had turned upward.

Weekly reporting member banks outside of New York City reduced their Government portfolios by \$23 millions during the week. New York City banks increased their holdings of Government securities by \$79 millions, however -- picking up a large volume of bills and some Treasury notes. Bank operations during the week reflected to some extent shifts incident to the refunding of the December notes.

On Tuesday, October 24, the Executive Committee of the Federal Reserve Open Market Committee authorized the tendering of the entire amount (\$105.7 millions) of the December note held in the Federal Reserve portfolio for exchange into the new 1 percent Treasury note. These holdings amounted to approximately 20 percent of the entire amount outstanding.

II. United States Treasury Bills

During the statement week ended last Wednesday, the Federal Reserve banks permitted another \$12.5 millions of their holdings of Treasury bills to run off (Chart III), and the Treasury issued its second enlarged series of such obligations. These operations brought the total of the month's increases in the market supply of Treasury bills to \$168 millions. The entire amount of this increase, plus some of the bills previously held by non-banking holders was taken up by weekly reporting member banks, thereby reversing the previous trend (Chart IV). Most of this addition to bill holdings took place in New York City, as is shown in the following table:

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Bank Holdings of Treasury Bills
September 27 - October 25, 1939

(In millions of dollars)

Increase in bill holdings by:

New York City banks	156
Banks outside of New York City	<u>54</u>
All weekly reporting member banks	<u>210</u>

Source of increase in bank holdings:

Increase in privately held marketable supply*	
Increase in outstanding amount	100
Reduction in Federal Reserve bank holdings	<u>68</u>
Total.	168
Net reduction in holdings of "others"	<u>42</u>
Total.	<u>210</u>

* The privately held marketable supply excludes holdings of the Federal Reserve banks and the holdings (if any) of other governmental agencies.

The rate on this week's increased offering of Treasury bills was .028 percent, as compared with .027 percent last week, and .033 percent the week before. These rates are practically the same as those obtaining during the two weeks preceding the raising of the level of the bill offering from \$100 millions to \$150 millions per week. A lack of relationship between changes in the weekly bill volume and in the rate on bills is in line with the experience of the past five years, however, and is probably to be expected in periods of large excess reserves.

III. Other Domestic Securities Markets

High-grade corporate and municipal bonds advanced slightly last week. The Treasury average of yields on high-grade corporate bonds declined from 3.09 percent to 3.04 percent during the week, and to 3.03 percent on Monday, October 30

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(Chart II). The Dow-Jones average of yields of twenty 20-year bonds declined from 2.96 percent to 2.93 percent. State of New York bonds were considerably stronger than the run of municipals, the yield on the 3's of 1971 dropping from 2.42 percent to 2.26 percent during the week (Chart V).

No corporate issues were offered publicly last week, but it was reported that the Northwestern Electric Company of Washington, a company located in the Bonneville Dam area, placed \$6.7 millions of 4 percent bonds with a group of four insurance companies. Some \$15 millions of municipal issues were offered, but they were reported to have been sticky, and a considerable portion of these issues were said to have remained unsold at the week end.

Future activity in the new corporate issues market was forecast by the registration with the SEC of \$42 millions of securities of the Jersey Central Power and Light Company, a former Insull company. This is the first major loan to be registered with the SEC since the outbreak of war.

IV. Foreign Markets

British Government securities were strong early last week, but eased slightly at the week end. The 2-1/2 percent consols reached a high of 68-3/8 on Thursday and closed on Monday, October 30, at 67-7/8, to yield 3.71 percent (Chart VI). The spread between the yield on the consols and the average yield on long-term Treasury bonds was 1.21 percent on Monday (Chart VI).

The Bank of England reduced its discount rate from 3 percent to 2 percent on Thursday, restoring that rate to the level maintained from June 30, 1932 until August 24, 1939, when the rate was increased to 4 percent. The press considered the week's action to be the last important step preliminary to the announcement of the first war loan. Earlier in the week, the press had noted that the consistent strength of the gilt-edge market was believed to be due in part to buying by Government brokers preparing the way for such a new offering.

The current improvement in the prices of consols has extended itself to other Government issues, although not in the same degree. The following table compares the prices on consols and other Government issues on Monday, October 30,

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with the minimum prices established by the London Stock Exchange, and the prices on May 31, 1939, the high following the spring (Czechoslovak) crisis, and August 18, the day before the beginning of the severe phase of the current crisis:

Prices of Selected British Government Issues

	Oct. 30	War crisis; minimum	Aug. 18	May 31
2½% Consols (Perpetual)	67-7/8	62	65-7/8	70
3½% War Loan (Perpetual)	91-3/8	88-1/2	91-5/16	96
4% Funding (1960-90)	104-3/8	100-1/2	105-1/4	108-1/2
3% Funding (1959-69)	90-1/2	87-1/2	91-3/8	94
2½% Defense (1944-48)	97-1/8	94-3/4	98	97-5/8

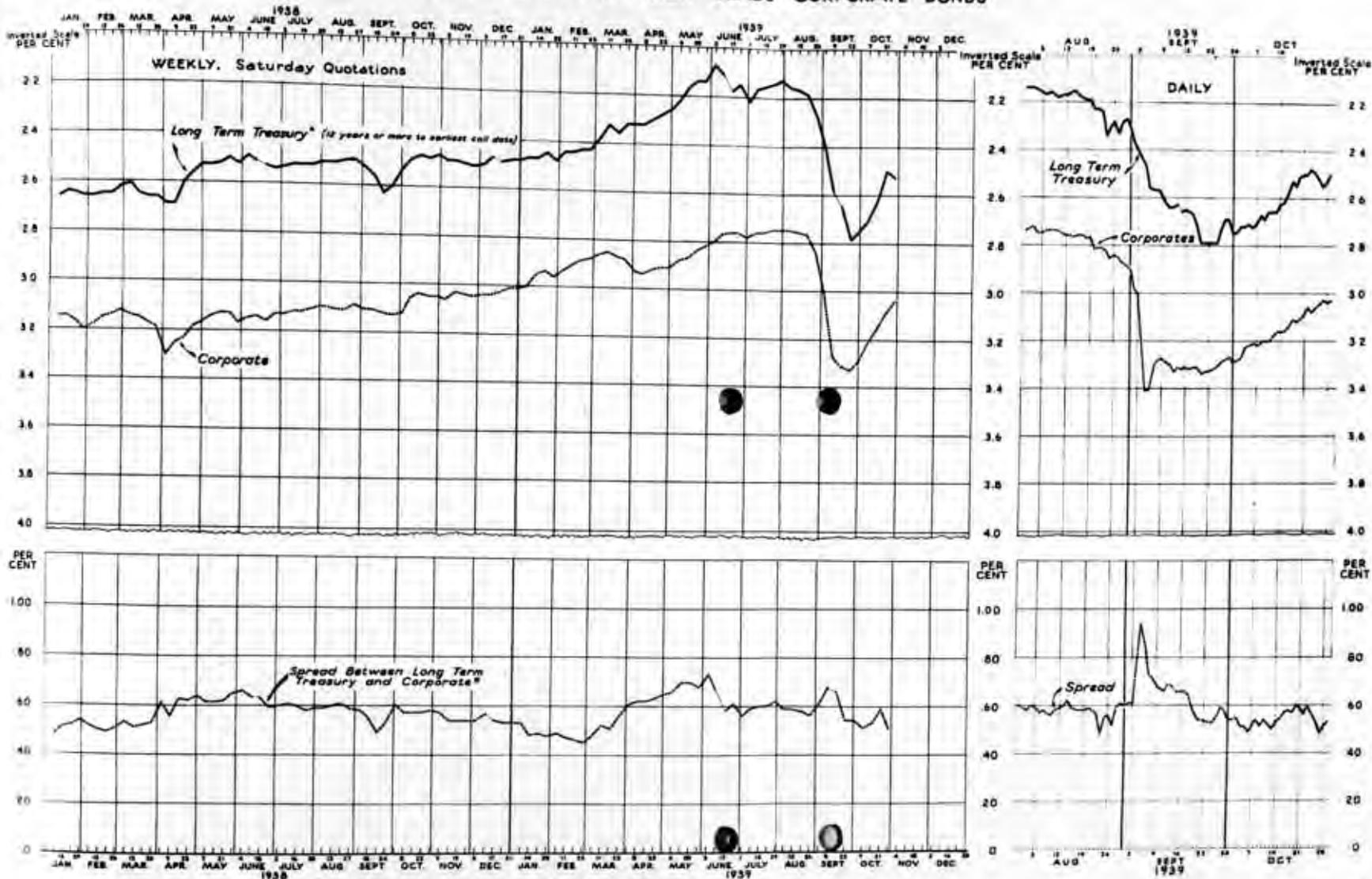
Short-term money rates in London fell on the announcement of the lower Bank Rate, call money moved from 2 percent at the beginning of the week to 1 percent on Thursday, and six-month commercial bills declined from 2 percent at the beginning of the week to 1-5/8 percent on Thursday. The average yield on Treasury bills on Friday was 1.19 percent as compared with 1.71 percent the previous week.

French Government securities were virtually unchanged last week, but rose sharply over the week end. Perpetual 3 percent rentes stood at 68.50 on October 23, and at 68.80 on October 27. On Monday they jumped to 70.00, to yield 4.29 percent.

Canadian bank reports for September 30 revealed sharp increases in the loans and demand deposits of the chartered banks during the first month of war. Demand deposits rose \$58 millions to \$763 millions; and current loans in Canada increased \$65 millions to \$891 millions. Combined circulation of the Bank of Canada and the chartered banks increased \$36 millions to \$308 millions in the same period. The magnitude of these moves may be appreciated when it is remembered that the population of Canada is only about one-twelfth of that of the United States. On a per capita basis the increase in loans, for example, is equivalent to an increase of about \$780 millions here.

Attachments

Chart II
**COMPARATIVE YIELDS OF AVERAGE OF ALL LONG TERM U.S. TREASURY
 AND AVERAGE OF HIGH GRADE CORPORATE BONDS**

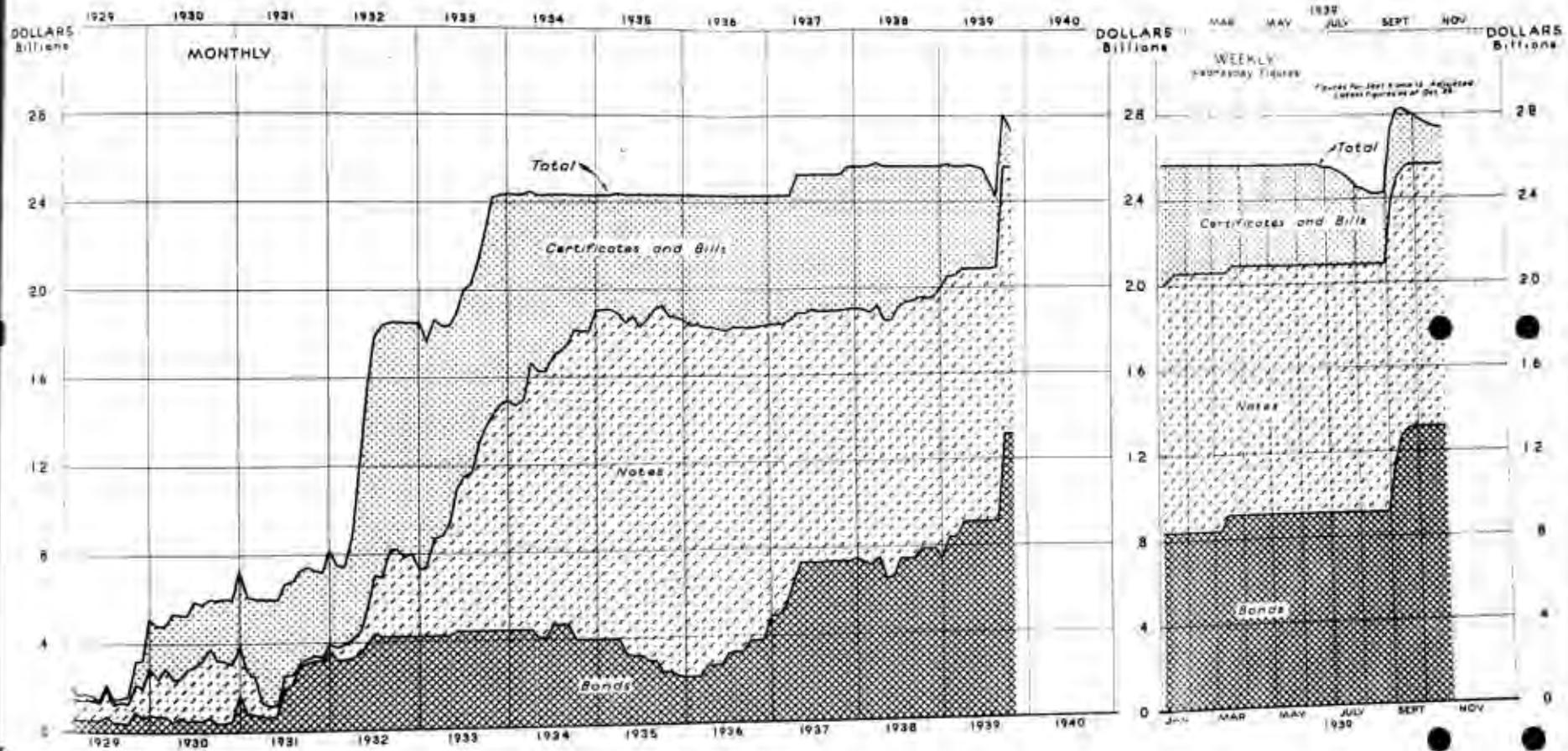


U.S. Dept. of the Treasury
 Division of Research and Statistics

*Break in line indicates change in composition of Long Term Treasury average.

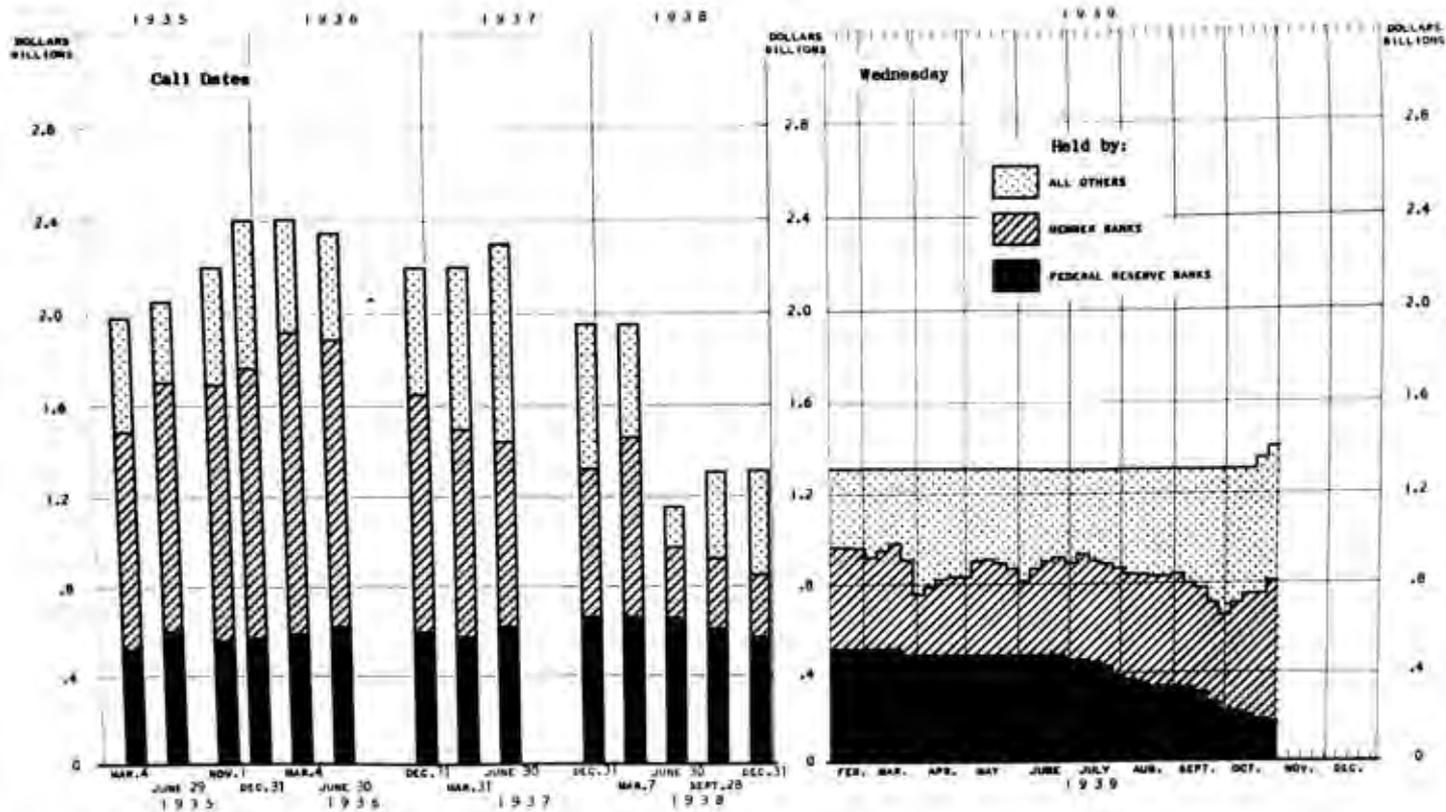
Chart III

FEDERAL RESERVE BANK HOLDINGS OF U.S. SECURITIES



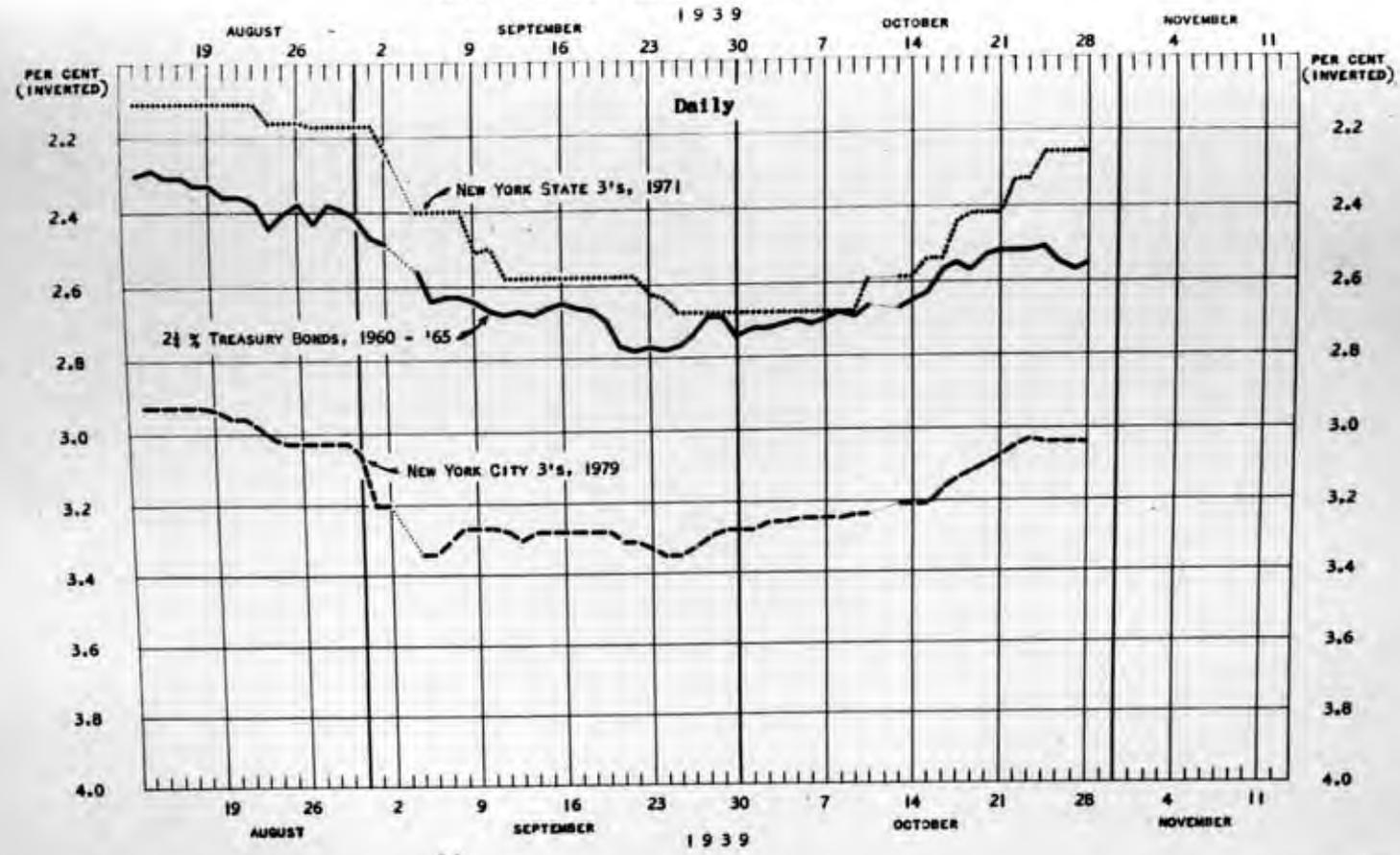
U.S. Treasury
Federal Reserve

TREASURY
DISTRIBUTION OF OWNERSHIP OF TREASURY BILLS



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

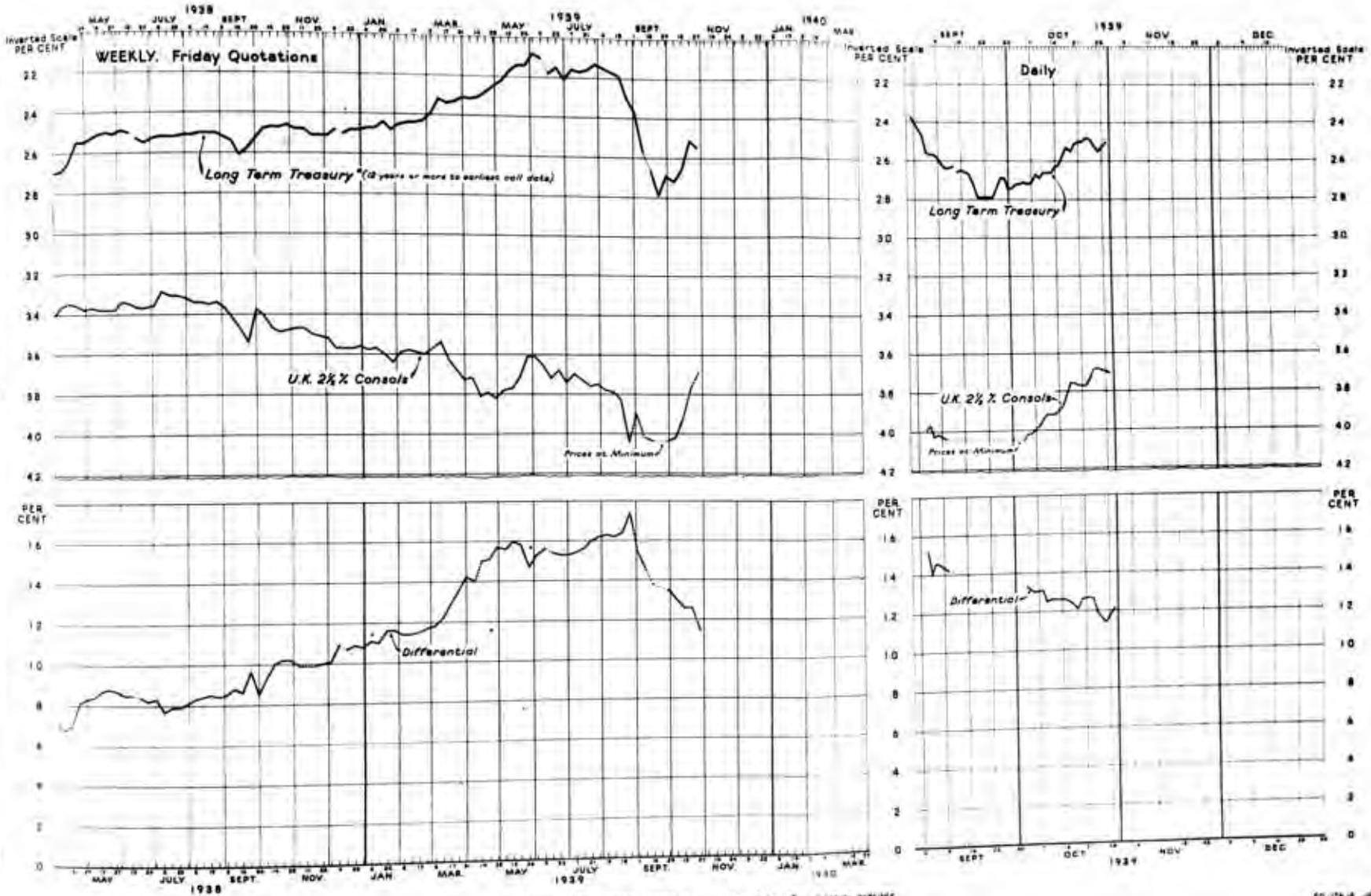
Chart
**COMPARATIVE YIELDS OF A LONG TERM TREASURY,
 N. Y. STATE AND N. Y. CITY BOND**



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

Chart VI

COMPARATIVE YIELDS OF AVERAGE OF ALL LONG TERM U.S. TREASURY BONDS AND U.K. 2½% CONSOLS



*Break in line indicates change in comparison of Long Term Treasury yields

FD-124-4

Source: Treasury of the Treasury

October 31, 1939.
3:00 p.m.

Present: Mr. Welles
Mr. Jones
Mr. Feis
Mr. Duggan
Mr. Cotton
Mr. Cochran
Mr. White
Mr. Hanson
Mr. Schmidt
Mr. Collado

H.M.Jr: I have something to go on. I have asked my men for a piece of paper with some questions we would like to ask. You (Jones) have got one. Let's have something.

Welles: It seems to me to be an admirable outline of the whole question.

H.M.Jr: Could we discuss some of these here?

Welles: I think it would be very helpful if we start in at the beginning and go right down the line.

H.M.Jr: Well, the prospects of successful debt settlement of Colombia's outstanding debt:

"1. Present status of debt settlement negotiations between the foreign bondholders and the Colombian Government."

We haven't got that.

Welles: Perhaps you will allow me to talk a little on that. I would like to ask Dr. Feis and Mr. Duggan to check me.

Jones: How much are the dollars?

Feis: I beg your pardon?

Jones: What does that amount to, what is the answer?

Duggan: 145 million dollars, Mr. Jones.

Feis: That includes, however, I take it....

Wellent: Can you break that down as to national and federal?

Feis: That is only dollar debt, not total debt. That includes state, municipal and federal, and discussions of....

Wellent: Can you break it down, Mr. Collado?

Collado: There is about 52 million dollars outstanding of federal dollar debt, of which approximately 7 million are held by the Colombian Treasury, making a little over 45 million actually outstanding. In addition, there is approximately 80 million of these state and municipal dollar debts. On top of that, there is approximately 7½ million dollars of sterling debt and in addition, a little over 5 more million of sterling debt which has recently been converted into a peso debt. It is no longer a foreign currency obligation.

Feis: 17 million dollars bank debt.

Collado: Yes, the City Bank.

Jones: Are all those in default?

Collado: The City Bank is not in default. That is a short-term debt entered into about 1930 and that is not in default. All of the funded debts are in complete default since about 1932 or 1933. They did issue some funding certificates in 1934, funding the unpaid interests through '34.

Feis: Well, they are paying on a French funded debt arising in connection with railway purchases and they are paying on their internal debt.

Jones: They are paying on the internal debt?

Feis: Yes, anywhere up to eight or nine percent.

Jones: You mean interest or on the principal?

Feis: Interest.

Jones: They are paying that much interest?

Feis: Up to that. They are paying a French debt and they are paying on the bankers' debt. They are paying

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on a few other debts.

Jones: You mean they pay that much interest?

Feis: That high rate is only in connection with certain elements in their internal debt.

Jones: Well, does that include the French?

Feis: The French rate is lower. I can't give you the rate from memory.

Duggan: But I would like to emphasize, Mr. Jones, that that French payment is in connection, really, with a railroad debt which has been reconverted and was not regular external funded loan. They are in default on all of their regular external funded debt.

Jones: Does this book here include it?

H.M.Jr: Yes.

Jones: That is in figures?

H.M.Jr: Yes.

Who is going to answer number....

Jones: Who is going to answer number two?

H.M.Jr: Mr. Welles said he was going to talk.

Welles: I will talk very briefly, Mr. Secretary, on point number one.

H.M.Jr: Yes.

Welles: As I remember it, negotiations first started, Dr. Feis, didn't they, about three years ago between the Protective Council and the Colombian Government, and the Protective Council upon two occasions sent a representative to Bogota, in order to negotiate directly in Colombia with the Colombian Government. On both of those occasions, the representative of the Protective Council was able to stay only a short time and the then President of Colombia was here in Washington yesterday. From what he said yesterday, he did not feel that he

had sufficient time in order to undertake any real negotiations, that all the representatives of the Protective Council said was that they wanted resumption, in full, as to the basis of the negotiation, and it was impossible for him in the short time available to convince the representatives of the Protective Council that he had his political and Congressional difficulties and that he couldn't possibly get Congress to agree to it. Last year there was a change of Government in Colombia. The present President of Colombia came through Washington and stated to me that one of the first things he wanted to do was to reach an agreement providing for resumption of payment. His point of view was that any agreement entered into by their representatives should provide for recognition, in full, of the capital investment and it should provide further for scaling down of interest rates and the scaling down of deferred interest payments.

I think it was in January, wasn't it, Dr. Peis, that the Colombian Ambassador finally had instructions to go ahead and undertake new negotiations with the Protective Council. It was about that time.

Peis: Yes.

Welles: My impression is that the proposal that he made was for a wiping out of the deferred interest payments, recognition of full capital value and resumption of interest payments, beginning at two percent, going up over a period of three years, was it?

Peis: About.

Duggan: Five years.

Welles: Five years, to three percent. The Council, as I understood, refused to consider it....

Jones: Council for the bondholders?

Welles: Yes.and negotiations were broken down, it flopped. I think the position of the Council, if I understand it, is that they were not recognizing anything but the bondholders in the way of a

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settlement, that it did not provide for a starting, resumption of interest payments, at a rate at least - four, is it?

Duggan: Starting at three.

Welles: And going up to four and a half.

Feis: I don't think the Council has ever said it was willing to start as low as three. They might be, but I don't believe they are.

White: It is four, starting at four.

Welles: The Colombian Government has refused to negotiate on those terms and the statement of position....

Jones: Have refused to....

Welles:negotiate on the terms proposed or rather tacitly acquiesced to the proposals of the Council and it is said that the Council is not a negotiator. The situation is really very unfortunate because the Colombian President, for whom I have the highest regard, feels that this matter must be settled and he is willing to settle on any reasonable basis of the character which is indicated. I think that is the present status in very general and rough terms.

H.M.Jr: Might I interject myself at this time? While I have never had any direct contact with this Council which I keep hearing about all the time, whether right or wrong, I think they seem to be the irritant that has kept us from getting anywhere, at least that is the impression that I have. Therefore, I have made the suggestion to the SEC that in this case they act as a Commission to handle the banks and that they represent the American bondholders in this incident and to assist us in arriving at a conclusion, and that we work through the SEC rather than through this Committee. I believe that the SEC would be very glad to do so.

Welles: I would like, before we pass on, to express a personal opinion, if I may.

H.M.Jr: Yes.

Welles: I think the difficulty is that we have considered the Council in the light of personalities and not the

institution itself. I think the institution itself is a very desirable institution and one that, if it functioned properly, would fill the long-felt want. I am awfully afraid of any Government agency, as such, entering into the picture when it comes to defaults on private debts of other American Governments. I fear that at some stage in the proceedings, the United States Government is going to be considered by public opinion in the rest of the continent as the old-time Shylock and as the bill collector. What I think is eminently desirable is that we now step in in the way the Secretary of the Treasury has suggested, because we have reached an impasse and the questions have to be settled. If that is so, I hope that we can avoid the impression on the rest of the continent that the United States Government, itself, is going to undertake the collection of several of these bills. I feel that if we can agree on this particular case, set the precedent that way, then possibly hold it up as a yardstick, that we might then try to work out some way for an effective Council, even if we have to reorganize it in some way.

E.M.Jr: Do I gather from that that if the SEC and the Commission is willing to assist us, you don't raise any objection?

Welles: Not a bit. I understand that their assistance would be just the sort of work that you and Mr. Jones and myself would have to do, that is, try and find out what we consider a fair settlement of the whole picture without stepping officially into the picture.

E.M.Jr: And that some one member of the Commission would be willing to sit with us and that they would sit in on this the way they would on any - whatever their status is in representing the American securities. I am not a lawyer and I don't know just what the legal status is, but at least in my mind I think their creation was to look after the interests of the American security holders. Is that about right, John?

Welles: Taking in the investors?

E.M.Jr: These are American investors who invested their money abroad instead of at home. Is there any difference?

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- Hanes: No, but I would want to examine it very carefully before we set them up as a trading committee.
- Cotton: Under the Securities Act of 1933 it could have been set up that way but the President never invoked that power. They could have set up a Government corporation to represent bondholders.
- H.M.Jr: Well, is anybody certain that they can sit in at this - certainly they can sit in at this, because this is informal and they can satisfy themselves as to how far they can go.
- Jones: And then our committee could determine how far we would want them to go. It might - Johnny's point there about - I think it is pretty well taken. I should like to have the benefit of their assistance and their background if this committee should reach a decision. Certainly it would be helpful to have the cooperation and approval of the SEC.
- H.M.Jr: Yes, and they volunteer the information that they have all this data over there.
- Jones: But the decision would really be the decision of this committee.
- H.M.Jr: Yes.
- Jones: With their help.
- H.M.Jr: Yes.
- Jones: Keeping the decision here with the committee, I understand.
- H.M.Jr: Yes.
- Jones: Is that your idea, Johnny?
- Hanes: Yes sir, that is my idea, exactly.
- H.M.Jr: Well, I will ask the SEC formally to designate somebody to talk with us, whom they would like, which member of the Commission.
- Welles: All right.

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- H.M.Jr: I will ask which one.
- Jones: Who can answer number 3? Sumner, have you got that?
- Welles: I think that Dr. White and Mr. Collado have all that data.
- White: Number 3?
- Welles: We haven't touched on point number 2 yet, and that, I should say, was an impossible question to answer.
- Feis: Well, accept anything that they can get. Of course, they are getting nothing now. We can, then, depend upon certain elements in it to criticize whatever they get, and if they should, by any chance, accept a settlement which then broke down after a year, we could then expect them to criticize the whole settlement.
- Jones: You say they would accept anything they could get?
- Feis: Yes. You have a problem always of a minority.
- Jones: How quickly could they....
- Feis: And, unknown at present, they can only act as advisers. They are in no way organized. They each have their individual rights to accept or refuse any offer that the Colombian Government may make. The great majority of them will accept any offer that the Colombian Government makes. Of course, they feel themselves in such a helpless position. You will have a minority that will cling to its funds and continue to demand for better terms. There is no way of coercing them that I know of, that I have ever heard anyone mention. The minority is always a difficult problem and it is one problem that always has to be borne in mind in the case of every settlement. We have had, in the case of various negotiating settlements of certain intermediaries, to step in to protect minorities.
- H.M.Jr: Well, that doesn't answer the question, does it, that Jones asked, "What is Colombia's capacity to pay"?

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White:

Well, the two problems there are, (1), the Federal Government, and the other, the State and local governments, which again resolves itself into two subdivisions as to what she can raise domestically and what she can transfer.

With respect to what she can raise domestically, I think there is little doubt that she could raise sufficient revenue to take care of the kind of settlement that would be accepted, though we don't know enough about their domestic finance to be certain of that. Yet, in this year she raised 32 million dollars revenue, as against 27 million last year for the first eight months. That shows an increase of 5 million and it oughtn't to be too difficult for her to make a change which would involve two or three million dollars a year. She already is setting aside a sum from her present budget for payment on the debt and she has been operating under a balanced budget and this year a slight surplus is anticipated, so that her budget is in good shape. Coupled with the fact that her oil output will substantially increase next year, which gives rise to some additional revenue, I don't think the limiting factor on a settlement would be her problem of getting the funds at home. I think she can take care of that.

With respect to her ability to get foreign exchange, that is, her ability to transfer that sum, I think that some flexible arrangement would have to be made. It has been suggested that they can take care of two percent, or so, without any trouble. Her gold production is increasing at the rate of about 10 percent a year. They expect to increase very greatly her oil output and though she doesn't get all of it, she gets a substantial quantity.

Jones:

Is she living within her means now?

White:

So far as her national budget is concerned, she is. So far as her ability to get foreign exchange is concerned, before the last two months - and we don't have data on the last two months.... I don't know who has that, possibly the State Department has it. Before the last two months, she has been able to meet her foreign exchange claims, exclusive of payments on these debts, and it seems quite possible that she will be able to pay at least two percent and possibly something more. Now, it appears to

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me, in view of the dependence of her success in the exchange market on the price of coffee and on her foreign trade, that a flexible arrangement might be worked out which would give the foreign bondholders any advantage on amortization payments that would result from an improved situation. If the exchange wasn't available, then those funds could be blocked to be made available when her exports reached a certain point, et cetera. I think some sort of criterion could be developed which would give some hope to the bondholders and yet not be so pressing a burden on the exchange to Colombia.

- Jones: Is it reasonable to assume that they might apply their increased revenue from oil to this debt settlement and the money they want to borrow?
- White: I suspect that they wouldn't want to apply it all. They have had hopes of some additional revenue, but they ought to provide enough to....
- Jones: I didn't say they would, I said they could.
- White: She could. Then she would have to provide some additional sums to take care of any loans that might be made, but if the terms were sufficiently long, that wouldn't be....
- Jones: I said the new money would be....
- White: That is right, I think there is an excellent chance of working that out satisfactorily.
- Jones: I think the oil revenue should be materially increased.
- Welles: Have we any estimates of the amount of oil revenue next year? You mentioned that once before.
- Hanson: A million dollars extra.
- White: For oil?
- Hanson: Yes.
- White: About a million dollars additional.

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- Welles: And the following year it will go way beyond that, won't it?
- Hanson: Yes.
- White: They are opening up new wells and they presumably have enormous oil reserves left open.
- H.M.Jr: Well, is that next question - can't you raise the foreign exchange....
- White: Yes, I also commented on that. Now, we have been speaking about the national government. The local government, unfortunately, we don't know anything about their state of finance, but the foreign exchange question which I raised included transfer of funds by local governments, provided the local government raised it, but we just don't know. I don't know whether the State Department has any more information on that.
- Welles: I can give you this bit of information on that. The ex-President told me yesterday that the majority of the local governments, both state and municipal, could today meet fully their debt obligations, and that in the case of many of them they were deliberately holding back because no agreement had been reached with the national government, at least that is their excuse for holding back. He said it is just on a par with the situation in the national government.
- H.M.Jr: We are not familiar here with the status of the sterling debt.
- White: The question there would be whether that settlement would be involved in a dollar settlement or whether it would raise any special problem.
- Collado: The budgetary allocation which they have made in the current budget provides for payments on about the same scale on the sterling debt as on the federal dollar debts.
- Jones: That is all she has got out, sterling and dollars?
- Collado: That is all.

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- H.H.Jr: Would it be the policy of the State Department to - I don't know what the right word is - to keep the English informed of what we are doing on this thing or would you just disregard them on their debt.
- Welles: My own personal feeling is that we ought to go ahead on our own problem. That is the attitude we have taken in connection with the Brazilian debt. The British have repeatedly been trying to get themselves into the picture because they feel that we can get the settlement more readily with Brazil than they can and I don't see any reason why we shouldn't consider ourselves entirely in the picture, without anyone else coming into it.
- H.H.Jr: You wouldn't consider them at all then?
- Duggan: I might add, Mr. Welles, that in the recent negotiations with the Colombian Government, that they have only been negotiating with us and I think it is quite clear that they had not intended to apply it to the British.
- Jones: I think maybe you can do the whole thing, as well as part of it. Maybe we ought to tell them. It seems to me if we are going to do anything for Colombia, that we ought to try to fix it where she can do anything that she is obligated to do.
- Welles: Mr. Duggan has just reminded me that the Colombian Government has said that she was going to negotiate with us, only, and only after she had reached an agreement with us, she would take it up with the British.
- Jones: I think we ought to help this customer, and if we are going to do that, we ought to do a full job.
- Welles: I think you are quite right, but I would suggest that any information come from the Colombian Government and not from us.
- Jones: That would be for your Department anyway.
- I think we have got to talk to somebody that represents Colombia as to what she can do.

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- H.M.Jr: Have you any indication how much you want within the next six months?
- Welles: Doctor, you can answer that question much better than I.
- Feis: It has never been stated in terms of dates.
- H.M.Jr: Twelve months, calendar year 1940?
- Feis: Oh, they speak of 20 million dollars, but it is always impossible to tell whether they have just put out a figure or - to act as a lightning rod, or whether they mean it. Their general line they have set for themselves is that they have got a program of national development under way, that that requires imports and they don't want to have to curtail those imports and thereby affect their program of national development. Now, if coffee prices hold steadily, there wouldn't be any great need for that. If coffee prices weaken, they would need somewhat more. I don't think that any figure that they have mentioned to you would be of any service to you in judging what you want.
- Jones: Who is going to talk for Colombia?
- Welles: Who is going to talk for Colombia?
- Jones: Who is going to come here?
- Welles: As I said in our last meeting, Mr. Jaramillo, who has been several times Secretary of the Treasury for Colombia, is actually on his way or will be on his way tomorrow or the day after. He will come to Washington and he will be fully prepared to discuss with you gentlemen here all of these matters.
- White: There is a statement here that might be helpful. This is a statement made by Mr. Feis on September 24th.
- "The amount of the loan would be fixed after a careful study of the most urgent needs of the financial situation of the country, of the countries under which the debt must be serviced and the form and terms under which the funds lent would be supplied."

H.M.Jr: What are Colombia's short-term needs to meet emergency exchange situations?

White: We have no information which would indicate an emergency situation, if it exists, but that is because we have no information in the last month or two.

H.M.Jr: It would be the same reply as to number 2, wouldn't it, wait until this gentleman gets here?

Welles: I think we would have to wait until he gets here on point (b). Point (a) might be taken up, pending his arrival.

H.M.Jr: Anybody got any figures on that? Collado?

White: There are figures up to two months ago. They show that she is in as good a position, so far as the foreign exchange - gold and foreign exchange assets - are concerned, as she has been any time during the last four years, but doubtless the last month or two may have seen some change and I don't see how one could answer that unless we knew. If she hasn't suffered any loss in exchange, if the trade in the next month or two will not be bad, she doesn't need very much, if anything, although I can see where a loan of approximately 5 million dollars, hedged under the proper conditions so that she wouldn't have to use it, might be very helpful in increasing the confidence in the currency, but it would have to be pretty well protected to make sure it wasn't used for unnecessary imports.

H.M.Jr: Have you got the figures up to September first?

White: Up to September first. We haven't got the September and October figures.

H.M.Jr: Couldn't you men back there get up a list of things that you want and send it down to our Ambassador, to get them up to October first or as recently as he has them?

Welles: I think when Jaramillo gets here he will have all that information for you.

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- Wais: One reason the decision is so difficult is that there are certain other interests, largely American interests, the treatment of which is more or less discretionary. At the present time they permit the oil exporters to keep their dollar exchange, bringing back to the country only what they need for local purposes. They can modify that rule if they wish under their exchange regulations. At the present time, they permit the miners of gold and platinum to take out a certain amount. There has been a Supreme Court decision which has facilitated gold and platinum mining recently. They are permitting full remission of dividends and interest on American investments down there. Up to perhaps a year ago, they were restraining those.
- Jones: Full remissions?
- Wais: Full remission of interest and dividends on investments. They are paying something on their 17 million dollar short-term banking debt. For certain periods, they have held up on that.
- Jones: You mean a remittance?
- Fets: Yes, sir. Now, all of those, to some extent, are discretionary policies and each of them inside the office, the Minister of Finance or the exchange control, is related to each other of them. They get into an exchange hole and they say, "Well, we won't let any companies transmit dividends for six months or a year." The debt element is only one of a diverse group of elements in that situation, making up the total exchange load or requirement.
- White: Our information is that they have never interfered with any of the payments on their profits and dividends, but they do amount to 15 or 20 million and they might decide that, but up to now our information is that they haven't done that.
- Wais: Your information is incorrect. They have now caught up, but there were periods in which we had these companies in and out of the State Department all of the time. They asked us to facilitate transmission of dividends. It is all caught up.

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Duggan: Gold and cotton, particularly, Dr. White.

Fels: It is all out of the way now.

White: They paid on that short-term debt, Mr. Jones, \$100,000 amortization.

Jones: Last month?

White: On the short-term debt.

Jones: Well, there again - Sumner, don't you think that - for instance, hasn't that got to wait on the stabilization thing to get facts and figures?

Welles: I think on that we probably could get some information before he gets here.

Jones: We haven't got it now is what I am getting at. We have got to get it.

Welles: Yes. Doesn't it seem to you that perhaps that is one of those things that we could be helpful enough in suggestions to them, once we know what the situation is - I mean, not only on account of the present emergency during the war but in view of the future even in normal times?

Jones: I would think so. Who knows the effect of the war on them?

White: Well, we know some things about it, not very much yet. We do know that they have temporarily, at least, lost their German market and they used to sell Germany about a million dollars a month and Germany took about 15 percent of her coffee exports and a smaller proportion of her banana exports. Now, whether that loss of exchange will be fully compensated by two other developments, one, the increased gold production, two, the increased oil exports, remains to be seen. England has curtailed her imports, as you know, some 30 percent and how much Colombia has lost in her exports to England, we don't know, but her total trade with England wasn't very important. Though we have no trade figures, doubtless the Minister will have some when he comes up. It doesn't appear at the moment to be serious. Her coffee exports

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remain good here and coffee prices have not declined yet, so that on the whole I should say that she should not be suffering acutely from the outbreak of the war, but our information is inadequate.

Duggan: Just with regard to bananas, Dr. White, we have some recent information from the United Fruit Company to the effect that they expect to be able to place all of the Colombian bananas, which previously were going to Europe, in the United States. Moreover, on account of the recent Supreme Court decision declaring unconstitutional a certain passage of a recent law on expropriation, United Fruit is going ahead to rehabilitate their banana lands there and to increase production, so that over a period there will be a certain compensation there on bananas.

H.M.Jr: Mr. Duggan, is Colombia one of the countries in which they have this banana disease?

Duggan: Yes, they have it very badly there and on account of this law that United Fruit Company thought hung over their heads like a sort of Damocles, they didn't go ahead to cure the disease in Colombia. Now the law has been declared, in part, unconstitutional and I am told by United Fruit Company officials that they are going to import pipe and other spraying apparatus and go out, not only on their own plantations, but also assisting the local planters to cure the disease.

H.M.Jr: Is that a disease which can be cured in one cycle of one year or is it something that takes several years to stamp out?

Duggan: Mr. Secretary, from what I am told by a number of United Fruit Company people, including their biologist, who is quite an authority on this, it is something that will never be cured once and for all. The spores of this disease are carried in the wind. Apparently they flew across, probably from Asia, from the Orient, and now they are here in the air and from now on it is a question of continuous spraying for disease control.

Welles: They are present at a very great height.

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- H.M.Jr: They use copper sulphate, don't they?
- Duggan: Yes.
- H.M.Jr: What I am getting at, being an apple grower, in one year of covering this foliage, can they cure it?
- Duggan: No, sir. It depends somewhat upon the rainfall, but they have to keep the spray, at all times, on the leaves. From two to four weeks, every plant has to be sprayed.
- H.M.Jr: But if United Fruit goes in there, it would mean a lot to Colombia, wouldn't it?
- Duggan: They are already in. It is a question now of going ahead with their spraying apparatus, spraying plants.
- White: There is one factor that I am merely suggesting that would require some - probably passing consideration. A good deal depends on her gold exports for her ability to get exchange. Her gold constitutes so important a proportion of her total exports. Now, if you are thinking of long-term trends and thinking of long-term debts, it is a little difficult to say what the future holds with respect to curtailment of international gold output. If any such arrangement is made, that would be additional risk. Possibly that is minimized by the fact that her oil is increasing so rapidly that it may take up the slack.
- Duggan: Might I venture a brief thought on coffee, Dr. White? The Colombian coffee, being a superior mild, has never had difficulty in finding a market and I wonder whether Colombia is going to have trouble placing its coffee, as compared, let's say, with the inferior qualities of Brazil.
- White: They claim not, but I had some things down in Brazil that they thought maybe they might go after their trade, but in general the opinion is that they are in somewhat of a preferred position and their prices are not nearly as sensitive to exchanges in the coffee market - to drops in the demand for coffee - as it would be in Brazil, but I don't know enough about it.

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Jones: I think the long-term trend, that is a little deep for us.

H.M.Jr: How would it be if I asked, for the next move, the SEC to notify us whether they will or won't help us on this and who would they have sit with us, and just as soon as I know, I will ask them please to do it this week and try to have another meeting this week. Is that all right?

Welles: Yes.

Jones: Fine.

H.M.Jr: Shall we meet with somebody from the SEC next to find out just how far they will go and how far we want them to go?

Jones: Yes, what they can do.

Welles: I am not going to make a lengthy dissertation upon it, only I think if we can get this present problem solved, that Colombia offers a more favorable opportunity for investment by the private American than any other republic. I think that is contingent upon reestablishment of contacts which can only be attained by....

Jones: That won't work very fast, though. It has got to become stable.

H.M.Jr: John, can you get in touch with the SEC and ask them whether they won't please designate somebody who can meet with us Thursday or Friday?

Hanes: Yes.

H.M.Jr: Thursday, if they could, and let us know.

Hanes: Any time for it? In the afternoon?

H.M.Jr: Thursday afternoon.

Hanes: Yes, sir, I will do that.

H.M.Jr: Somebody who would have the time to give to this.

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Hanes: It won't be one of the Commissioners.

H.M.Jr: Oh, tell them it has got to be a Commissioner.

Hanes: All right.

H.M.Jr: If we can give it the time, they can. Hell, they are not so busy. They just think they are busy.

COLOMBIA

Suggested Agenda for Conference at Treasury Department,
October 31, 1939.A. Prospects of a successful debt settlement of Colombia's
outstanding debt.

1. Present status of debt settlement negotiations between the foreign bondholders and the Colombian Government.

2. How much are the foreign bondholders likely to accept as a minimum?

3. What is Colombia's capacity to pay?

(a) Can she raise the funds internally (1) for the Federal debt? (2) for the local government debt?

(b) Can she raise the necessary foreign exchange?

4. Possibility of developing a flexible scale of debt payments.

5. Status of sterling debt settlement.

6. Will she be able to service a new debt as well as settlement of the old?

B. Desirability of extending credits to Colombia.

1. What are Colombia's short-term needs to meet emergency exchange situation?

(More information needed as to the acuteness and cause of the emergency situation.)

2. Long-term needs.

(a) For monetary stabilization.

(b) For economic development.

C. Colombia's foreign trade prospects.

1. Effect of war on Colombia's trade.

2. Long-term trends.

D. Prospect of Colombia attracting foreign private capital.

HDW:lrs
10/31/39

TREASURY DEPARTMENT

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INTER OFFICE COMMUNICATION

DATE October 31, 1939

TO Secretary Morgenthau

FROM Mr. Cochran

The foreign exchange market was again very quiet. The rate for sterling fluctuated within a narrow range and closed at 4.00. During the afternoon, the Bankers Trust Company, whose operations are not included in the figures below, received orders from commercial concerns to purchase £350,000. Of this amount £200,000 was supplied by Japanese banks.

Sales of sterling by reporting banks in New York totaled £375,000, from the following sources:

Commercial concerns.....	£ 94,000
Foreign banks (Europe, Far East and South America).....	£ 281,000
Total.....	£ 375,000

Purchases of sterling amounted to £226,000 as indicated below:

By commercial concerns.....	£ 57,000
By foreign banks (Europe and Far East).....	£ 169,000
Total.....	£ 226,000

The banks also reported that the British Control purchased sterling amounting to £110,000, at the official rate of 4.02. All of the sterling sold to the Control represented cotton bills.

The rates for the other important currencies closed as follows:

French francs	.0226-7/8
Guilders	.5309
Swiss francs	.2242-1/2
Belgas	.1664
Canada	10-1/4% discount

The Chinese yuan declined from yesterday's quotation of .08-13/16 to .08-3/8.

We purchased from the earmarked accounts of the banks listed below the following amounts of gold:

Bank of the Republic, Colombia.....	\$ 350,000
National Bank of Belgium.....	175,000
Netherlands Bank.....	800,000
Total.....	\$1,325,000

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The Federal Reserve Bank reported to us the following shipments of gold to this country:

- \$ 462,000 from India, consigned to the Guaranty Trust Company of New York, for sale to the U. S. Assay Office at New York
 - 386,000 from Switzerland, consigned to the Federal Reserve Bank of New York, by the National Bank of Switzerland, by order of the National Bank of Hungary, to be held at the disposal of the BIS.
- \$1,465,000 Total

The National Bank of Rumania cabled to the Federal Reserve Bank of New York stating that it intended to buy approximately \$12,375,000 in gold, and it requested the Federal to obtain from the Treasury the necessary authorization. The Federal advised the Rumanian Bank, by cable, that the Treasury does not sell gold for future delivery. However, the Federal Reserve Bank stated that it would be pleased to make applications from time to time, in the behalf of the National Bank of Rumania, for the necessary licenses for the purchase of this gold, as and when the necessary funds are provided, and instructions are received to apply such funds in such purchases. The Federal also stated that it assumes that the Rumanian Bank is acquiring the gold for the purpose of strengthening its gold reserve, and that the Federal has reason to believe that such applications will be promptly and favorably acted upon by the Treasury. The Federal requested that the Rumanian Bank confirm the assumption regarding the reason for acquiring the gold, when applications for its purchase are to be made to the Treasury.

The Federal Reserve Bank also informed us that they had received a letter from the Bank of Greece inquiring whether it would be possible for the Federal to buy with dollars, which the Bank of Greece might eventually possess in New York, gold bars to be earmarked with the Federal for account of the Bank of Greece. The Federal, in its reply, informed the Bank of Greece that gold for earmarking or for export can be obtained here only from the Treasury, under license issued by the Secretary of the Treasury as set forth in Article 5, Section 34 of the Provisional Regulations, issued under the Gold Reserve Act of 1934. The balance of the reply was similar to that given to the National Bank of Rumania.

The Federal Reserve Bank of New York received \$57,000,000 for credit to the account of the Bank of England. An additional payment of \$28,000,000, for which the instructions are uncertain, is also believed to be for the account of the same bank. All of these payments are being made to the Federal Reserve Bank by New York banks, by order of various English banks which have been appointed by the British Control as authorized dealers in all foreign currencies. In the circumstances, it would appear that these payments represent dollar balances surrendered to the British Control in accordance with the Defense (Finance) Regulations.

The United States equivalent of today's London silver price was 41.80¢. The price fixed by Handy and Harman for foreign silver remained unchanged at 34-3/4¢. The Treasury's price was also unchanged at 35¢. In New York we made one purchase of silver amounting to 125,000 ounces. We also purchased from Canada 350,000 ounces of silver, making a total of 970,000 ounces purchased for the month of October under our agreement to buy 1,200,000 ounces monthly.

[Handwritten Signature]
CONFIDENTIAL

10/31/39

Mr. Foley met the Secretary at
8:15 am and gave him the attached
in preparation for the 9:30 meeting.

STATEMENT OF FACTS

In May, 1933, Twentieth Century Pictures, Inc., was incorporated. Joseph M. Schenck and William Goetz were sole stockholders of record. Goetz, however, acted in his capacity as trustee of the Mayer Family Trust of which he was a minor beneficiary and of which his father-in-law, Louis B. Mayer, was the creator.

Schenck invested \$350,000 in cash in Twentieth Century and the Mayer Family Trust also invested \$350,000 in the enterprise. In return for such investment Schenck and Goetz each received 2500 shares of preferred stock having a par value of \$100 a share. The common stock of Twentieth Century Pictures, Inc., which consisted of 100 shares was split between Schenck and Goetz on a fifty fifty basis, each receiving 50 shares. Schenck then assigned to the Corporation a personal service contract between Zanuck and himself which provided for a weekly salary plus 10 per cent of the net profits.

Zanuck had no stock interest in Twentieth Century Pictures, Inc., until March, 1934, when his personal service contract was revoked and in lieu thereof a new written contract was made under which he was permitted to buy 20 shares of the common stock owned by Schenck and 10 shares of the common stock owned by Goetz at a nominal price of \$100 a share. This gave him a 20 per cent interest in the Corporation for the nominal sum of \$2,000. In addition his salary was reduced from \$4,000 to \$2,000 a week and he was permitted to retain \$100,000 which had been advanced to him by Schenck in anticipation of Zanuck's 10 per cent share of the net earnings under the original contract.

In his tax return for the year 1935 Zanuck did not report the gain represented by his purchase of these 20 shares at a nominal price of \$100 a share. The book value attributed to the stock indicated that it was worth at least \$10,100 a share. Upon ascertaining these facts Kadis reopened Zanuck's return for the year 1934 in September 1936 and recommended that Zanuck and his wife be assessed an additional tax of approximately \$100,000, Zanuck and his wife holding their property as community property.

In August, 1935, a merger was effected between Twentieth Century, Inc., and Fox Film Corporation under a plan of reorganization which required Twentieth Century, Inc., to transfer all of its assets to Fox Film Corporation in exchange for stock in Fox Film Corporation. The name of Fox Film Corporation after the merger was Twentieth Century-Fox Film Corporation. The name of the old Twentieth Century Pictures, Inc., was changed to S-Q-Z Corporation, and it was shortly afterward dissolved.

In effecting the merger two classes of stock were issued. The preferred stock represented the assets of both Corporations. The book value of Fox assets was approximately \$37,000,000. The book value of Century assets was approximately \$4,000,000. Preferred stock in the amount of 1,338,000 shares was issued, each share being valued for purposes of the merger at about \$30 a share. Consequently Fox stockholders received 1,286,000 shares of preferred stock and Century stockholders received 132,000 shares of preferred stock on the basis of their respective assets.

The common stock was treated for purposes of the reorganization as if it had no monetary value. The old stockholders of Fox received the new common stock on the basis of one-half share of common for each share of new preferred. Therefore, old shareholders of Fox received 613,000 shares of common stock. An equal amount of common stock was issued to stockholders of Century. If Century stockholders had received the same treatment as Fox stockholders 66,000 shares of common stock (one-half of the 132,000 shares of preferred) would have been issued to Century stockholders. The tax liability is predicated upon the excess of 547,000 shares of common stock received by Century stockholders which was apparently issued as compensation for the personal service contracts required under the plan of reorganization to be entered into by Zanuck and Schenck with the new Twentieth Century-

distribution of the

Fox Film Corporation.

Moreover, when received by Century the preferred stock was allocated in accordance with the stockholdings of record, that is 40 per cent to Schenck, 40 per cent to Goetz and 20 per cent to Zanuck, whereas the common stock was divided on the basis of 35 per cent to Schenck, 35 per cent to Goetz and 30 per cent to Zanuck. Although Schenck through manipulation of the asset value per share of preferred stock tried to make it appear that Zanuck was receiving 30 per cent of the preferred as well as the common and Goetz and he only 35 per cent of the preferred for the purpose of fooling Zanuck, this was not actually the fact. This tricking of Zanuck by Schenck is of concern only to establish that their holdings were actually as they were of record, namely 40 per cent in Schenck, 40 per cent in Goetz and 20 per cent in Zanuck.

The actual distribution among Century stockholders of the new preferred stock in Twentieth Century-Fox was as follows:

	<u>Total Shares</u>	<u>Zanuck</u>	<u>Goetz</u>	<u>Schenck</u>
Preferred stockholders: 700,000 at \$30	22,000	—	11,000 (50%)	11,000 (50%)
Common stockholders: Balance Preferred Stock (Basis 20-40-40)	<u>110,000</u>	<u>22,000 (20%)</u>	<u>44,000 (40%)</u>	<u>44,000 (40%)</u>
	132,000	22,000	55,000	55,000

The purported distribution among Century stockholders of new preferred stock in Twentieth Century-Fox was as follows:

	<u>Total Shares</u>	<u>Zanuck</u>	<u>Goetz</u>	<u>Schenck</u>
Preferred stockholders: 1,000 at \$12 per share (asset value reached working backward on Schenck's orders)	59,000	—	30,000	30,000
Balance Preferred stock Common stockholders: (Basis 30-35-35)	<u>73,000</u>	<u>22,000 (30%)</u>	<u>25,000 (35%)</u>	<u>25,000 (35%)</u>
	132,000	22,000	55,000	55,000

The distribution among Century stockholders of the new common stock in Twentieth Century-Fox was as follows:

	<u>Total Shares</u>	<u>Zanuck</u>	<u>Goetz</u>	<u>Schenck</u>
	613,000	183,000 (30%)	214,000 (35%)	214,000 (35%)

*SEC. 112. RECOGNITION OF GAIN OR LOSS

“(a) GENERAL RULE.--Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

“(b) EXCHANGE SOLELY IN KIND. * * *

“(3) Stock for Stock on Reorganization.--No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

“(4) Same.--Gain of Corporation.--No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.”

* * *

Construing the meaning of the word "reorganization" as used in section 112 of the Revenue Act of 1928 (from which section 112 of the Internal Revenue Code is derived) the Supreme Court in 1935 in the case of Gregory v. Helvering, (293 U.S., 465), involving the tax liability resulting from a reorganization which conformed to the literal terms of section 112, had this to say:

* * * Putting aside, then, the question of motive in respect of taxation altogether, and fixing the character of the proceeding by what actually occurred, what do we find? Simply an operation having no business or corporate purpose - a mere device which put on the form of a corporate reorganization as a disguise for concealing its real character, and the sole object and accomplishment of which was the consummation of a preconceived plan, not to reorganize a business or any part of a business, but to transfer a parcel of corporate shares to the petitioner. * * *

"In these circumstances, the facts speak for themselves and are susceptible of but one interpretation. The whole undertaking, though conducted according to the terms of subdivision (B), was in fact an elaborate and devious form of conveyance masquerading as a corporate reorganization, and nothing else. The rule which excludes from consideration the motive of tax avoidance is not pertinent to the situation, because the transaction upon its face lies outside the plain intent of the statute. To hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose."

October 31, 1939

FOR THE SECRETARY:

I saw Bob Kintner today and told him you had authorized me to speak for you, and that I was able to give him information on two points: (1) The preparations last April in conjunction with SEC and Federal Reserve to take care of the financial markets, and (2) the preparation of the instructions which were sent to Coast Guard and Customs under the Neutrality Act.

He replied that there were many more incidents on which they would like to get information, and I listed the following:

- (1) Any conversations on what was to be done with the Tripartite Agreement.
- (2) Any meetings, conversations, or preparations aimed to protect foreign exchange.
- (3) Conversations and arrangements on British and French liquidation of American securities.
- (4) The story of the French airplane purchase, including letters and any conversations with Bullitt.
- (5) Meetings in the Treasury during the days just before the war broke out, who was here, how contact was kept with you and with the White House,

and how the news of war reached the Treasury.

(6) What arrangements were made to secure the six special advisers and what they did while they were in the Treasury.

(7) The story of imposition of countervailing duties on German imports.

(8) Treasury efforts to stimulate South American trade, particularly in competition with Germany.

I told him that I felt sure that on many of these subjects, for example the French plane deal, you had already said all that you could say, and that on many other subjects there was nothing which you could appropriately make public at this time. In the course of the conversation, Bob said that he thought the Treasury would unavoidably appear in a bad light if it did not "open up" because all the other Departments were competing to appear as the one most forehanded. I told him that I was sure there were other motives which far outweigh any desire of the Treasury to appear as the hero of peace. Bob also said that because they were getting from other sources information on your attitude in various group meetings, he thought that in fairness to yourself you should allow them an hour at the conclusion of their other work to check these purported attitudes against your own recollection of these meetings.

ESD



THE SECRETARY OF THE TREASURY
WASHINGTON

170
10-31-39

MEMORANDUM FOR THE FILE

My attention has been called to the discussion on the floor of the Senate on October 26, 1939 relative to the stabilization fund. As the Congressional Record indicates, the following letters were received and sent by me relative to this matter:

- (1) Letter of October 19, 1939 from Senator Wagner.
- (2) Letter of October 19, 1939 to Senator Wagner.
- (3) Letter of October 17, 1939 from Senator Vandenberg.
- (4) Letter of October 24, 1939 to Senator Vandenberg.
- (5) Letter of October 19, 1939 to Senator Barkley. (not in Cong. Rec.)

In addition there was left with Senator Barkley on October 29, 1939 by Mr. Foley, a memorandum relative to this matter, and there was left with Senator Wagner on October 25, 1939 by Messrs. Foley and White, a memorandum dated October 24, 1939. Copies of such memoranda and letters are attached hereto. I had no telephone conversations with either Senator Wagner or Senator Barkley relative to this matter. I had several telephone conversations with Senator Vandenberg, transcripts of which are attached hereto. I have not stated, nor have I authorized anyone else to state, that the stabilization fund would not purchase any currencies of belligerents during the existence of the war. Messrs. Foley and White, with my approval, indicated to Senators Wagner and Barkley that I had no present intention of purchasing currencies of belligerent countries, but that I thought that it was inadvisable to tie my hands by putting any limiting provision in the statute. My views with respect to the use of the stabilization fund in time of war are those which I have expressed in the letters and memoranda referred to above, and as indicated herein, and in the hearings in connection with the bill to extend the stabilization fund.

Messrs. Foley and White had several conversations with Senator Wagner and Barkley relative to this matter, but at no time were any views expressed in any way contrary to my views as above indicated.

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Messrs. Foley and White had several conversations with Senator Wagner and Barkley relative to this matter, but at no time were any views expressed in any way contrary to my views as above indicated.

JEF:MB:men
10/30/39

✓ E.H.H. F.H.W.

CONGRESSIONAL RECORD

October 26, 1939

pages 1495-97

MR. THOMAS of Utah. I thank the Senator from Ohio.
Mr. TAFT. Mr. President, I offer the amendment which I send to the desk.

The PRESIDING OFFICER. The amendment offered by the Senator from Ohio to the amendment reported by the committee will be stated.

The LEGISLATIVE CLERK. On page 22, after line 21, it is proposed to insert the following:

(d) Subsection (a) of section 10 of the Gold Reserve Act of 1934, as amended, is amended by inserting therein, immediately after the first sentence thereof, the following new sentence: "The Secretary of the Treasury shall not at any time hold currency, or bills of exchange payable in the currency, of any state named in any currently effective proclamation issued under the authority of section 1 (a) of the Neutrality Act of 1939, for which he has expended more than \$20,000,000 from the stabilization fund."

Mr. TAFT. Mr. President, under the Stabilization Fund Act, the President has available \$2,000,000,000 in gold for the purpose of stabilizing exchange. It will be entirely possible, entirely legal, so far as I can see, if he should wish to do so for him to spend the entire \$2,000,000,000 in maintaining the pound, say, at \$4.20 or any other figure at which he might wish to stabilize it. If he should do that, then, of course, the

only the operation could have any substantial effect in accumulating that purpose would be to buy pounds with the stabilization fund. That would be a proper exchange operation, and it could be done very easily within the powers granted to the Secretary of the Treasury in connection with the stabilization fund; but the result would be that when that operation was completed there might be in the fund \$3,000,000,000 worth of pounds. If England should lose the war, or even if she should not, those pounds might not be worth \$3,000,000,000, much less the \$2,000,000,000 expended for that purpose. The French Government lost large sums of money when they attempted to support the pound back in the financial crisis of 1934, as I recall.

Mr. ADAMS. Mr. President, will the Senator yield for an hour?

The PRESIDING OFFICER. Does the Senator from Ohio yield to the Senator from Colorado?

Mr. TAFT. Certainly.

Mr. ADAMS. I am wondering if the Senator is accurate in saying that the stabilization fund was created for the purpose of stabilizing the pound or any other foreign currency. My impression is that it was created to stabilize the American dollar, and that, so far as investments were made in foreign currency, they were made only insofar as might be necessary to stabilize the American dollar. There are some 50 different foreign currencies, and it was not the purpose of the stabilization fund to reach out and endeavor to stabilize the currencies of individual countries.

Mr. TAFT. Perhaps not; yet the pound determines the currencies of many countries throughout the world, and when the pound is stabilized at \$4.20 the dollar is stabilized at a certain number of shillings in the pound. The two operations are simultaneous; there is no difference between them. I think it may fairly be said that it is wholly within the legal authority granted to the Secretary of the Treasury in connection with the stabilization fund that that sum be used for the very purpose of maintaining the pound so as to protect the dollar in export transactions throughout the world. I think the Secretary of the Treasury so admits. At least when he was before the Banking and Currency Committee last year I asked him this question:

Suppose there is a foreign war and suppose you go out and do what you can to buy two billion dollars' worth of pounds. Isn't the effect of that to give England the power to buy \$3,000,000,000 worth of goods in this country, under the cash-and-carry provision?

Secretary MORGENTHAU. Senator, if there is a war in any foreign country, before we would use the stabilization fund or any money in the Treasury to assist any country in prosecuting that war I would come up before the proper committee and ask for guidance.

The Secretary repeated that statement in his letter to the Senator from Michigan (Mr. VANNEBUSH), read to the Senate yesterday. As the Congress will probably soon adjourn, there may be no committee of Congress here. The Secretary is asking for guidance, and I am proposing that we give it to him by stating frankly that the stabilization fund is not to be used for that purpose.

Mr. SCHWELLENBACH. Mr. President—

The PRESIDING OFFICER. Does the Senator from Ohio yield to the Senator from Washington?

Mr. TAFT. I yield.

Mr. SCHWELLENBACH. May I ask the Senator how he arrives at the figure \$20,000,000? Is it because of the experience in the operation of the stabilization fund in the past?

Mr. TAFT. I understand \$20,000,000 would enable the Treasury to carry on day-to-day transactions which have been carried on up to this time. Ordinarily the fund does not buy pounds except for 1 day. The Secretary of the Treasury has from time to time bought pounds with the promise of the British Government that it would redeem those pounds in gold on the next day. Consequently the actual sum that has been laid out at any one time under the procedure that has been followed in the past does not exceed \$20,000,000. As a matter of fact, the Secretary says he has no pounds at the present time and does not intend to buy any; and he says

that if he should think of doing so he would like to be guided. I think we should give the guidance to him.

Mr. ADAMS. Mr. President—

Mr. TAFT. I yield to the Senator from Colorado.

Mr. ADAMS. The impression that I received, I will say to the Senator, from Secretary Morgenthau when he was asked why such a large stabilization fund was needed was not that they intended to use it, but because of the desirability of having the capacity, which would enable the Treasury to do certain things if necessary. If we restrict their capacity to \$20,000,000, then we would utterly defeat the purpose of the stabilization fund, because there may be those who seek to destabilize deliberately or conditions which result in destabilization may continue regardless of anything, and it might be impossible to meet such a situation with a mere \$20,000,000. I was impressed by the fact presented by the Secretary of the Treasury that it was the power to do these things with a vast stabilization fund which made people conscious of the purpose of this Government to stabilize the dollar and fend off any hostile movement.

Mr. TAFT. It seems to me the Senator answers his own argument, because if we are going to threaten to buy pounds in order to maintain the pound, we will have to carry out that threat sooner or later, and use a great deal of the fund for that purpose. It seems obvious, therefore, that we should make it clear that we do not intend this fund to be so used.

I wish to point out that this is a cash-and-carry measure, intended to prevent credit. But the operation suggested here is not covered by the prohibition against credit. The stabilization fund does not loan any money to England and France, but the operation is just as effective as a loan, because if the fund buys pounds or francs it pays dollars for them, and then the English or the French Governments have dollars with which they may pay for purchases in this country, and we have pounds which may or may not be good, according to what the credit of the English Government is at the end of the war.

Mr. BARKLEY. Mr. President, will the Senator yield?

Mr. TAFT. I yield.

Mr. BARKLEY. Of course, the Senator realizes that under the terms of the law itself the stabilization fund is not created for the purpose of maintaining the value of any other currency but of stabilizing the dollar. Certainly foreign currencies are linked with the dollar, but the price of foreign currencies will determine the amount of stabilization of the dollar.

Mr. TAFT. Not only that, but the very purpose of the stabilization fund was to keep the pound from depreciating, so that we would not be at a disadvantage in trading in South America, because the British could sell cheaper than we could sell. That is the very purpose of the fund. Therefore, if it is used for that very purpose and used effectively we are going, gradually, to accumulate pounds under present conditions until the amount is considerable.

Mr. BARKLEY. The purchase of pounds or francs or guilders or any other foreign currency is only incidental to the purpose of the law to maintain the stability of the American dollar and thereby not place our own country at a disadvantage with respect to cheap foreign currencies. Since the Senator has read the answer of the Secretary of the Treasury in which he said that if he contemplated the purchase of any currencies in order to assist any country at war he would come back here for guidance, I think that another answer of the Secretary ought to be put into the Record. After he said he would come back here for guidance the Senator from Ohio said:

I have no doubt you would, perhaps. But nevertheless, the authority granted in this extension would give you power to do that, would it not, if you did choose to do so?

Secretary MORGENTHAU. To do what?

Senator Tamm. What I suggested: To buy pounds, and, in return, an English credit here of \$3,000,000,000, and we would make an English credit here of \$3,000,000,000, and we would make up, in the end, and find ourselves with \$2,000,000,000 worth of pounds that were worth nothing? I am now asking whether you would do it. My question is whether that is not legally possible. Isn't that legally possible?

Secretary MONROE. Well, if I lost all sense or reason in the performance of my duty, I might do a lot of things.

Senator TAPT. In other words, it is legally possible.

Secretary MONROE. Well, a lot of things are legally possible, which you would not do under the rule of common sense.

It is in that connection that the Secretary announced that if he had any such purpose in mind he would come to Congress and obtain authority for it.

While I am on my feet I may say that the Secretary of the Treasury has not bought a pound since the war started; he has not bought a franc since the war started; and he now holds only \$3,960 worth of pounds and \$82 worth of francs, which he bought long before the beginning of the war.

Mr. TAPT. Mr. President, just as an example of how the Secretary may have changed his views, I should like to read a United Press dispatch of October 19 which discusses how the stabilization fund may now be used, or the officials think it may be used, in South America:

Officials said that the fund's machinery could perform useful functions in the administration's plans for enlarging trade with Latin America. The fund could be used, officials said, in developing exchange arrangements similar to those made with Brazil.

Those were made by the Export-Import Bank. They were not made by any stabilization fund.

Gold could be made available in Latin-American countries to enable them to stabilize their exchange.

According to this United Press dispatch last week, that is what the officials are saying they may do now with the stabilization fund; not stabilize the dollar, but give gold to South American countries to enable them to stabilize their exchange. I say that if ideas of that kind are abroad as to the powers under this fund, we ought to make it perfectly clear that we are not going to finance a European war through the use of the stabilization fund.

Mr. BARKLEY. Mr. President, will the Senator yield at that point for an additional brief statement?

Mr. TAPT. Yes.

Mr. BARKLEY. I wish to say that I am authorized by the Secretary of the Treasury to say that the position he took in the testimony in March is the position he now takes, and he desires to reiterate that position; that he has no intention of using the stabilization fund for the purpose of enabling belligerent countries to buy war supplies in this country or anywhere else, and that he now holds no currencies at all that have been bought since the war began. Certainly, it seems to me that in view of the very conservative administration of the stabilization fund by the Secretary of the Treasury we have no warrant for now amending this particular Neutrality Act by undertaking to legislate on the use of the stabilization fund, which is entirely a different proposition. In the exigencies and uncertainties of our own commerce, a \$20,000,000 limit, as fixed in the amendment of the Senator, might handicap the Secretary of the Treasury in using the stabilization fund in any effective way to stabilize the American dollar and thereby put it on an equality with the currencies of the world.

Mr. TAPT. The Secretary says he will not do it, but he apparently thinks he has power to do it. He says that before he does it he will come to a committee of Congress for guidance.

It seems to me this amendment is directly material to the very purpose of the joint resolution. It provides, in effect, that the Government itself shall not make what amounts to a loan to England and France, which is within the broad purpose of the joint resolution but is not covered by its specific provisions. The law is doubtful. The operations of the stabilization fund are secret, and nobody knows whether or not it is used until something like a month later, when a report has to be made. I think we can clear up the Secretary's mind; I think we can clear up a good deal of misapprehension in this country, a number of rumors that are likely to arise that the fund is being used, by adopting this amendment now and making it perfectly definite that the fund is to be used solely for exchange operations.

—Mr. TOWNSEND. Mr. President—

Mr. TAPT. I yield to the Senator from Delaware.

Mr. BARKLEY. Mr. President, may I ask a question of the Senator from Ohio?

The PRESIDING OFFICER (Mr. HAYES in the chair). The Senator from Ohio has yielded to the Senator from Delaware.

Mr. BARKLEY. In the Senator's time—I think the Senator from Ohio has taken his seat—let me say that I wonder what he means by clearing up the Secretary's mind by an amendment. The Secretary's mind does not seem to be muddled on the subject. He is not asking that his mind be cleared up. It seems to me a rather gratuitous matter on our part to attempt to clear up a mind that is not at all addled or muddled on the subject, but seems to be very clear.

Mr. TAPT. After reading this testimony, my conclusion would be that the Secretary's mind was very muddled, and furthermore that he is so stating, and is asking for guidance.

Mr. WAGNER: They do not need a dollar of gold to pay for the products they purchase here. They have available much more than will be needed for any of their purchases. The gold problem is not involved in the question at all. That is another point.

When the discussion first arose as to the stabilization fund, I wrote a letter to the Secretary of the Treasury, and he replied, I shall ask that my letter and the Secretary's answer be read, and then I shall conclude with a few more words.

The PRESIDING OFFICER: Without objection, the clerk will read, as requested.

The legislative clerk read as follows:

October 19, 1939.

The Honorable the SECRETARY OF THE TREASURY,
Washington, D. C.

MY DEAR MR. SECRETARY: It appears from recent discussions on the Senate floor that some of the Members are fearful that the stabilization fund is being used to support the currencies of England and France during this period of war in Europe.

I know that you publish quarterly information which reveals the operations of the stabilization fund, but, as I understand it, the information concerning operations during September will not be available in the ordinary course of events until January 1, 1940. In view of the questions which are being raised at the present time as to the operations of the stabilization fund, I would appreciate it if you would advise me as chairman of the Senate Committee on Banking and Currency whether the stabilization fund is acquiring the currencies of England and France or whether the fund is supporting these currencies.

I appreciate the reasons why the Treasury would hesitate to make public any information concerning the scope of the activities of the fund without the lapse of an adequate period of time, but under the circumstances I hope that you will be able to make an exception in this instance.

Very sincerely yours,

THE SECRETARY OF THE TREASURY,
Washington, October 19, 1939.

HON. ROBERT F. WAGNER,

Chairman of the Senate Committee on Banking and Currency,
United States Senate, Washington, D. C.

MY DEAR SENATOR: I have your letter of October 19, in which you refer to recent discussions on the floor of the Senate with reference to the operations of the stabilization fund.

Of course, as the Treasury Department has at all times made clear, the stabilization fund has never been used to support the currencies of any foreign country, but has been used solely for the express purpose set out in the statute pursuant to which it was created, namely, to stabilize the exchange value of the dollar. In connection with the carrying out of such purpose it has been necessary, as was explained at the hearings last spring on the bill to extend the stabilization fund powers, for the fund to acquire foreign currencies from time to time. I should like to state, however, that the stabilization fund is not acquiring any currencies of belligerent

countries and is holding only buying accounts of foreign currencies of belligerent countries which were acquired long before the outbreak of the war.

Sincerely,

H. MOONSHAWAN, Jr., Secretary.

Mr. WAGNER. Mr. President, I add just a word to that statement. Not only are they not purchasing any currencies of belligerents now, but during the existence of the war they will not purchase any, and the Secretary has authorized me so to state.

Mr. VANDENBERG. Mr. President, will the Senator yield?

Mr. WAGNER. I yield.

Mr. VANDENBERG. I wish to ask the Senator a further question. Will the Senator tell me how the stabilization fund is used to stabilize the exchange value of the dollar, which is the Secretary's language, if it is not used in connection with foreign currencies? How can the value of the dollar be stabilized without dealing in foreign exchange?

Mr. WAGNER. The purpose in dealing in exchange is, of course, to stabilize the dollar. But the suggestion is preposterous that the Secretary of the Treasury, who has made such a remarkable record, and has acted with such fidelity and ability, would deliberately use \$1,000,000,000 of American money in an unneutral manner to bolster the currency of a foreign government so that it may purchase goods here, with perhaps a very serious loss to his own country.

Mr. VANDENBERG. I wanted to ask the Senator one question at that point, inasmuch as my other question seemed to have been responsible for this explosion.

Mr. WAGNER. I did not intend it as an explosion. I wanted to be emphatic about it, because I have great confidence in the Secretary, and I know of his integrity as well as his ability.

Mr. VANDENBERG. I share the Senator's confidence. Mr. WAGNER. I know there is no intention to suggest, or any implied suggestion, that he is not honest.

Mr. VANDENBERG. None.

Mr. WAGNER. But yet such an interpretation could be placed upon the amendment.

Mr. VANDENBERG. Not upon the question which I asked the Senator, which produced the explosion.

Mr. WAGNER. Not at all.

Mr. VANDENBERG. The question I asked is: How can the exchange value of the dollar be stabilized without dealing in exchange?

Mr. WAGNER. It cannot.

Mr. VANDENBERG. It cannot be done. So the stabilization fund then is sterile for the length of the war.

Mr. WAGNER. So far as the belligerent countries are concerned, I take it, it is.

Mr. VANDENBERG. Then, what is the objection to saying so in the statute?

Mr. WAGNER. There are other countries to deal with. There are more than belligerent countries whose currencies are involved. The stabilization fund is not used solely to buy British pounds.

Mr. VANDENBERG. I call the attention of the Senator that the pending amendment applies only to the currencies of belligerents.

Mr. WAGNER. That is true.

Mr. VANDENBERG. Then, why not put it in, if that is the way it is going to work?

Mr. WAGNER. Because I say that the suggestion itself is an implication that the Secretary of the Treasury is going to fail to perform his duty with fidelity.

Mr. TAPT. Mr. President, will the Senator yield?

Mr. WAGNER. I wish to finish what I have to say, and then I will yield. I just wish to say to the Senate that the whole matter was before the Committee on Banking and Currency. Senators will recall the rumors which were spreading—even some Senators made the suggestions upon the floor and elsewhere—that there was something mysterious about the operation of the stabilization fund; that it might get out

for purposes, even domestic purposes, other than its exclusive purpose to stabilize the exchange value of the American dollar. So we had a hearing upon this whole matter before the Committee on Banking and Currency. The Secretary came before the committee with a complete audit of the entire fund, of every operation in detail. He was questioned, particularly by the Senator from Delaware (Mr. Townsend) and the Senator from Ohio (Mr. Tapp) in a most scrutinizing and able manner. The Secretary not only acquitted himself well but showed how every dollar was expended. All these rumors, of course, went right out of the window, because not only had he been faithful to his trust but he was so faithful that he actually made money for the Government from the operation.

Mr. MALONEY. Mr. President, will the Senator yield?
Mr. WAGNER. I yield.

Mr. MALONEY. I was very much impressed with the observation made by the Senator from Colorado when he said that the \$20,000,000 limitation would deny to the Secretary of the Treasury and the United States the power of a "threat"—and the word "threat" is mine—in the event of an assault on the American dollar. For that reason it seemed to me that it would be inadvisable to adopt the amendment offered by the Senator from Ohio. But it now seems to me, Mr. President—and it seems also important that I make this observation—that the Senator from New York, intentionally or otherwise, has tied the hands of the Secretary of the Treasury and completely destroyed the contention of the Senator from Colorado by pointing out and saying that he does it with the authority of the Secretary of the Treasury, that no money of the stabilization fund will be used for the purchase of foreign currency during the war. If that statement is permitted to stand, I do not see how anybody can oppose the amendment offered by the Senator from Ohio, and I hope that the Senator from New York will at least reflect further upon his statement.

Mr. WAGNER. I thank the Senator. The Secretary of the Treasury said that there was no present intention of purchasing any of the currencies of the belligerent countries. But, as was very well said, even by the Senator from Ohio, we are not in session at all times. I do not know what critical situation may arise, and I can only stick to the question of his present intention. That is what I had in mind when I made the statement. I do not contradict a single word of what the Senator from Colorado has so ably stated. The Secretary of the Treasury himself characterized this fund as much of a national defense measure as an army and a navy.

Mr. MALONEY. I respectfully suggest to the senior Senator from New York that he examine the Record. It may have been a slip of the tongue, or a mistake on my part. Perhaps I did not hear correctly; but if I did the Senator from New York said he was authorized by the Secretary of the Treasury to state that the stabilization fund would not be used for that purpose.

Mr. WAGNER. Certainly the fund would not be used for the purpose suggested by the Senator from Ohio. That is the Secretary of the Treasury would not deliberately purchase foreign currencies for the purpose of providing credit to any of the belligerents.

Mr. MALONEY. I am sure of that. I am in sympathy with what I think is the viewpoint of the Senator from New York; but I think his language shackles the Secretary of the Treasury.

Mr. WAGNER. My assertion might have been too broad; if so, it was unintentional.

Mr. VANDENBERG. Mr. President, I should like to renew the language, because the Secretary said to me yesterday in words of one syllable that he did not propose to use this fund to buy foreign currencies from belligerent nations.

Mr. MALONEY. Mr. President, will the Senator yield further?

Mr. WAGNER. I yield.

Mr. MALONEY. That language is quite different from the language which the Senator from New York credited to the

Secretary of the Treasury. The Secretary might not intend to make such purchases, but if I correctly understood the Senator from New York he said that the Secretary would not do it. I think there is considerable difference in the language.

Mr. WAGNER. If I so stated, I think the Senator for calling my attention to it. It was certainly too broad a statement of the Secretary's views. However, there is no present intention of buying any currencies of belligerents. Of course, we cannot tell what problems may arise, but there is no such intention at the present time. As a matter of fact, I may say that at the present time the Secretary of the Treasury has as part of the stabilization fund only 746 pounds sterling, or approximately \$2,980, and 3,652 French francs, representing about \$2253.

Mr. MALONEY. Mr. President, will the Senator yield to me again so that I may complete an expression of my view?
Mr. WAGNER. I yield.

Mr. MALONEY. I am in sympathy with what I think are the desires of the Senator from New York, but I do not think it is paradoxical to say that I am also in sympathy with the statement just made by the Senator from Michigan (Mr. Vandenberg). I think it would be despicable for the Secretary of the Treasury or anyone else to use any part of the stabilization fund, under the circumstances now existing, and particularly in the light of the pending legislation, to furnish credits to belligerent nations. I wish to add to that statement, however, that I do not believe that the Secretary of the Treasury would do such a thing under any circumstances.

Mr. WAGNER. That is it exactly. The Secretary was asked that very question—

Mr. SHIPSTEAD. Mr. President, will the Senator yield?
Mr. WAGNER. I was trying to finish my thought.

The PRESIDING OFFICER. The Senator declines to yield at the moment.

Mr. WAGNER. The Secretary was asked that very question by the Senator from Ohio (Mr. Tapp): I do not recall the exact language of the question. The Senator from Ohio will recall it very well. The Secretary was asked whether it would be possible to use the stabilization fund for the purpose of purchasing \$2,000,000,000 worth of English pounds, so as to provide sufficient credits or moneys to a particular belligerent in case of war, that particular belligerent to use the fund for the purchase of armaments and other materials. The Secretary questioned whether he would have that authority. However, he said, in effect, "I have common sense. I would not think of doing anything of that kind without first coming to Congress for guidance."

Mr. MALONEY. There is no question that he has the right, or rather that it would be legal.

Mr. WAGNER. I disagree with the Senator. I think it would not be legal unless it were done for the purpose of stabilizing the American dollar.

Mr. MALONEY. I said it would be legal.

Mr. WAGNER. If it were done for that purpose, it would be legal, but not otherwise.

Mr. WHEELER. Mr. President, will the Senator yield to me?

Mr. WAGNER. I yield.

Mr. WHEELER. Suppose the British pound dropped from \$4 to \$2.50. Then the Secretary could say he wanted to buy British pounds in order to stabilize the American dollar because such a drop would destabilize it. First of all, let me say that I am extremely glad that this question came up because I think it has clarified the situation in the minds of the many Senators. However, I do not conceive that in the situation which exists at the present time, with a war in progress, and with the currency of any belligerent likely to drop, that we ought to buy British pounds and French francs in order to try to bring them up.

Mr. WAGNER. The Senator knows very well that the Secretary would not do such a thing.

Mr. WHEELER. I do not believe he would. However, I am delighted that the question came up because various rumors have been circulated. I think the Secretary would

have the power to do so under the law. Merely I do not think he should do it, and I do not think he would.

Mr. WAGNER. I have grave doubt whether he would have the power.

Mr. BARKLEY. Mr. President, will the Senator yield? Mr. WAGNER. I yield.

Mr. BARKLEY. During the war the Secretary of the Treasury might purchase some pounds or francs for the purpose of stabilizing the American dollar. That would not automatically or necessarily result in the use of those pounds or francs to give Britain or France purchasing power in the United States to buy war materials.

Mr. WAGNER. That is correct.

Mr. WHEELER. But if the pound should drop to \$250, and the Treasury should buy pounds to bring it up to \$5, the effect, of course, would be twofold.

Mr. BARKLEY. The effect would not necessarily be to provide money with which to purchase material to send to England.

Mr. WHEELER. If the pound should drop to \$350, and the Treasury bought it at \$4 in order to stabilize it at that point, as a matter of fact the Treasury would be making a gift to England, and also providing the English with gold which they could use to purchase American goods. The British would not use the stabilization fund. They would use the gold, if they could obtain it, to purchase goods from America. So, in effect, if that were done we would be giving them a loan. I am delighted to hear the distinguished Senator from New York say that there is no intention upon the part of the Secretary to do so. As I say, I cannot conceive of his attempting to do so.

SEVERAL SENATORS. Voie! Voie!

Mr. SHIPSTEAD. Mr. President, will the Senator yield?

Mr. WAGNER. I yield.

Mr. SHIPSTEAD. If it is not the intention of the Secretary of the Treasury to buy the currencies of belligerent nations during the war, then I do not see why this amendment should be necessary. However, if he should start to stabilize the dollar by buying British pounds or French francs, he might have to buy so much that he would endanger the fund. Then, in my opinion, this amendment would be necessary.

Mr. WAGNER. An effort was made in the committee— and, as I recall, upon the floor—by the Senator from Ohio to reduce the stabilization fund to \$200,000,000 in place of \$2,000,000,000. When that question came before the committee for consideration, the Secretary of the Treasury declared that it was very important to have a large stabilization fund, for the same reason we have a large Navy, merely as notice to the world that other nations must not fool with our currency or try a competitive devaluation procedure, because we have a fund to meet the situation. That is the only purpose of the fund.

Mr. TAFT. Mr. President, the whole purpose of the stabilization fund was considered by the Banking and Currency Committee last year. When it finally came down to the question, "Why do you want \$2,000,000,000?" the answer was: "We are afraid of the competitive devaluation of the pound throughout the world, which might result in our being underbid by the English and by every other country on a sterling basis throughout the world." That is the only purpose of having \$2,000,000,000 in the stabilization fund. I do not agree with the Senator from New York. I think the Secretary would be perfectly justified in using the fund for that purpose, because he thinks—and so stated—that if we permit the pound to depreciate it means a reduction in the price of cotton and the price of wheat and other prices in this country, in a war which will unfavorably affect our economy. The Secretary thinks that condition may exist. It is even more likely to occur in the present circumstances than when he testified. I was almost prepared to withdraw the amendment when the Senator stated that the Secretary authorized him to promise that he would not buy any pounds or francs during the war period. He has now made

that statement, and he says it is not the intention of the Secretary to do so. Am I correct in that statement? I think the record will show that there is a substantial difference between the two statements.

Mr. WAGNER. I know the Senator wants to be fair. We cannot look into what may happen in the future. At the present time there is no intention to buy any currencies of any belligerents. That is all we can say at the present time. One of the main reasons was given by the Senator from Montana (Mr. WHELAN). With war and chaos existing, it would be very undesirable and unprofitable today to purchase pounds when the pound is dropping. However, does not the Senator think we ought to leave the stabilization fund intact, just as we leave our Navy intact? We have no present intention of going to war; but we would not scrap our Navy for that reason.

Mr. TAFT. Mr. President, the pending measure is a cash-and-carry proposal. It lays down the principle in legislation—not in the discretion of the Secretary of the Treasury—that we do not propose in any way to advance credit to belligerent nations to buy the goods they would like to buy in this country. It ought not to be left in anybody's discretion. We are laying down that policy. The Secretary said that if there were a war in any foreign country before he used the stabilization fund he would come to Congress and ask the proper committee for guidance. In other words, he has said, in effect, the Banking and Currency Committee and I will decide whether or not to use the stabilization fund.

What the amendment seeks to do is to have Congress lay down a perfectly definite rule that he shall not do what he says he does not intend to do, and what the Senator from New York (Mr. WAGNER) is almost—but not quite—willing to promise he will not do. It seems to me that we ought to put the amendment in the law, and definitely lay down a policy before all the peoples of the world that this country does not propose, directly or indirectly, to finance any belligerent in the present war.

UNITED STATES SENATE

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Washington, D.C.

October 19, 1939

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

My dear Mr. Secretary:

It appears from recent discussions on the Senate Floor that some of the members are fearful that the Stabilization Fund is being used to support the currencies of England and France during this period of war in Europe.

I know that you publish quarterly information which reveals the operations of the Stabilization Fund, but as I understand it, the information concerning operations during September will not be available in the ordinary course of events until January 1, 1940. In view of the questions which are being raised at the present time as to the operations of the Stabilization Fund, I would appreciate it if you would advise me as Chairman of the Senate Committee on Banking and Currency whether the Stabilization Fund is acquiring the currencies of England and France or whether the Fund is supporting these currencies.

I appreciate the reasons why the Treasury would hesitate to make public any information concerning the scope of the activities of the Fund without the lapse of an adequate period of time but under the circumstances I hope that you will be able to make an exception in this instance.

Very sincerely yours,

(signed) Robert F. Wagner

October 19, 1939

My dear Senator:

I have your letter of October 19, in which you refer to recent discussions on the floor of the Senate with reference to the operations of the Stabilization Fund.

Of course, as the Treasury Department has at all times made clear, the Stabilization Fund has never been used to support the currencies of any foreign country but has been used solely for the express purpose set out in the statute pursuant to which it was created, namely, to stabilize the exchange value of the dollar. In connection with the carrying out of such purpose it has been necessary, as was explained at the hearings last spring on the bill to extend the Stabilization Fund powers, for the Fund to acquire foreign currencies from time to time. I should like to state, however, that the Stabilization Fund is not acquiring any currencies of belligerent countries and is holding only trifling amounts of foreign currencies of belligerent countries which were acquired long before the outbreak of the war.

Sincerely,

(signed) H. Morgenthau, Jr.

Secretary.

Honorable Robert F. Wagner
Chairman of the Senate Committee on Banking and Currency
United States Senate
Washington, D. C.

UNITED STATES SENATE

Committee on Finance

October 17, 1939.

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

My dear Mr. Secretary:

I should like to inquire - if I am entitled to the information - whether the stabilization fund is now being used in connection with the stabilization of the British pound and the French franc; and whether there is any stabilization agreement under which we continue to operate in conjunction with England and France or any other foreign countries.

I should also appreciate your viewpoint on another phase of this problem. I assume that you are continuing to purchase at \$35 an ounce, all foreign gold that is offered. In view of depreciated foreign currencies, is not this equivalent to paying considerably more than \$35 an ounce so far as the foreign seller is concerned? If we put our foreign trade with belligerents on a strict "cash and carry" basis, will it not be likely to substantially increase this inflow of foreign gold - perhaps to so dangerous an extent that we finally shall practically monopolize the world's gold supply? Would this not seriously threaten the world's subsequent return to the use of monetary gold - and thus relatively threaten the ultimate value of our own enormous gold hoard? Should not the purchase of foreign gold be curtailed and re-priced at least for the period of the war?

I am not asserting any pre-conceived judgments of my own in submitting these questions to you. I am simply seeking information from authentic sources and I shall greatly appreciate a reply within the next few days.

With warm personal regards and best wishes,

Cordially and faithfully,

(Signed) A. H. VANDENBERG

October 24, 1939.

My dear Senator:

I should like to answer in some detail the questions in your letter of October 17, so as to clarify certain aspects of problems relating to gold.

You write:

"I assume that you are continuing to purchase at \$35 an ounce, all foreign gold that is offered. In view of depreciated foreign currencies, is not this equivalent to paying considerably more than \$35 an ounce so far as the foreign seller is concerned?"

I am uncertain what you mean by this question. It is subject to several different interpretations and to make certain that you obtain the information you ask I will endeavor to answer each of them separately.

1. Does the question ask whether the foreign seller of gold receives more purchasing power over goods and services here than he did prior to depreciation? If that is the sense of your question then the answer is "No". The \$35 per ounce (less 1/4 of 1 percent) which the foreign seller of gold receives probably represents less and certainly not more purchasing power in terms of goods and services in this country than it did before the depreciation of currencies in recent months. Such purchasing power of \$35 in the United States varies, of course, with changes in prices of goods and services in the United States. Since most goods and services that can be purchased here by a resident of a foreign country have risen in price during the past two months, it follows that the foreign seller of gold probably gets less goods and services for his \$35 now than he did a few months ago.

2. Does the question ask whether the foreigner can get more units of his own currency for gold by selling it in the United States than by selling it in his own country? If this is the sense of your question, again the answer is "No". We pay no higher price for gold (allowing for commissions, handling charges, etc.) than other countries do. After a foreign seller of gold converts the dollars he obtains for his gold into sterling, for example, he finds that he has approximately

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the same amount of money as he would have had if he had sold that gold in London. (For a further explanation of this I refer you to pages 7, 8 and 9 of my letter to Senator Wagner, dated March 22, 1938, a copy of which is enclosed for your convenience.)

3. Does the question ask whether the foreign seller of gold gets more units of his local currency for his gold now than he did before the depreciation of his currency? If this is the sense of the question, the answer is clearly "Yes". That is exactly what depreciation of a currency in terms of gold means, namely, that each unit of a depreciated currency is exchangeable for less gold.

4. Does the question ask whether the greater number of units of the depreciated currency which the foreign seller obtains for his gold can purchase more goods and services at home than could the smaller number of units he obtained for his gold before depreciation? The answer to this question is "Probably yes". Prices in the country of a depreciated currency do not usually rise as much as the currency depreciates for a considerable period of time, if at all. During that period the holder or producer of gold will get more local goods and services for an ounce of gold than he did before. But he gets more goods only if he buys goods at home; furthermore, he gets more goods for an ounce of gold not because we continue to pay \$35 an ounce for gold, but because his own country gives more units of its currency for an ounce of gold.

When taken in the context of your whole letter one further possible interpretation of your question suggests itself. You may be asking whether the recent depreciation of foreign currencies will of itself lead to an increased inflow of gold. If this is the sense of your question, the answer is "Probably no". It is, of course, impossible to foretell at this time the total effect of a Europe at war upon our balance of payments. The specific effect of the recent depreciations of foreign currencies, however, would clearly seem to operate in the direction of a reduction in gold offerings. Depreciation of foreign currencies vis-a-vis the dollar means that American goods and services are less attractive to the foreigner because he must give more of his own currency in exchange for a dollar's worth of merchandise than formerly. In other words, the depreciation of foreign currencies is a factor which operates in the direction of reducing our exports to and increasing our imports from the countries involved. Thus the effect of the change will tend to reduce our favorable balance of trade and consequently such inflow of gold as may be attributable to our export surplus. It is true that price changes may in time offset the effect on the relative attractiveness of foreign and American goods initiated by the depreciation of foreign currencies. But even in normal times this adjustment usually does not take place for some time.

You ask the further question:

"If we put our foreign trade with belligerents on a strict 'cash and carry' basis, will it not be likely to substantially increase this inflow of foreign gold - perhaps to so dangerous an extent that we finally shall practically monopolize the world's gold supply?"

The prohibition of credits to belligerent governments may possibly have the effect of reducing our exports to belligerent countries. This might in turn reduce the value of our total exports compared with what our exports would be were the prohibition not included in the Neutrality Act. Were the belligerent governments to purchase some of their imports from the United States on credit, a portion of the payments due us might be postponed. However, whether this postponement would result even in a temporary reduction in the inflow of gold cannot be forecast because:

(1) It is not known what proportion of the dollars used for payments would be acquired from the sale to us of gold, and what proportion would be acquired from other sources.

(2) It is not known whether an extension of credits to belligerents would result in greater purchases from the United States or whether there would simply be a substitution of some credit purchases for cash purchases. Only in the latter instance would it be possible for part of the inflow of gold to the United States to be postponed. In the former case it would mean that the gold inflow would be the same over the short period of time and would be greater at some subsequent time when credits were liquidated.

You ask this further question with respect to gold:

"Would this (increased inflow of gold) not seriously threaten the world's subsequent return to the use of monetary gold - and thus relatively threaten the ultimate value of our own enormous gold hoard?"

This war demonstrates, if any demonstration were needed, that gold constitutes the best form in which foreign exchange resources can be held. Even under the most difficult conditions of war, belligerent governments which possess gold can buy with it anything that is for sale.

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The new situation in world trade brought about by the war in Europe will, of course, introduce some changes in the distribution of gold among the nations of the world. Belligerent countries will probably lose gold, but numerous neutral countries, which now have little gold, may be put in a position to increase their holdings as a result of improvements in their trade balances. As a consequence, the war may well have the effect of causing a wider distribution of gold among the countries of the world. Such an increase in gold holdings by many countries would give more countries a stake in the continuation of gold as a medium of international payments. The gold producing countries, of course — including the British Empire, which now produces half the world's gold — will continue to have a vital interest in the use of gold as a monetary metal.

These considerations, as well as others, indicate that gold will emerge from this disturbed period with added prestige as the international medium of exchange. For further discussion of the future usefulness of gold as a monetary metal, you may wish to refer to pages 16, 17, 18 and 19 of my letter to Senator Wagner referred to above.

Your last question on gold relates to a suggested change in our monetary policy. You ask:

"Should not the purchase of foreign gold be curtailed and re-priced at least for the period of the war?"

I am not clear whether by re-pricing gold you have in mind an increase or a decrease in the price of gold. I judge from the context of your letter, however, that you are inquiring about the effects of a reduction in the dollar price of gold.

My views with respect to the consequences of reductions in the price of gold are fully set forth in my letter to Senator Wagner referred to above. The discussion appears on pages 13 to 16 of that letter, and I think it may be appropriately re-read in connection with your inquiry.

You raise the question of the advisability of reducing the price of gold "for the period of the war". Any substantial change in the price of gold which is known to be temporary would have seriously disrupting influences on trade and international capital flows. It would introduce a still greater risk element in business relations with foreign countries and would, moreover, increase world speculation in dollar exchange.

I now turn to the question in your letter referring to the Stabilization Fund.

You write:

"I should like to inquire - if I am entitled to the information - whether the stabilization fund is now being used in connection with the stabilization of the British pound and the French franc; and whether there is any stabilization agreement under which we continue to operate in conjunction with England and France or any other foreign countries."

When I appeared before the Senate Committee on Banking and Currency last March, Senator Taft raised the following question:

"Suppose there is a foreign war and suppose you go out and do what you can to buy \$2,000,000,000 worth of pounds: Isn't the effect of that to give England the power to buy \$2,000,000,000 worth of goods in this country under the cash and carry provisions?"

I would like to reaffirm the position which I took at that time. My reply was, and still is, as follows:

"Senators, if there is a war in any foreign country, before we would use the stabilization fund or any money in the Treasury to assist any country in prosecuting that war, I would come up before the proper committee and ask for guidance."

The stabilization fund is not acquiring any currencies of belligerent countries and is holding only a trifling amount of foreign currencies of belligerent countries acquired long before the outbreak of the war.

I trust that this furnishes you with the information you requested.

Sincerely,

Enclosures.

(Signed) HENRY MORGENTHAU, JR.,
Secretary of the Treasury.

Honorable Arthur H. Vandenberg,

United States Senate.

October 19, 1939

My dear Senator:

Since Mr. Foley talked with you the other day concerning the activities of the Stabilization Fund I have received a letter on this subject from Senator Wagner, copy of which I am enclosing, together with copy of my reply. I think this covers the point in which you were interested.

If additional information is needed I shall be happy to furnish it.

Sincerely,

(Signed) H. Morgenthau, Jr.

Secretary.

Honorable Alben W. Barkley,
United States Senate.

Enclosures

A question has been asked as to whether the Stabilization Fund will be used to assist a belligerent country in prosecuting the war. This identical question was raised and answered during the testimony of the Secretary of the Treasury before the Senate Committee on Banking and Currency last March. It might be recalled that Senator Taft raised the following question: "Suppose there is a foreign war and suppose you go out and do what you can to buy \$2,000,000,000 worth of pounds; Isn't the effect of that to give England the power to buy \$2,000,000,000 worth of goods in this country under the cash and carry provisions?" The following discussion then took place:

*SECRETARY MORGENTHAU. Senators, if there is a war in any foreign country, before we would use the stabilization fund or any money in the Treasury to assist any country in prosecuting that war, I would come up before the proper committee and ask for guidance.

*SENATOR TAFT. I have no doubt you would, perhaps. But nevertheless, the authority granted in this extension would give you power to do that, would it not, if you did choose to do so?

*SECRETARY MORGENTHAU. To do what?

*SENATOR TAFT. What I suggested: To buy pounds, and in effect, create an English credit here of \$2,000,000,000; and we would wake up, in the end, and find ourselves with \$2,000,000,000 worth of pounds that were worth nothing? I am not asking whether you would do it. My question is whether that is not legally possible. Isn't that legally possible?

*SECRETARY MORGENTHAU. Well, if I lost all sense or reason in the performance of my duty, I might do a lot of things.

*SENATOR TAFT. In other words, it is legally possible?

*SECRETARY MORGENTHAU. Well, a lot of things are legally possible, which you would not do under the rule of common sense."

I am authorized by the Secretary of the Treasury to state that he wishes at this time to reaffirm the position he took last March and that he wishes to repeat that before the Stabilization Fund is used to assist any country in prosecuting a war he will come before the appropriate committees of the Senate and House of Representatives and ask for guidance.

I am also authorized to state that currencies of belligerent countries are not being purchased by the Stabilization Fund and that the present trifling holdings in the Stabilization Fund of currencies of belligerent countries were acquired a considerable time prior to the war.

October 24, 1939

Secretary Morgenthau

Messrs. White and Foley

Senator Wagner inquired by telephone as to the Department's position on Taft's amendment to the Neutrality Bill to limit the stabilization fund's holdings of the currency of any belligerent to no more than \$50,000,000 at any one time. We feel that the Department should indicate to Senator Wagner its opposition to Taft's amendment for the following reasons:

- (1) When Congress extended the stabilization powers it was fully conscious of the possibility or probability of a war in Europe. There is accordingly no need at this time for Congress to reconsider the problem and to limit the stabilization powers.
- (2) Senator Taft questioned the Secretary about the use of the stabilization fund in the event of war. The Secretary said that before he would use the stabilization fund to assist any country in prosecuting that war he would come up before the proper committee and ask for guidance. This procedure would permit greater flexibility than Taft's proposal in dealing with an emergency situation in which it might be greatly in the interests of this country to purchase the currency of a belligerent in amounts greater than \$50,000,000. By going to the congressional committees the Treasury could ascertain the views of Congress without the publicity and delay involved in getting new legislation.
- (3) If we do not indicate our opposition to Taft's amendment, there is likelihood that other amendments would be offered prohibiting the stabilization fund from purchasing any belligerent currency and in effect nullifying its use during the war.

If you agree with the foregoing, we can give these views to Senator Wagner orally.

(Initialed) E.H.F., Jr.
" H.D.W.

APPROVED:

October 25, 1939

H. M., Jr.

Phone conversation between HM, Jr and Vandenberg Oct. 25 at 11:15 a.m. was attached. It is now filed separately in the diary.

Phone conversation between HM, Jr and Vandenberg on Oct. 23 at 9:45 a.m. was attached. It is now filed separately in the diary.

Telephone conversation between HM, Jr and Senator Vandenberg at 2:50 p.m., October 24, 1939, was attached. It is filed separately in the diary.